

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION

INDEPENDENT AUDITOR'S REPORT
AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2006

Burridge A. Omeron
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January 23, 2007

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, 2006, 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, 2006, 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. 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

Member
American Institute of
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Colorado Society of
Certified Public Accountants

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2006

	Operating Fund	Replacement Fund	Total
<u>ASSETS</u>			
Cash and cash equivalents (Note 2)	\$ 47,213	\$ 172,685	\$ 219,898
Cash - painting escrow (Notes 3 and 8)	4,763		4,763
Temporary cash investments		174,000	174,000
Assessments receivable, net of allowance for doubtful accounts of \$2,000 (Note 2)	3,737		3,737
Prepays, including insurance and other	6,144		6,144
Due to operating fund		(86,866)	(86,866)
Due from replacement fund	86,866		86,866
Furniture and equipment -at cost, net of accumulated depreciation of \$11,258 (Note 2)	1,194		1,194
TOTAL ASSETS	\$ 149,917	\$ 259,819	\$ 409,736
<u>LIABILITIES</u>			
Accounts payable	\$ 35,256	\$	\$ 35,256
Income taxes payable (Note 5)	216		216
Contingencies (Note 7)	-	-	-
Prepaid assessments	8,664		8,664
Total liabilities	44,136	0	44,136
<u>FUND BALANCE</u>	105,781	259,819	365,600
TOTAL LIABILITIES AND FUND BALANCE	\$ 149,917	\$ 259,819	\$ 409,736

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, 2006

	Operating Fund	Replacement Fund	Total
	<u> </u>	<u> </u>	<u> </u>
<u>REVENUES</u>			
Member assessments (Note 3)	\$ 384,360	\$ 42,000	\$ 426,360
Painting assessments (Notes 3 and 8)	67,320		67,320
Other member assessments	2,005		2,005
Miscellaneous income	802		802
Interest income	1,440	15,455	16,895
TOTAL REVENUES	<u>455,927</u>	<u>57,455</u>	<u>513,382</u>
<u>EXPENSES</u>			
Grounds maintenance	110,269		110,269
Water and sewer	99,059		99,059
Exterior painting (Note 8)	79,309		79,309
Maintenance coordinators - payroll and related taxes	63,942		63,942
Trash removal	24,525		24,525
Pool and amenity expenses	18,954		18,954
Snow removal	17,934		17,934
Insurance expense	15,271		15,271
Bookkeeping fees and office expense	12,929		12,929
Gas and electric	7,966		7,966
Legal and audit	2,972		2,972
Telephone expense	1,982		1,982
Committee expenses (publicity and hospitality)	1,895		1,895
Income taxes (Note 5)	1,316		1,316
Miscellaneous expenses	858		858
Depreciation expense (Note 2)	512		512
Replacement fund expenses:			
Asphalt and concrete repairs		114,382	114,382
Grounds renovation		20,603	20,603
Amenity repairs		8,507	8,507
Miscellaneous		1,145	1,145
TOTAL EXPENSES	<u>459,693</u>	<u>144,637</u>	<u>604,330</u>
EXCESS OF (EXPENSES OVER REVENUES)	(3,766)	(87,182)	(90,948)
BEGINNING FUND BALANCE	114,231	342,317	456,548
Transfer of Fund Balance (Note 9)	(4,684)	4,684	0
ENDING FUND BALANCE	<u>\$ 105,781</u>	<u>\$ 259,819</u>	<u>\$ 365,600</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, 2006

	Operating Fund	Replacement Fund	Total
	<u> </u>	<u> </u>	<u> </u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Member assessments collected	\$ 454,112	\$ 42,000	\$ 496,112
Interest received	1,440	15,455	16,895
Other income received	802		802
Cash paid for operating expenditures	(433,598)		(433,598)
Replacement expenditures paid		(144,637)	(144,637)
Payment of income taxes	(2,165)		(2,165)
Transfer from Operating Fund (Note 9)	(4,684)	4,684	0
Borrowings from operating fund	(35,785)	35,785	0
Net cash used by operating activities	<u>(19,878)</u>	<u>(46,713)</u>	<u>(66,591)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investments in temporary investments -net		123,806	123,806
NET INCREASE (DECREASE) IN CASH AND			
CASH EQUIVALENTS	(19,878)	77,093	57,215
Cash and cash equivalents at beginning of year	71,854	95,592	167,446
Cash and cash equivalents at end of year	<u>\$ 51,976</u>	<u>\$ 172,685</u>	<u>\$ 224,661</u>

RECONCILIATION OF EXCESS OF (EXPENSES OVER REVENUES)
TO NET CASH USED BY OPERATING ACTIVITIES:

Excess of (expenses over revenues)	\$ <u>(3,766)</u>	\$ <u>(87,182)</u>	\$ <u>(90,948)</u>
Adjustments to reconcile excess of (expenses over revenues) to net cash used by operating activities:			
Increase (decrease) in interfund balances	(35,785)	35,785	0
Transfer from Operating Fund (Note 9)	(4,684)	4,684	0
Depreciation expense	512		512
Decrease in assessments receivable	191		191
Decrease in prepaid expenses	666		666
Increase in accounts payable	23,601		23,601
Decrease in income taxes payable	(849)		(849)
Increase in prepaid assessments	236		236
Total adjustments	<u>(16,112)</u>	<u>40,469</u>	<u>24,357</u>
Net cash used by operating activities	<u>\$ (19,878)</u>	<u>\$ (46,713)</u>	<u>\$ (66,591)</u>

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

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

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
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THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

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

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.

Regular monthly assessments to owners have been, and are scheduled to be, as follows:

<u>Year</u>	<u>Assessment</u>		<u>Total</u>
	<u>Regular</u>	<u>Painting</u>	
Since September 2005	\$ 90	\$ 15	\$ 105
2006 (current year)	95	15	110
2007	110	15	125
2008 - tentative	120	15	135

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 KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

NOTE 4. FUTURE MAJOR REPAIRS AND REPLACEMENTS (continued)

The Board conducted a study in February of 2004, which has not been subsequently updated, 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 Colorado Reserves - Colorado, LLC..

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, \$42,000 has been included in the 2006 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, 2006, the cumulative budgeted Replacement Fund assessments, less expenditures, was less than the funds' specifically allocated assets by \$86,866. The Board intends to repay that amount during 2007 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 \$1,316 as of December 31, 2006.

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2006

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 2006 activity in the segregated account was as follows:

Beginning painting escrow balance	\$15,689
Monthly transfers in, at \$5,610 per month for 12 months	67,320
Interest earned	954
Less: Exterior painting expenses paid from escrow account	<u>(79,200)</u>
Painting escrow balance at December 31, 2006	<u>\$ 4,763</u>
2004 painting expenses borrowed from Reserves	\$15,627
2005 partial repayment to Reserves	(5,000)
2006 partial repayment to Reserves	<u>0</u>
Remaining balance due to Reserves, included In the interfund borrowing	<u>\$10,627</u>

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

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 11 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.

Burrige A. Omeron
Certified Public Accountant
January 23, 2007

THE KNOLLS VILLAGE TOWNHOUSE ASSOCIATION
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS
 DECEMBER 31, 2006
 (UNAUDITED)

The Board conducted a study in February 2004, which has not been subsequently updated, 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, 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 at the time of the study, it 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>	As of February 2004			
	Estimated	Estimated	Annual	Amount Which
	Remaining Useful	Current	Funding	Should Be
	Lives (Years)	Replacement	Requirement	Accumulated At
	Costs		December 31, 2004	
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		291,150	17,281	155,876
Total		\$1,075,400	\$33,600	\$681,619
Cash and temporary investments in Replacement Fund - net, December 31, 2006				\$346,685