

Terry J. Tagwerker
Certified Public Accountant

Member:

American Institute
of CPA's

California Society
of CPA's

February 21, 2017

Board of Directors
The Knolls Condominium Homeowner Association
8181 Mission Gorge Road #F
San Diego, CA 92120

Dear Members of the Board:

I have audited the financial statements of The Knolls Condominium Homeowner Association for the year ended December 31, 2016, and have issued my report thereon dated February 21, 2017. Professional standards require that I provide you with the following information about my responsibilities under generally accepted auditing standards, and to communicate to you the following information.

1. My responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.
2. As part of my audit, I considered the internal accounting control of The Knolls Condominium Homeowner Association. Such consideration was solely for the purpose of determining my audit procedures and not to provide any assurance concerning such internal control.
3. I am responsible for communicating significant matters related to the audit that are, in my professional judgment, relevant to your responsibilities in overseeing the financial reporting process.

Generally accepted accounting principles require that an allowance for doubtful accounts be recorded in the financial statements when the amount of accounts receivable become significant and material. An allowance for doubtful account is recorded on the balance sheet as a decrease to the net accounts receivable account. It does not remove delinquent member accounts from the accounts receivable, but it records a bad debt expense which corresponds with the amount of the allowance account. This represents an amount of delinquent accounts that can reasonably be considered uncollectible. On The Knolls Condominium Homeowner Association's audit report for the year ending December 31, 2016, I reported an allowance for doubtful accounts which totals \$16,692.

4. As stated in my engagement letter dated October 3, 2016 my responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with the generally accepted accounting principles.

Qualitative Aspects of Accounting Practices

5. Management is responsible for the selection and use of appropriate accounting policies. I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by The Knolls Condominium Homeowner Association are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the 2016 year. I noted no transactions entered into by The Knolls Condominium Homeowner Association during the year for which there is a lack of authoritative guidance. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Difficulties Encountered in Performing the Audit

6. I encountered no difficulties in dealing with management in performing and completing my audit.

Corrected and Uncorrected Misstatements

7. Professional standards require that I accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and to communicate them to the appropriate level of management. I found no such misstatements.

Disagreements with Management

8. For purposes of this letter, a disagreement is a financial statement accounting, reporting, or unaudited matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. There have been no such disagreements during the course of my audit.

Management Representations

9. I have requested certain representations from the Board that are included in the management representation letter dated February 21, 2017 which I sent and have requested the Board to sign and return to me.

Other Audit Issues

10. I generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Association's auditor. However, these discussions occurred in the normal course of my professional relationship and were not a condition to my retention

This information is intended solely for the use of the Board of Directors and management of The Knolls Condominium Homeowner Association and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours



Terry J. Tagwerker CPA

**The Knolls Condominium
Homeowner Association**

Financial Statement

December 31, 2016

TABLE
OF
CONTENTS

Accountant's Letter

Financial Statements:

Balance Sheet2

Statement of Revenue and Expenses
and Changes in Fund Balances3

Statement of Expenses4 & 5

Statement of Cash Flows6 & 7

Supplementary Information on Future
Major Repairs and Replacements.....8

Notes to the Financial Statements9 - 12

INDEPENDENT AUDITOR'S REPORT

Board of Directors
The Knolls Condominium Homeowner Association
San Diego, California

Report on the Financial Statements

I have audited the accompanying financial statements of The Knolls Condominium Homeowner Association, which comprise the balance sheet as of December 31, 2016, and the related statements of revenues and expenses and changes in fund balance, statement of expenses, and cash flows for the year ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

My audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Knolls Condominium Homeowner Association as of December 31, 2016, 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 of America.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements of common property on page 8, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during the audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.



Terry J. Tagwerker CPA
La Mesa, California
February 21, 2017

**The Knolls Condominium
Homeowner Association**
Balance Sheet
December 31, 2016

	<u>Operating Fund</u>	<u>Reserves Fund</u>	<u>Construction Fund</u>	<u>Total</u>
<u>ASSETS</u>				
Current Assets:				
Cash on Deposit	\$ 71,459	\$ 81,840	\$ 141,450	\$ 294,749
Certificates of Deposit		330,000		330,000
Total Cash	\$ 71,459	\$ 411,840	\$ 141,450	\$ 624,749
Accounts Receivable (Note 2)	20,298			20,298
Allowance for Doubtful Accounts	(16,692)			(16,692)
Prepaid Insurance	1,802			1,802
Prepaid Taxes (Note 3)	226			226
Total Current Assets	<u>\$ 77,093</u>	<u>\$ 411,840</u>	<u>\$ 141,450</u>	<u>\$ 630,383</u>
 <u>LIABILITIES</u>				
Current Liabilities:				
Accounts Payable	\$ 9,692	\$	\$	\$ 9,692
Prepaid Assessments	11,964			11,964
Total Current Liabilities	\$ 21,656	\$ -	\$ -	\$ 21,656
 <u>FUND BALANCE</u> (Note 5)	 <u>\$ 55,437</u>	 <u>\$ 411,840</u>	 <u>\$ 141,450</u>	 <u>\$ 608,727</u>
 TOTAL LIABILITIES & FUND BALANCE	 <u>\$ 77,093</u>	 <u>\$ 411,840</u>	 <u>\$ 141,450</u>	 <u>\$ 630,383</u>

The accompanying notes are integral parts of this financial statement.

**The Knolls Condominium
Homeowner Association**
Statement of Revenues and Expenses
and Changes in Fund Balances
For the Year Ending December 31, 2016

	<u>Operating Fund</u>	<u>Reserves Fund</u>	<u>Construction Fund</u>	<u>Total</u>
<u>REVENUES</u>				
Homeowner Assessments	\$ 252,626	\$ 80,674	\$ 591	\$ 333,300
Interest Income		2,391		2,982
Other Income	4,856			4,856
Total Revenues	<u>\$ 257,482</u>	<u>\$ 83,065</u>	<u>\$ 591</u>	<u>\$ 341,138</u>
<u>EXPENSES</u>				
Operating:				
Repair & Maintenance	\$ 108,775			\$ 108,775
Utilities	97,783			97,783
Administrative/ Community Related	67,694			67,694
Reserves/Construction:		<u>55,870</u>	<u>150</u>	<u>56,020</u>
Total Expenses	<u>\$ 274,252</u>	<u>\$ 55,870</u>	<u>\$ 150</u>	<u>\$ 330,272</u>
Excess of Revenues over Expenses		\$ 27,195	\$ 441	\$ 27,636
Excess of Expenses over Revenues	\$ (16,770)			\$ (16,770)
Fund Balances-Beginning of Year	\$ 72,207	\$ 384,645	\$ 141,009	\$ 597,861
Transfers/Allocations				-
Fund Balances-End of Year	<u><u>\$ 55,437</u></u>	<u><u>\$ 411,840</u></u>	<u><u>\$ 141,450</u></u>	<u><u>\$ 608,727</u></u>

The accompanying notes are integral parts of this financial statement.

**The Knolls Condominium
Homeowner Association**
Statement Expenses
For the Year Ending December 31, 2016

Operating Expenses

Repair & Maintenance:

Landscape	\$ 54,836
Tree Trimming	2,504
Common Area	34,771
Janitorial	5,562
Pest Control	3,742
Pool Maintenance	<u>7,360</u>
Total Repair & Maintenance	\$ <u><u>108,775</u></u>

Utilities:

Gas & Electric	\$ 12,812
Water & Sewer	59,639
Trash Removal	<u>25,332</u>
Total Utilities	\$ <u><u>97,783</u></u>

Administrative/
Community Related:

Insurance	\$ 23,956
Management	14,400
Professional Fees	6,649
General Office	3,546
Income tax & License	1,414
Security	13,566
Bad Debt (Note 2)	<u>4,163</u>
Total Administrative/ Community Related	\$ <u><u>67,694</u></u>

The accompanying notes are integral parts of this financial statement.

**The Knolls Condominium
Homeowner Association**

Statement of Expenses
(Continued)

For the Year Ending December 31, 2016

Reserves Expenses

Stairs/Balconies	\$	15,842
Termite Control		30,800
Furniture		6,703
Spa Refurbish		2,500
Contingency		<u>25</u>
Total Reserves Expenses	\$	<u><u>55,870</u></u>

Construction Expenses

Contingency	\$	<u><u>150</u></u>
-------------	----	-------------------

The accompanying notes are integral parts of this financial statement.

**The Knolls Condominium
Homeowner Association**
Statement of Cash Flows
For the Year Ending December 31, 2016

	<u>Operating Fund</u>	<u>Reserves Fund</u>	<u>Construction Fund</u>	<u>Total</u>
Cash Flows from				
<u>Operating Activities:</u>				
Member Assessments	\$ 248,487	\$ 80,674	\$ 591	\$ 329,161
Interest Receipts		2,391	591	2,982
Other Receipts	4,877			4,877
Total sources of Operating Cash	\$ 253,364	\$ 83,065	\$ 591	\$ 337,020
Cash paid for Operating Expenditures	(267,430)			(267,430)
Cash paid for Reserves/ Construction		(55,870)	(150)	(56,020)
Net cash provided by Operating Activities	\$ (14,066)	\$ 27,195	\$ 441	\$ 13,570
Net Cash flows from				
<u>Financing Activities:</u>				
Interfund transfers				-
Net cash provided by Financing Activities	\$ -	\$ -	\$ -	\$ -
Net increase in cash and cash equivalents	\$ (14,066)	\$ 27,195	\$ 441	\$ 13,570
Cash and Cash equivalents at beginning of year	\$ 85,525	\$ 384,645	\$ 141,009	\$ 611,179
Cash and Cash equivalents at end of year	<u>\$ 71,459</u>	<u>\$ 411,840</u>	<u>\$ 141,450</u>	<u>\$ 624,749</u>
Supplemental disclosure:				
Income Taxes Paid			\$ 1,299	

The accompanying notes are integral parts of this financial statement.
See Independent Auditors Report

**The Knolls Condominium
Homeowner Association**
Statement of Cash Flows
(Continued)

For the Year Ending December 31, 2016

	Operating Fund	Reserves Fund	Construction Fund	Total
Reconciliation of operating surplus (deficit) to net cash provided by Operating activities:				
Operating surplus (deficit)	\$ (16,770)	\$ 27,195	\$ 441	\$ 10,866
Adjustments to reconcile operating surplus (deficit) to net cash provided by operating activities:				
Allowance for Doubtful Accounts	(4,862)			(4,862)
(Increase) decrease in:				
Accounts Receivable	4,203			4,203
Prepaid Expenses	(181)			(181)
Increase (decrease) in:				
Accounts Payable	3,575			3,575
Prepaid Assessments	383			383
Accrued Expenses	(414)			(414)
Total adjustments	\$ 2,704	\$ -	\$ -	\$ 2,704
Net cash provided by operating activities	\$ (14,066)	\$ 27,195	\$ 441	\$ 13,570

The accompanying notes are integral parts of this financial statement.

See Independent Auditors Report

**The Knolls Condominium
Homeowner Association**
Supplementary Information on Future Major
Repair and Replacement
(Unaudited)
December 31, 2016

The Board of Directors engaged an independent contractor to conduct a study in August 2016, of the Association's components of common property, to estimate the remaining lives and replacement costs. Replacement costs were based on the estimated costs to repair and replace the common property components at the date of the study. Estimated current replacement costs have not been revised since that date and do not take into account the effects of inflation between the date of the study and the date that the components will require repair and replacement.

<u>Component</u>	<u>Estimated Remaining Life (Years)</u>	<u>Current Replacement Costs</u>	<u>Annual Funding Requirement</u>	<u>Accumulated Reserves Requirement</u>
Asphalt & Concrete Surfaces	0-3	183,485	13,544	171,363
Fencing & Walls	0-16	128,384	5,774	90,709
Landscape	4-15	23,560	1,909	7,956
Lighting	5	35,740	1,787	26,806
Miscellaneous	0-1	42,500	9,860	42,500
Paint	0-9	95,062	10,943	55,465
Plumbing	0-5	23,945	7,095	22,397
Pool & Spa	0-6	62,245	5,970	57,116
Recreation Area	0-12	20,735	1,949	11,208
Roof	2-12	706,165	28,681	421,085
Security & Fire Systems	1	16,592	1,659	14,932
Termite Treatment	0-9	86,556	8,656	58,680
Total		<u>\$ 1,424,969</u>	<u>\$ 97,824</u>	<u>\$ 980,218</u>

Note: California Civil Code requires an Association to cause a reserves study of the Association's reserves components to be performed every three years, if the current replacement value of an Association's reserves components is equal to or greater than one-half of the gross budget of the Association for any fiscal year.

The Board of Directors is required to review the study annually and consider making any necessary adjustments to the reserves accounts as a result of this review.

According to the study, the Association would be 100% funded if there was \$980,218 in the Reserve Fund. At December 31, 2016 the actual Reserves/Construction Funds total \$553,290.

The accompanying notes are integral parts of this financial statement.
See Independent Auditors Report

**The Knolls Condominium
Homeowner Association**
Notes to the Financial Statements

December 31, 2016

Note 1 - **Organization**

The Knolls Condominium Homeowner Association (the Association) was incorporated in May 1991 as a non-profit mutual benefit corporation to provide for the maintenance, preservation, and architectural control of the commonly owned areas of the residential housing complex. The Association comprises 101 member units located in San Diego County, California.

Note 1a- **Summary of Significant Accounting Policies**

Accounting Principles - The Association's books of account are prepared using the modified accrual basis of accounting; revenue is recorded when earned and expenses are recorded when paid. This financial statement follows the accrual basis of accounting pursuant to generally accepted accounting principles, which recognizes revenue when it is earned and expenses when they are incurred.

Fund Accounting - The Association uses fund accounting that requires funds such as operating, and reserves designated for future major repairs and replacement, be classified separately for accounting and reporting purposes. Disbursements from the Operating Fund are generally for daily maintenance operations while Reserve Fund disbursements are made only for designated major repair and replacement.

Cash & Cash Equivalents - According to generally accepted accounting principles regarding the statement of cash flows, certificates of deposit and securities with original maturities of three months or less are considered as cash equivalents. Certificates of deposit and securities with original maturities over three months are considered short-term investments. The Association's policy is to record all cash, cash equivalents and short-term investments as cash funds. At December 31, 2016 the Association holds certificates of deposit totaling \$330,000 with original maturities exceeding three months. The certificates of deposit are considered to be held-to-maturity and are reported on the cost basis, which approximates the fair market value.

Investment Income - Interest income earned on Reserves cash accounts is allocated to the Reserves Fund. All income tax expenses are paid by, and allocated to the Operating Fund.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management and the Association to make estimates and assumptions that affect the reported amounts of 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.

Management Review – Management has evaluated subsequent events and transactions for potential recognition or disclosure through February 21, 2017, the date the financial statements were available to be issued.

**The Knolls Condominium
Homeowner Association**
Notes to the Financial Statements

December 31, 2016

Note 2 - **Member Assessments/Accounts Receivable**

Each member unit owner of the Association is billed monthly homeowner assessments that provides for the Association's operating expenses, and the Reserves Fund future major repairs and replacement. For the year ending December 31, 2016 the monthly unit homeowner assessment was \$275. The Association retains excess funds for expenses in future years. Monthly homeowner assessments and other member charges billed to the unit owners, but not collected, are recorded as accounts receivable and the Association's policy is to retain legal counsel and place liens on the units of owners whose assessments and other charges are in arrears. The Association's Board of Directors has determined that delinquent accounts totaling \$9,025 are to be written off as uncollectible. An allowance for doubtful accounts totaling \$16,692 has been recorded, of which \$4,163 is allocated to the year ending December 31, 2016.

Note 3 - **Income Taxes**

The Association qualifies as a tax-exempt homeowner association under Internal Revenue Code Section 528 for the year ended December 31, 2016. Under that Section, the Association is not taxed on income and expenses related to its exempt function, which is the acquisition, construction, management, maintenance, and care of Association property. Net non-exempt function income which includes earned interest and revenues received from non-members is taxed at 30% by the federal government and 8.84% by the State of California. The Association's federal tax returns generally are subject to examination by taxing authorities for three years after the returns are filed, and the state returns and subject to examination for four years after the returns are filed. In evaluating the Association's tax provisions and accruals, the Association believes that its estimates are appropriate based on current facts and circumstances. For the year ending December 31, 2016, the federal income tax expense and prepayment is \$446 and \$154 respectively, and the state income tax expense and prepayment is \$246 and \$72, respectively.

Note 4 - **Common Real and Personal Property**

The real property and related capital improvements of the Association housing complex are not recorded on these financial statements as such property is owned by the member unit owners. The Knolls Condominium Homeowner Association recognizes purchases of common personal property as assets in conformity with reporting guidelines of Common Interest Realty Associations established by the American Institute of Certified Public Accountants. The Association records such purchases when they are determined to be significant.

**The Knolls Condominium
Homeowner Association**
Notes to the Financial Statements

December 31, 2016

Note 5 - **Reserves/Construction Fund**

The Association allocates a portion of the monthly homeowner assessments to the Reserves Fund that provides for the major repair and replacement of the commonly owned property. The Association's budgeted reserves funding for the year ending December 31, 2016 was \$80,674 which was transferred to the Reserves Fund bank account. The Reserves Fund is segregated into separate accounts and is not used for the general daily maintenance and administration operations of the Association.

The Association's Board of Directors conducted a study of the Associations' components of common property, the purpose of which was to estimate the components' remaining useful lives and replacement costs. The Association's policy is to fund for major repairs and replacements over the remaining useful lives of the components based upon the study's estimates of current replacements costs and considering amounts previously accumulated in the Reserves Fund. Accumulated reserves are based upon estimates of future needs for major repairs and replacements. Actual reserve expenses may vary from estimated future expenses; therefore, amounts accumulated in the Reserves Fund may not be adequate to meet all future expenses. If additional funds are needed, the Association has the authority to increase regular assessments, levy special assessments, or delay major repairs until funds are available. The Construction Fund accounts for major repair and replacements in the common area related to the Association's construction projects.

Note 6 - **Cash Accounts**

The Association's policy is to deposit cash assets with financial institutions protected with depository insurance. The Association deposits the Reserves and Construction Fund cash in Merrill Lynch accounts comprising interest-bearing treasury money funds insured by the Securities Investor Protection Corporation (SIPC). All other cash deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 for each financial institution.

<u>Depository Name</u>	<u>Account Type</u>	<u>Account</u>
Pacific Western Bank	Checking-Operating	\$ 71,459
Merrill Lynch	Money Market-Reserves	81,840
Merrill Lynch	Certificate of Deposit	330,000
Merrill Lynch	Money Market-Construction	141,450

	Total	\$ 624,749
		=====

**The Knolls Condominium
Homeowner Association**
Notes to the Financial Statements

December 31, 2016

Note 7 - **Fair Value Measurements**

The Association defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy is established that prioritizes the inputs to valuation techniques used to measure the fair value.

Fair values for investment assets considered held-to-maturity are measured along the following criteria:

Level 1 Input: Quoted prices in active markets for identical assets

Level 2 Input: Significant observable inputs for similar assets in active markets

Level 3 Input: Significant unobservable inputs based on valuation techniques

The hierarchy gives the highest priority to Level 1 measurements and the lowest priority to Level 3 measurements. The method and assumptions used to determine the fair value of the Association's investment assets is based on Level 1 Input. Fair value of the Association's investment assets at December 31, 2016 is as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Cash Equivalents/Money Fund	\$ 223,290	\$ 223,290
Certificates of Deposit	330,000	330,238
	-----	-----
Totals	<u>\$ 553,290</u>	<u>\$ 553,528</u>