

HERITAGE LAKE ASSOCIATION, INC.

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

CONTENTS

	<u>Page Number</u>
Report of Independent Auditors	1 - 2
Financial Statements:	
Balance Sheet	3
Statement of Operations and Retained Earnings	4
Statement of Cash Flows	5
Notes to the Financial Statements	6 - 10
Supplementary Information:	
Schedule of Operating Expenses	11 - 12



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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, 2003 and 2002, 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, 2003 and 2002, 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 7, 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 23, 2004

BALANCE SHEETS

December 31, 2003 and 2002

ASSETS	<u>2003</u>	<u>2002</u>
CURRENT ASSETS:		
Cash	\$ 85,623	\$ 65,299
Cash designated for emergency purposes	5,000	5,000
Cash held as construction security deposits	20,861	11,770
Accounts receivable:		
Lot owner assessments	27,185	21,228
Lake fund charge	2,685	-
Road fund charge	6,408	4,265
Other receivables	4,917	-
Less allowance for doubtful accounts	<u>(25,615)</u>	<u>(16,900)</u>
Net accounts receivable	15,580	8,593
Prepaid expenses	<u>1,900</u>	<u>1,900</u>
Total current assets	128,964	92,562
PROPERTY AND EQUIPMENT	<u>471,454</u>	<u>248,844</u>
TOTAL ASSETS	<u>\$ 600,418</u>	<u>\$ 341,406</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long term debt	\$ 22,694	\$ -
Accounts payable - trade	2,203	5,234
Construction security deposits of members	20,861	11,770
Accrued liabilities	<u>2,414</u>	<u>581</u>
Total current liabilities	48,172	17,585
LONG-TERM LIABILITIES	<u>148,100</u>	<u>-</u>
TOTAL LIABILITIES	196,272	17,585
STOCKHOLDERS' EQUITY:		
Contributed capital	272,902	272,902
Retained earnings	<u>131,244</u>	<u>50,919</u>
Total stockholders' equity	<u>404,146</u>	<u>323,821</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 600,418</u>	<u>\$ 341,406</u>

See accompanying notes.

HERITAGE LAKE ASSOCIATION, INC.
STATEMENT OF OPERATIONS AND RETAINED EARNINGS
For the Years Ended December 31, 2003 and 2002

	2003	2002
Operating income:		
Assessments	\$ 171,331	\$ 161,787
Road fund charge	43,201	42,214
Lake fund charge	33,097	-
Permits, fees and other operating income	24,267	23,010
Water revenues	-	584
Gain on sale of fixed assets	1,650	-
Fundraising income	2,297	-
Investment income	8,688	4,140
	284,531	231,735
Operating expenses:		
General and administrative	96,296	78,157
Property owner services	9,940	8,009
Conservation	11,571	6,201
Campgrounds	1,870	3,311
Beach	2,568	2,464
Maintenance and repairs	50,303	111,564
Lodge and pool	30,444	23,264
Water services	-	120
	202,992	233,090
Net income (loss) from operations	81,539	(1,355)
Other income (expenses):		
Loss on write-off of water distribution system	-	(10,208)
Net income (loss) before income taxes	81,539	(11,563)
Income tax expense	1,214	70
Net income (loss)	80,325	(11,633)
Retained earnings, beginning of the year	50,919	62,552
Retained earnings, end of the year	\$ 131,244	\$ 50,919

See accompanying notes.

STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 80,325	\$ (11,633)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	26,783	16,183
Loss on write-off of water distribution system	-	10,208
(Increase) decrease in operating assets:		
Accounts receivable	(6,987)	307
Increase (decrease) in operating liabilities:		
Accounts payable - trade	(3,031)	671
Accrued liabilities	1,833	(1,048)
	<u>98,923</u>	<u>14,688</u>
Net cash provided by operating activities	98,923	14,688
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(249,393)	(1,568)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long term debt	175,047	-
Payments on long term debt	(4,253)	(583)
	<u>170,794</u>	<u>(583)</u>
Net cash provided by (used in) financing activities	170,794	(583)
Increase in cash	20,324	12,537
Cash, beginning of the year	<u>65,299</u>	<u>52,762</u>
Cash, end of the year	<u>\$ 85,623</u>	<u>\$ 65,299</u>
Supplemental Data:		
Cash paid during the year for Interest expense	<u>\$ 1,392</u>	<u>\$ -</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 \$160 and \$150 for 2003 and 2002, respectively. 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 - During 2003 and 2002, each property owner was charged a fee of \$62 and \$60, respectively, 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.

Lake Fund Charges - Beginning in 2003, each property owner was charged a fee of \$48 to assist in covering the cost of upkeep to the lake. Charges are determined prior to April 1st. 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, 2003 and 2002 was \$26,783 and \$16,183, 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
	<u>2003</u>	<u>2002</u>	Useful Lives (<u>Years</u>)
Land improvements	\$251,453	\$ 36,068	7 – 15
Buildings	175,445	172,864	7 – 31
Machinery and equipment	69,451	67,071	3 – 10
Transportation equipment	60,529	33,576	5
Office equipment	<u>14,621</u>	<u>14,621</u>	5
	571,499	324,200	
Less accumulated depreciation	<u>292,989</u>	<u>268,300</u>	
	278,510	55,900	
Subdivision lots	31,000	31,000	
Common properties – land	<u>161,944</u>	<u>161,944</u>	
	<u>\$471,454</u>	<u>\$248,844</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. Notes Payable

Note payable, bank – dated March, 2003, original amount of \$29,047, secured by vehicle. Due in monthly installments of \$564.55, including interest at 6.25% per annum. Final payment due March, 2008. Principal balance \$24,794.

Note payable, bank – dated September, 2003, original amount of \$146,000, secured by 28 lots. Due in annual payments of \$26,237.44, including interest at 6.09% per annum. Final payment due September, 2008. Principal balance \$146,000.

4. Notes Payable (cont'd)

Maturities of long-term debt are as follows:

<u>For the Year</u> <u>Ended December 31</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2004	\$10,318	\$ 22,694	\$ 33,012
2005	8,918	24,094	33,012
2006	7,431	25,581	33,012
2007	5,852	27,160	33,012
2008	<u>4,282</u>	<u>71,265</u>	<u>75,547</u>
	<u>\$36,801</u>	<u>\$170,794</u>	<u>\$207,595</u>

5. Income Taxes

The Association filed its federal income tax return under Internal Revenue Code (IRC) Section 277 in 2003 and 2002. The income tax liability for the years ended December 31, 2003 and 2002 was \$1,214 and \$70, respectively.

6. Operating Lease

The Association leases a printer under an operating lease with the following commitments:

2004	\$1,423
2005	1,423
2006	<u>356</u>
	<u>\$3,202</u>

Total lease expenditures for the year ending December 31, 2003 were \$431.

7. 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.

7. Future Major Repairs and Replacements (cont'd)

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. In 2003 the Association's by-laws were amended to limit the Association to never borrow at any one time in excess of the current values of non-amenity properties for the purchase of real property, the issuance of bonds or debentures or the mortgage of any of its properties nor shall it mortgage any of the amenity properties without a two-thirds vote of the full board. The 2003 appraised value of non-amenity properties was \$146,000.

OPERATING EXPENSES

For the Years Ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
General and administrative:		
Bookkeeping/secretarial	\$ 17,292	\$ 20,529
Payroll taxes	5,428	6,099
Contribution to Individual Retirement Account	-	-
Depreciation	26,783	16,183
Insurance	11,370	9,542
Professional fees	10,854	1,650
Telephone	875	745
Office supplies and expense	4,214	2,760
Property taxes	113	109
Audit	1,809	10,078
Collection	-	-
Postage	1,996	1,813
Garbage service	446	1,133
Bad debts	8,652	5,469
Interest expense	1,392	-
Miscellaneous	5,072	2,047
	<u>96,296</u>	<u>78,157</u>
Property owner services:		
Enforcement	6,095	6,030
Newsletter	2,422	1,009
Other	1,423	970
	<u>9,940</u>	<u>8,009</u>
Conservation:		
Electricity	1,268	1,275
Restock fish	2,231	2,035
Lake and dam upgrades	5,500	-
Other	2,572	2,891
	<u>11,571</u>	<u>6,201</u>
Campgrounds:		
Electricity	851	801
Other	1,019	2,510
	<u>1,870</u>	<u>3,311</u>
Beach	2,568	2,464

OPERATING EXPENSES

For the Years Ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Maintenance and repairs:		
Fuel	\$ 4,476	\$ 3,083
Mowing	5,014	7,659
Snowplowing	2,975	903
Supplies	5,277	2,149
Salaries	23,212	31,736
Equipment	4,909	4,405
Roads	2,834	59,668
Other	1,606	1,961
	<u>50,303</u>	<u>111,564</u>
Lodge and pool:		
Natural gas	2,322	1,516
Lifeguards	5,350	5,218
Pool manager	4,282	4,250
Chemicals	3,521	3,827
Lodge repairs and maintenance	8,421	2,408
Pool repairs	872	1,227
Electricity	4,161	3,463
Water	379	325
Other	1,136	1,030
	<u>30,444</u>	<u>23,264</u>
Water services:		
Bad debts	-	120
	<u>-</u>	<u>120</u>
	<u>\$ 202,992</u>	<u>\$ 233,090</u>