

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION

INDEPENDENT AUDITOR'S REPORT  
AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2005

January 21, 2006

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Association Members  
The Knolls Village Townhouse Association  
Arapahoe County, Colorado

I have audited the accompanying balance sheet of THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION as of December 31, 2005, and the related statements of revenues, expenses and changes in fund balance and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States. Those standards require that I 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 presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION as of December 31, 2005, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As more fully explained in Note 4 to the financial statements, the Board has elected to only partially adopt the funding recommendations of a recent study conducted to determine current estimates of major repairs and replacements required in the future.

The supplementary information on Future Major Repairs and Replacements on page 10 is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants, and is based on such study. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

Burridge A. Omeron  
Certified Public Accountant

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
BALANCE SHEET  
AS OF DECEMBER 31, 2005

	Operating Fund	Replacement Fund	Total
<u>ASSETS</u>			
Cash and cash equivalents (Note 2)	\$ 56,165	\$ 95,592	\$ 151,757
Cash - painting escrow (Notes 3 and 8)	15,689		15,689
Temporary cash investments		297,806	297,806
Assessments receivable, net of allowance for doubtful accounts of \$2,000 (Note 2)	3,928		3,928
Prepaid insurance and other	6,810		6,810
Due to operating fund		(51,081)	(51,081)
Due from replacement fund	51,081		51,081
Furniture and equipment -at cost, net of accumulated depreciation of \$10,745 (Note 2)	1,706		1,706
<b>TOTAL ASSETS</b>	<b>\$ 135,379</b>	<b>\$ 342,317</b>	<b>\$ 477,696</b>
<u>LIABILITIES</u>			
Accounts payable	\$ 11,655	\$	\$ 11,655
Income taxes payable (Note 5)	1,065		1,065
Contingencies (Note 7)	-	-	-
Prepaid assessments	8,428		8,428
Total liabilities	21,148	0	21,148
<u>FUND BALANCE</u>	114,231	342,317	456,548
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b>\$ 135,379</b>	<b>\$ 342,317</b>	<b>\$ 477,696</b>

The accompanying notes are an integral part of the financial statements.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
STATEMENT OF REVENUES AND EXPENSES  
AND CHANGES IN FUND BALANCES  
FOR THE YEAR ENDED DECEMBER 31, 2005

	Operating Fund	Replacement Fund	Total
	<u>          </u>	<u>          </u>	<u>          </u>
<u>REVENUES</u>			
Member assessments (Note 3)	\$ 373,920	\$ 30,000	\$ 403,920
Painting assessments (Note 3)	59,840		59,840
Other member assessments	2,020		2,020
Miscellaneous income	1,403		1,403
Interest income	316	10,103	10,419
TOTAL REVENUES	<u>437,499</u>	<u>40,103</u>	<u>477,602</u>
<u>EXPENSES</u>			
Grounds maintenance	102,566		102,566
Water and sewer	83,666		83,666
Maintenance coordinators - payroll and taxes	59,857		59,857
Exterior painting (Note 8)	50,948		50,948
Trash removal	23,625		23,625
Pool and amenity expenses	14,670		14,670
Insurance expense	13,790		13,790
Bookkeeping fees and office expense	13,184		13,184
Snow removal	8,444		8,444
Gas and electric	7,691		7,691
Legal and audit	4,676		4,676
Committee expenses (publicity and hospitality)	2,238		2,238
Telephone expense	1,374		1,374
Income taxes (Note 5)	1,065		1,065
Miscellaneous expenses	928		928
Depreciation expense (Note 2)	551		551
Replacement fund expenses:			
Asphalt/concrete repairs		73,602	73,602
Tree removal/replacement		17,596	17,596
Timber walls replacement and regrade		5,434	5,434
All others		7,215	7,215
TOTAL EXPENSES	<u>389,273</u>	<u>103,847</u>	<u>493,120</u>
EXCESS OF REVENUES OVER EXPENSES			
(EXPENSES OVER REVENUES)	48,226	(63,744)	(15,518)
BEGINNING FUND BALANCE	116,937	355,129	472,066
Transfer of Fund Balance (Note 9)	(50,932)	50,932	0
ENDING FUND BALANCE	<u>\$ 114,231</u>	<u>\$ 342,317</u>	<u>\$ 456,548</u>

The accompanying notes are an integral part of the financial statements.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2005

	Operating Fund	Replacement Fund	Total
	<u>          </u>	<u>          </u>	<u>          </u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Member assessments collected	\$ 442,661	\$ 30,000	\$ 472,661
Interest received	316	10,103	10,419
Other income received	1,403		1,403
Cash paid for operating expenditures	(393,492)		(393,492)
Replacement expenditures paid		(124,539)	(124,539)
Payment of income taxes	(935)		(935)
Transfer from Operating Fund (Note 9)	(50,932)	50,932	0
Borrowings from operating fund	3,245	(3,245)	0
Net cash provided (used) by operating activities	<u>2,266</u>	<u>(36,749)</u>	<u>(34,483)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in furniture and equipment	(755)		(755)
Investments in temporary investments -net		49,787	49,787
	<u>          </u>	<u>          </u>	<u>          </u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,511	13,038	14,549
Cash and cash equivalents at beginning of year	70,343	82,554	152,897
Cash and cash equivalents at end of year	<u>\$ 71,854</u>	<u>\$ 95,592</u>	<u>\$ 167,446</u>

RECONCILIATION OF EXCESS OF REVENUES OVER EXPENSES

(EXPENSES OVER REVENUES) TO NET CASH PROVIDED (USED)

BY OPERATING ACTIVITIES:

Excess of revenues over expenses (expenses over revenues)	\$ 48,226	\$ (63,744)	\$ (15,518)
Adjustments to reconcile excess of revenues over expenses (expenses over revenues) to net cash provided (used) by operating activities:			
Increase (decrease) in interfund balances	3,245	(3,245)	0
Transfer from Operating Fund (Note 9)	(50,932)	50,932	0
Depreciation expense	551		551
Decrease in assessments receivable	1,772		1,772
Increase in prepaid expenses	(2,408)		(2,408)
Decrease in accounts payable	(927)	(20,692)	(21,619)
Increase in income taxes payable	130		130
Increase in prepaid assessments	2,609		2,609
Total adjustments	<u>(45,960)</u>	<u>26,995</u>	<u>(18,965)</u>
Net cash provided (used) by operating activities	<u>\$ 2,266</u>	<u>\$ (36,749)</u>	<u>\$ (34,483)</u>

The accompanying notes are an integral part of the financial statements.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

NOTE 1. ORGANIZATION

The Knolls Village Townhouse Association is an association organized as a not-for-profit corporation for the purposes of maintaining and preserving its common property. The development consists of 374 residential units occupying a site of approximately 47 acres. The Association began its operations in 1976.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**FUND ACCOUNTING.** The Association uses fund accounting, which requires that funds, such as operating funds and funds designated for future major repairs and replacements, be classified separately for accounting and reporting purposes. Assessments collected for exterior painting have been deposited into a separate "painting escrow" account. Disbursements from the operating fund are generally at the discretion of the Board. Disbursements from the replacement fund generally may be made only for designated purposes.

**INTEREST EARNED.** The Board's policy is to not allocate interest earned between funds, but rather report such interest in the fund in which it was earned.

**ALLOWANCE FOR DOUBTFUL ACCOUNTS.** The Association's policy is to enforce collection of assessments by retaining legal counsel and by placing liens on the properties of delinquent members. It is the opinion of the Association's Board that, in the absence of foreclosure or personal bankruptcy proceedings of the delinquent members, the Association will ultimately prevail in most instances. However, the Association has adopted the allowance for doubtful accounts method of providing for assessments which may not be collected.

**RECOGNITION OF ASSETS AND DEPRECIATION POLICY.** The Association's policy for recognizing common property as assets in its balance sheet is to recognize (a) common personal property and (b) real property to which it has title and that it can dispose of for cash while retaining the proceeds or that is used to generate significant cash flows from members on the basis of usage or from nonmembers. No such property has been capitalized. The Association recognizes personal property such as furniture and equipment at cost. Such property is depreciated using an accelerated method of depreciation over the following useful lives:

Furniture	7 years
Equipment	7 years

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

CASH AND CASH EQUIVALENTS POLICY. For purposes of the statement of cash flows, the Association considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

ESTIMATES. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 3. OWNERS' ASSESSMENTS

Regular monthly assessments to owners were \$90.00 for the year 2005, of which approximately 6 percent was designated to the replacement fund ... in addition to a monthly painting assessment of \$12.50 for the eight months to August 31, 2005 and \$15.00 for the four months to December 31, 2005. As a result of the amendment to the Association's governing documents, approved during the fall of 2003 by the members, the Association has assumed the responsibility for exterior painting.

The annual budget and assessments of owners are determined by the Board and are approved by the owners. The Association retains excess operating funds at the end of the operating year, if any, for use in the replacement fund.

NOTE 4. FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association's governing documents require that funds be accumulated for future major repairs and replacements. Accumulated funds are held in separate investment accounts and generally are not available for expenditures for normal operations.

The Board conducted a study in February of 2004 to estimate the remaining useful lives and the replacement costs of the components of common property. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on that study.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

NOTE 4. FUTURE MAJOR REPAIRS AND REPLACEMENTS (continued)

The Board decided to fund in 2005 only 89 percent of the amount recommended by the study. Accordingly, \$30,000 has been included in the 2005 budget. For that reason, and because actual expenditures may vary from estimated future expenditures and the variations may be material, amounts accumulated in the replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Association has the right, subject to membership approval, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

As of December 31, 2005, the cumulative budgeted Replacement Fund assessments, less expenditures, was less than the funds' specifically allocated assets by \$51,081. The Board intends to repay that amount during 2006 and has, therefore, reflected it as an interfund receivable and payable. See also Note 9.

NOTE 5. FEDERAL AND STATE CORPORATE INCOME TAXES

The Association may elect annually to file its income tax return as a regular corporation or as a homeowners association in accordance with Code Section 528.

For the current year, the Association elected to file its income tax returns as a regular corporation.

The Association's investment income and other non-exempt income were subject to tax, resulting in a liability of \$1,065 as of December 31, 2005.

NOTE 6. REAL PROPERTY

Although this is not a title report or opinion based on information provided to us, the Association appears to own the following properties:

- (a) Lot 108A of filing No. 2: greenbelts and four alleys
- (b) Lot 109 of filing No. 2: greenbelts and six alleys
- (c) Lot 126 of filing No. 3: greenbelts, eleven alleys and the recreation center ( consisting of the clubhouse, pool and tennis courts)
- (d) Lot 143 of filing No. 4: greenbelts, thirteen alleys, open space, and East Geddes Place and South Columbine Way

The disposition and use of that property is restricted by the Association's governing documents. Each member of the Association has a beneficial or undivided interest in such property.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2005

NOTE 7. CONTINGENCIES

The Association is a party to various legal actions normally associated with townhome associations, such as the collection of delinquent assessments and covenant compliance matters, the aggregate effect of which, in management's opinion, would not be material to the future financial condition of the Association.

NOTE 8. PAINTING ESCROW

A separate savings account was established in January 2004 to segregate exterior painting assessments (See Note 3) from regular assessments. The 2005 activity in the segregated account was as follows:

Beginning painting escrow savings balance		\$11,766
Monthly transfers in, at \$4,675 per month for 8 months		37,400
Monthly transfers in, at \$5,610 per month for 4 months		22,440
Interest earned		31
Less: Exterior painting expenses paid from <u>escrow account</u>		(50,948)
Less: 2004 painting expenses borrowed from Reserves	\$15,627	
2005 partial repayment to Reserves	<u>( 5,000)</u>	<u>( 5,000)</u>
Painting escrow balance at December 31, 2005		<u>\$15,689</u>
Remaining balance due to Reserves, included In the interfund borrowing	<u>\$10,627</u>	

NOTE 9. TRANSFER OF FUND BALANCE

The association has transferred excess membership net income from the Operating Fund to the Replacement Fund in recent years. Such transfers are required for years in which a regular corporate return is filed, and voluntary when filing as a homeowners association. (See Note 5) Each current year excess is normally transferred early in the subsequent year to the reserve investment account(s).

Independent Accountant's Report  
on Supplementary Information

Board of Directors and Association Members  
The Knolls Village Townhouse Association  
Arapahoe County, Colorado

The supplementary information on Future Major Repairs and Replacements on page 10 is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

Burridge A. Omeron  
Certified Public Accountant  
January 21, 2006

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS  
 DECEMBER 31, 2005  
 (UNAUDITED)

The Board conducted a study in February 2004 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were obtained from Association Reserves - Colorado, LLC, which inspected the property.

The study recommends annual reserve contributions of \$33,600, although actual 2005 contributions were \$30,000 (89% of recommended), and assumes future inflation rates averaging 3%, and after-tax investment income of .5% per year. Since the reserve fund monies were 74% of what should have been on deposit, the study recommended a \$50,000 special assessment be levied during 2005. There were no such special assessments in 2005.

The following table is based on this most recent study and presents significant information about the components of common property.

<u>Major Components</u>	<u>Estimated Remaining Useful Lives (Years)</u>	<u>Estimated Current Replacement Costs</u>	<u>Annual Funding Requirement</u>	<u>Amount Which Should Be Accumulated At December 31, 2004</u>
Pool deck- replacement	3	\$27,550	\$355	\$24,795
Landscape timbers and steps- replacement	6 to 18	65,900	2,145	11,090
Asphalt - resurface	3 to 8	510,000	7,045	412,858
Drain pans/garage aprons - concrete	1 to 3	55,000	4,254	32,800
Perimeter fence - replace	6 to 16	125,800	2,520	44,200
Other 46 components		<u>291,150</u>	<u>17,281</u>	<u>155,876</u>
	Total	<u>\$1,075,400</u>	<u>\$33,600</u>	\$681,619
Cash and temporary investments in Replacement Fund - net, December 31, 2005				<u>\$342,317</u>
Indicated (deficiency) at December 31, 2005				<u>(\$339,302)</u>