

HERITAGE LAKE ASSOCIATION, INC.

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Members
Heritage Lake Association, Inc.

We have audited the accompanying balance sheets of Heritage Lake Association, Inc. as of December 31, 2002 and 2001, and the related statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heritage Lake Association, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements of Heritage Lake Association, Inc. taken as a whole. The schedules of operating expenses on pages 10 and 11 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is stated fairly in all material respects in relation to the basic financial statements taken as a whole.

As discussed in Note 5, the Association has not estimated the remaining lives and replacements costs of the common property and, therefore, has not presented information about the estimates of future costs of major repairs and replacements that will be required in the future that the American Institute of Certified Public Accountants has determined is required to supplement, although not required to be a part of, the basic financial statements.

Donald M. Heinold, CPA, P.C.

Donald M. Heinold, CPA, P.C.

February 6, 2003

BALANCE SHEETS

December 31, 2002 and 2001

ASSETS	<u>2002</u>	<u>2001</u>
CURRENT ASSETS:		
Cash	\$ 65,299	\$ 52,762
Cash designated for emergency purposes	5,000	5,000
Cash held as construction security deposits	11,770	9,398
Accounts receivable:		
Lot owner assessments	21,228	16,004
Water billings	-	2,730
Road fund charge	4,265	4,571
Collection fees	-	975
Less allowance for doubtful accounts	<u>(16,900)</u>	<u>(15,380)</u>
Net accounts receivable	8,593	8,900
Prepaid expenses	<u>1,900</u>	<u>1,900</u>
Total current assets	92,562	77,960
PROPERTY AND EQUIPMENT	<u>248,844</u>	<u>273,667</u>
TOTAL ASSETS	<u>\$ 341,406</u>	<u>\$ 351,627</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long term debt	\$ -	\$ 583
Accounts payable - trade	5,234	4,563
Construction security deposits of members	11,770	9,398
Accrued liabilities	<u>581</u>	<u>1,629</u>
Total current liabilities	17,585	16,173
STOCKHOLDERS' EQUITY:		
Contributed capital	272,902	272,902
Retained earnings	<u>50,919</u>	<u>62,552</u>
Total stockholders' equity	<u>323,821</u>	<u>335,454</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 341,406</u>	<u>\$ 351,627</u>

See accompanying notes.

HERITAGE LAKE ASSOCIATION, INC.
STATEMENT OF OPERATIONS AND RETAINED EARNINGS

For the Years Ended December 31, 2002 and 2001

	2002	2001
Operating income:		
Assessments	\$ 161,787	\$ 162,637
Road fund charge	42,214	42,307
Permits, fees and other operating income	23,010	17,221
Water revenues	584	44,102
Investment income	4,140	2,956
	231,735	269,223
Operating expenses:		
General and administrative	78,157	72,398
Property owner services	8,009	9,810
Conservation	6,201	2,308
Campgrounds	3,311	1,019
Beach	2,464	4,706
Maintenance and repairs	111,564	102,940
Lodge and pool	23,264	30,006
Water services	120	45,937
	233,090	269,124
Net income (loss) from operations	(1,355)	99
Other income (expenses):		
Loss on write-off of water distribution system	(10,208)	-
Net income (loss) before income taxes	(11,563)	99
Income tax expense	70	119
Net income (loss)	(11,633)	(20)
Retained earnings, beginning of the year	62,552	62,572
Retained earnings, end of the year	\$ 50,919	\$ 62,552

See accompanying notes.

STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (11,633)	\$ (20)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	16,183	20,711
Loss on write-off of water distribution system	10,208	-
(Increase) decrease in operating assets:		
Accounts receivable	307	27,686
Increase (decrease) in operating liabilities:		
Accounts payable - trade	671	(21,310)
Accrued liabilities	<u>(1,048)</u>	<u>(665)</u>
Net cash provided by operating activities	14,688	26,402
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(1,568)	(7,746)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on loan payable	<u>(583)</u>	<u>(5,128)</u>
Increase in cash	12,537	13,528
Cash, beginning of the year	<u>52,762</u>	<u>39,234</u>
Cash, end of the year	<u>\$ 65,299</u>	<u>\$ 52,762</u>
Supplemental Data:		
Cash paid during the year for Interest expense	<u>\$ -</u>	<u>\$ 776</u>

See accompanying notes.

1. Summary of Significant Accounting Policies

Organization - Heritage Lake Association, Inc. ("Association") is a corporation organized under the General Not for Profit Corporation Act of Illinois. The purpose of the Association is to: promote pleasure, social recreation and sports activities for its members, their families and guests, and maintain a recreationally oriented environment in Heritage Lake subdivision, Mackinaw Township, Tazewell County, Illinois; provide a means for operating, maintaining, repairing and replacing the streets, parks, lakes, recreational areas and facilities and other amenities owned by the Association; and provide a means for governing the use and enjoyment of the Association's properties.

Assessments - Each lot owner in Heritage Lake subdivision is a member of the Association and is assessed annually by the Association. Assessments must be used for the purpose of promoting the recreation, health, safety and welfare of the Association's members, and improving and maintaining the Association's properties. No portion of the assessment is designated for future major repairs and replacements. Assessments are determined prior to February 1 each year by the Board of Directors, and are payable on or before March 1. Each lot was assessed at the rate of \$150 for 2002 and 2001. Delinquent accounts are charged penalties computed at the rate of seven percent (included in assessment income in the financial statements) and may be subject to various lien and collection fees.

Road Fund Charges - Beginning in 2001, each property owner was charged a fee of \$60 to assist in covering the cost of road repairs and maintenance. Charges are determined prior to June 1 by the Board of Directors and are payable on or before August 15. Delinquent accounts are charged penalties computed at the rate of seven percent (included in road fund income in the financial statements) and may be subject to various lien and collection fees.

Cash and Cash Equivalents - For purposes of the statement of cash flows, the Association considers all short-term securities purchased with a maturity of three months or less to be cash equivalents.

1. Summary of Significant Accounting Policies (cont'd)

Property and Equipment – Generally, all property and equipment owned by the Association is recognized as an asset in the financial statements. Property and equipment are stated at cost. Depreciation is computed primarily using the applicable tax method which allows for accelerated depreciation over the estimated useful lives of the assets. Estimated useful lives range from three to thirty-one years. The cost of maintenance and repairs is charged to operations as incurred; significant renewals and betterments are capitalized. Depreciation expense for the years ended December 31, 2002 and 2001 was \$16,183 and \$20,711, respectively.

Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates based on management's knowledge and experience. Due to their prospective nature, actual results could differ from those estimates.

2. Designated Cash

In April 1989 the Board of Directors established a reserve account of \$50,000 to be used for emergency purposes as determined by the Board. The Board has periodically authorized transfers from the reserve to the general checking account in order to pay expenses. It is the Board's intention to replenish the reserve when able to do so from operating cash receipts.

3. Property and Equipment

A summary of property and equipment follows:

	Cost at December 31,		Estimated Useful Lives (Years)
	<u>2002</u>	<u>2001</u>	
Land improvements	\$ 36,068	\$ 36,068	7 – 15
Buildings	172,864	172,864	7 – 31
Machinery and equipment	67,071	65,503	3 – 10
Fire hydrants	--	41,535	15
Transportation equipment	33,576	33,576	5
Office equipment	<u>14,621</u>	<u>14,621</u>	5
	324,200	364,167	
Less accumulated depreciation	<u>268,300</u>	<u>283,444</u>	
	55,900	80,723	
Subdivision lots	31,000	31,000	
Common properties – land	<u>161,944</u>	<u>161,944</u>	
	<u>\$248,844</u>	<u>\$273,667</u>	

The Village of Mackinaw assumed responsibility for the water distribution system as of March 1, 2001, and the assets associated with the distribution system were transferred to the Village of Mackinaw. The undepreciated cost of such assets totaled \$87,620. \$77,412 of this amount was written-off in the year ended December 31, 2000, while the balance was written off in the year ended December 31, 2002 and is reflected as a loss on the statement of operations.

4. Income Taxes

The Association filed its federal income tax return under Internal Revenue Code (IRC) Section 277 in 2002 and 2001. The income tax liability for the years ended December 31, 2002 and 2001 was \$70 and \$119, respectively.

5. Future Major Repairs and Replacements

The Association has not conducted a study to determine the remaining useful lives of the components of common property and current estimates of costs of major repairs and replacements that may be required in the future. When replacement funds are needed to meet future needs for major repairs and replacements, the Association may seek membership approval for special assessments or delay major repairs and replacements until funds are available.

The Association's governing documents do not require that funds be accumulated for future major repairs and replacements. Through 1993, the Association's by-laws limited annual assessments to a maximum of \$100 per lot, none of which was designated for future major repairs and replacements. In 1993 the members approved revisions to the by-laws enabling the Board of Directors to increase the annual assessment by the larger of \$10 or the annual rate of inflation, subject to a maximum increase of \$50 over a seven year period. The revisions also allow for special assessments, subject to approval by the members, in years when there is no increase in the annual assessment, and borrowing up to \$25,000.

OPERATING EXPENSES

For the Years Ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
General and administrative:		
Bookkeeping/secretarial	\$ 20,529	\$ 17,017
Payroll taxes	6,099	5,749
Contribution to Individual Retirement Account	-	1,900
Depreciation	16,183	20,711
Insurance	9,542	8,744
Professional fees	1,650	5,082
Telephone	745	709
Office supplies and expense	2,760	1,675
Property taxes	109	104
Audit	10,078	3,150
Collection	-	175
Postage	1,813	1,748
Garbage service	1,133	690
Bad debts	5,469	2,819
Interest expense	-	776
Miscellaneous	2,047	1,349
	<u>78,157</u>	<u>72,398</u>
Property owner services:		
Enforcement	6,030	7,217
Newsletter	1,009	1,296
Other	970	1,297
	<u>8,009</u>	<u>9,810</u>
Conservation:		
Electricity	1,275	1,381
Restock fish	2,035	-
Other	2,891	927
	<u>6,201</u>	<u>2,308</u>
Campgrounds:		
Electricity	801	828
Other	2,510	191
	<u>3,311</u>	<u>1,019</u>
Beach	<u>2,464</u>	<u>4,706</u>

OPERATING EXPENSES

For the Years Ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Maintenance and repairs:		
Fuel	\$ 3,083	\$ 3,277
Mowing	7,659	9,532
Snowplowing	903	4,846
Supplies	2,149	2,884
Salaries	31,736	25,145
Equipment	4,405	11,006
Roads	59,668	44,420
Other	1,961	1,830
	<u>111,564</u>	<u>102,940</u>
Lodge and pool:		
Natural gas	1,516	2,132
Lifeguards	5,218	5,153
Pool manager	4,250	4,250
Chemicals	3,827	3,222
Lodge repairs and maintenance	2,408	3,267
Pool repairs	1,227	6,940
Electricity	3,463	3,708
Water	325	320
Other	1,030	1,014
	<u>23,264</u>	<u>30,006</u>
Water services:		
Water	-	39,198
Hook-ups	-	1,240
Meters and installation	-	-
Meter reader	-	568
Water operator	-	450
Administration	-	-
Repairs and maintenance	-	748
Data processing	-	-
Audit	-	5,285
Postage	-	365
Bad debts	120	(1,932)
Depreciation	-	-
Miscellaneous	-	15
	<u>120</u>	<u>45,937</u>
	<u>\$ 233,090</u>	<u>\$ 269,124</u>