

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION

INDEPENDENT AUDITOR'S REPORT  
AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2008

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheet of **THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION** as of December 31, 2008, 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. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 presentation. We believe that our audit provides 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 **THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION** as of December 31, 2008, 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.

The supplementary information on Future Major Repairs and Replacements on page 11 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. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Omeron and Associates, P.C.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
BALANCE SHEET  
AS OF DECEMBER 31, 2008

	Operating Fund	Replacement Fund	Total
	<u>          </u>	<u>          </u>	<u>          </u>
<u>ASSETS</u>			
Cash and cash equivalents (Note 2)	\$ 15,804	\$ 116,559	\$ 132,363
Cash - painting escrow (Notes 3 and 8)	45,502		45,502
Temporary cash investments		298,925	298,925
Assessments receivable, net of allowance for doubtful accounts of \$6,000 (Note 2)	5,003		5,003
Prepays, including insurance and other	2,947		2,947
Prepaid income taxes (Note 5)	3,196		3,196
Due from operating fund		22,356	22,356
Due to replacement fund	(22,356)		(22,356)
Furniture and equipment -at cost, net of accumulated depreciation of \$14,105 (Note 2)	4,024		4,024
<b>TOTAL ASSETS</b>	<u>\$ 54,120</u>	<u>\$ 437,840</u>	<u>\$ 491,960</u>
<u>LIABILITIES</u>			
Accounts payable	\$ 13,310	\$	\$ 13,310
Contingencies (Note 7)	-	-	-
Prepaid assessments	6,301		6,301
Total liabilities	<u>19,611</u>	<u>0</u>	<u>19,611</u>
<u>FUND BALANCE</u>	<u>34,509</u>	<u>437,840</u>	<u>472,349</u>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<u>\$ 54,120</u>	<u>\$ 437,840</u>	<u>\$ 491,960</u>

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, 2008

	Operating Fund	Replacement Fund	Total
<u>REVENUES</u>			
Member assessments (Note 3)	\$ 406,560	\$ 132,000	\$ 538,560
Painting assessments (Notes 3 and 8)	67,320		67,320
Other member assessments	945		945
Miscellaneous income	601		601
Interest and dividend income	879	14,225	15,104
TOTAL REVENUES	<u>476,305</u>	<u>146,225</u>	<u>622,530</u>
<u>EXPENSES</u>			
Water and sewer	117,229		117,229
Exterior painting (Note 8)	108,388		108,388
Maintenance coordinators - payroll and related taxes	106,339		106,339
Grounds maintenance	77,059		77,059
Trash removal	29,494		29,494
Pool and amenity expenses	21,479		21,479
Insurance expense	14,372		14,372
Bookkeeping fees and office expense	13,161		13,161
Gas and electric	10,062		10,062
Snow removal	4,744		4,744
Committee expenses (publicity and hospitality)	3,025		3,025
Legal and audit	2,836		2,836
Telephone expense	2,565		2,565
Income taxes (Note 5)	2,404		2,404
Depreciation expense (Note 2)	1,661		1,661
Miscellaneous expense	1,065		1,065
Replacement fund expenses:			
Asphalt and concrete repairs		53,895	53,895
Tree/shrub/bark - replace or prune		27,512	27,512
Fence painting		13,353	13,353
Retaining wall repair		8,074	8,074
Clubhouse flooring and other		3,830	3,830
TOTAL EXPENSES	<u>515,883</u>	<u>106,664</u>	<u>622,547</u>
EXCESS OF REVENUES OVER EXPENSES			
(EXPENSES OVER REVENUES)	(39,578)	39,561	(17)
BEGINNING FUND BALANCE	94,087	378,279	472,366
Transfer of Fund Balance (Note 9)	(20,000)	20,000	0
ENDING FUND BALANCE	<u>\$ 34,509</u>	<u>\$ 437,840</u>	<u>\$ 472,349</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, 2008

	Operating Fund	Replacement Fund	Total
	<u>          </u>	<u>          </u>	<u>          </u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Member assessments collected	\$ 474,406	\$ 132,000	\$ 606,406
Interest received	879	14,225	15,104
Other income received	601		601
Cash paid for operating expenditures	(514,478)		(514,478)
Replacement expenditures paid		(106,664)	(106,664)
Payment of income taxes	(11,706)		(11,706)
Transfer from Operating Fund (Note 9)	(20,000)	20,000	0
Borrowings from operating fund	16,093	(16,093)	0
Net cash provided (used) by operating activities	<u>(54,205)</u>	<u>43,468</u>	<u>(10,737)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in property	(84)		(84)
Investments in temporary investments -net		1,075	1,075
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(54,289)</u>	<u>44,543</u>	<u>(9,746)</u>
Cash and cash equivalents at beginning of year	115,595	72,016	187,611
Cash and cash equivalents at end of year	<u>\$ 61,306</u>	<u>\$ 116,559</u>	<u>\$ 177,865</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)	\$ (39,578)	\$ 39,561	\$ (17)
Adjustments to reconcile excess of revenues over expenses (expenses over revenues) to net cash provided (used) by operating activities:			
Increase (decrease) in interfund balances	16,093	(16,093)	0
Transfer from Operating Fund (Note 9)	(20,000)	20,000	0
Depreciation expense	1,661		1,661
Decrease in assessments receivable	461		461
Decrease in prepaid expenses	5,062		5,062
Decrease in accounts payable	(7,722)		(7,722)
Increase in prepaid income taxes	(9,302)		(9,302)
Decrease in prepaid assessments	(880)		(880)
Total adjustments	<u>(14,627)</u>	<u>3,907</u>	<u>(10,720)</u>
Net cash provided (used) by operating activities	<u>\$ (54,205)</u>	<u>\$ 43,468</u>	<u>\$ (10,737)</u>

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

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008

NOTE 1. ORGANIZATION

The Knolls Village Townhouse Association is an association organized as a not-for-profit corporation for the purposes of exterior painting and 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 is a component of the Operating Fund and have been deposited into a separate "painting escrow" investment 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 accelerated methods of depreciation over the following useful lives:

Equipment and furniture	5 and 7 years
Storage shed	7 years

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008

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

The monthly assessments to owners were \$125 per lot per month for the 2008 year, composed of:

Operating Fund assessment income	\$406,560	67 %
Painting assessment income	67,320	11 %
Replacement Fund assessment income	<u>132,000</u>	<u>22 %</u>
Total	<u>\$605,880</u>	<u>100%</u>

As a result of the amendment to the Association's governing documents, 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.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008

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 January of 2009 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, and was prepared by Association Reserves, Inc..

The Board is funding for major repairs and replacements over the remaining lives of the components based on the study's estimates of current replacement costs, and considering amounts previously accumulated in the replacement fund, among other factors. Accordingly, \$132,000 has been included in the 2008 budget. 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, 2008, the cumulative budgeted Replacement Fund assessments, less expenditures, was more than the funds' specifically allocated assets by \$22,356. The Board intends to repay that amount during 2009 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 filed its income tax return as a regular corporation. The Association had an excess of expenses for the maintenance of the common property over membership source income. That excess, in the amount of \$35,826, may be carried over to future periods to offset future income from membership sources when the Association files as a regular corporation.

The Association's investment income and other non-exempt income were subject to tax, resulting in a liability of \$2,404 as of December 31, 2008.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008

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.

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 investment account was established in January 2004 to segregate exterior painting assessments (See Note 3) from regular assessments. The 2008 activity in the segregated account and the borrowing from the Replacement Fund was as follows:

Beginning painting escrow balance at January 1, 2008	\$ 70,282
Monthly transfers in, at \$5,610 per month for 12 months	67,320
Interest earned and other	789
Borrowed from Reserves	15,500
Less: Exterior painting expenses paid from <u>escrow account</u>	(108,388)
Painting escrow balance at December 31, 2008	<u>\$ 45,503</u>
2004 painting expenses borrowed from Reserves	\$15,627
2005 partial repayment to Reserves	( 5,000)
2008 painting expense borrowed from Reserves	<u>15,500</u>
Remaining balance due to Reserves, included In the interfund borrowing	<u>\$26,127</u>

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008

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 usually required for years in which a regular corporate return is filed, and voluntary when filing as a homeowners association. Each current year excess is normally transferred early in the subsequent year to the reserve investment account(s).

During 2008, the Board of Directors approved the transfer of \$20,000 from the Operating Fund to the Replacement Fund.

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

Omeron and Associates, P.C.  
February 18, 2009

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION  
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS  
 DECEMBER 31, 2008  
 (UNAUDITED)

The Board conducted a study in January 2009 to estimate the remaining useful lives and the replacement costs of the components of common property. The study was obtained from Association Reserves, Inc., which updated the previous 2004 study.

The study recommended annual reserve contributions of \$152,400, and assumes future inflation rates averaging 3%, and after-tax investment income of 3.8% per year. Actual reserve contributions for 2008 were \$132,000.

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

As of January 2009

<u>Major Components</u>	<u>Estimated Remaining Useful Lives (Years)</u>	<u>Estimated Future Replacement Costs **</u>	<u>Annual Funding Requirement</u>
Pool deck- replacement	4	\$32,640	\$1,234
Landscape timbers and steps- replacement	4 to 14	97,651	8,399
Asphalt - resurface/sealcoat	0 to 23	456,654	4,229
Drain pans/garage aprons - concrete	0 to 23	264,332	16,742
Perimeter fence - replace	12	127,148	5,692
Landscape improvements	0	12,360	15,319
Other 52 components		733,834	100,785
Total		\$1,724,619	\$152,400
Cash and temporary investments in Replacement Fund - net, December 31, 2008			\$415,485

\*\* for one cycle/replacement