

**FINANCIAL STATEMENTS
AND AUDITOR'S REPORT**

**ATASCOCITA COMMUNITY
IMPROVEMENT ASSOCIATION**

**Year Ended December 31, 2010
(With Comparative Totals for 2009)**

DRAFT
For Discussion Purposes Only

O'NEAL & HOLMES, LLP.
A Registered Limited Liability Partnership

O'Neal & Holmes, LLP

Certified Public Accountants

Board of Directors

Atascocita C.I.A.

9802 FM 1960 Bypass W, Suite 210

Humble, TX 77338

September 8, 2011

Dear Board Members:

We have audited the financial statements of Atascocita C.I.A. for the year ended December 31, 2010 and have issued our report thereon dated September 8, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you dated January 21, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Atascocita C.I.A. 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 2010. We noted no transactions entered into by the Association during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Management's estimate of the allowance for doubtful accounts is based on management's experience and historical foreclosure rate. We evaluated the key factors and assumptions used to develop the allowance for doubtful accounts in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of depreciation expense is based on management's estimate of depreciable life of the assets. We evaluated the key factors and assumptions used in determining that depreciation expense is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was:

The disclosure of the reserve funding program and the lack of a study in Note 6 to the financial statements, and the related party disclosure in Note 4 to the financial statements.

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Atascocita Community Improvement Association

We have audited the accompanying balance sheets of Atascocita Community Improvement Association as of December 31, 2010 and 2009, and the related statements of revenues and expenses, changes in fund balances, 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 audits 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 present fairly, in all material respects, the financial position of Atascocita Community Improvement Association as of December 31, 2010 and 2009, 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 audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedules of operating and administrative expenses [page 13] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of the Association's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Management has omitted the information about future major repairs and replacements that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by the missing information.

Humble, Texas
September 8, 2011

O'NEAL & HOLMES, L.L.P.
A Registered Limited Liability Partnership

**ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION
BALANCE SHEETS**

December 31, 2010

(With Comparative Totals for 2009)

ASSETS

| | 2010 | | | 2009 |
|--|---------------------|-------------------|---------------------|---------------------|
| | Operating Fund | Reserve Fund | Total | Total |
| CURRENT ASSETS | | | | |
| Cash, note 7 | \$ 210,853 | \$ 158,986 | \$ 369,839 | \$ 161,554 |
| Certificates of deposit | 101,014 | | 101,014 | 0 |
| Assessments receivable, net of allowance for doubtful accounts of \$9,400, note 1 | 995,851 | | 995,851 | 964,937 |
| Accrued interest receivable | 0 | | 0 | 137 |
| Accounts receivable | 2,267 | | 2,267 | 3,016 |
| Prepaid expenses | 27,615 | | 27,615 | 21,500 |
| Marketable securities, note 1 | 90,407 | | 90,407 | 298,315 |
| Total current assets | 1,428,007 | 158,986 | 1,586,993 | 1,449,459 |
| FIXED ASSETS, NOTES 1 AND 2: | | | | |
| Land | 233,000 | | 233,000 | 233,000 |
| Fences and landscaping | 28,220 | | 28,220 | 28,220 |
| Furniture and fixtures | 4,387 | | 4,387 | 4,387 |
| Pool facilities | 593,031 | | 593,031 | 593,031 |
| Playground equipment | 150,222 | | 150,222 | 150,222 |
| Tennis courts | 145,952 | | 145,952 | 145,952 |
| Marina improvements | 47,483 | | 47,483 | 47,483 |
| Lighting, irrigation system and signage | 21,332 | | 21,332 | 21,332 |
| Less: accumulated depreciation | (957,979) | | (957,979) | (945,325) |
| TOTAL ASSETS | \$ 1,693,655 | \$ 158,986 | \$ 1,852,641 | \$ 1,727,761 |

LIABILITIES AND FUND BALANCES

| | | | | |
|--|---------------------|-------------------|---------------------|---------------------|
| CURRENT LIABILITIES | | | | |
| Accounts payable and accrued expenses | \$ 46,038 | \$ | \$ 46,038 | \$ 45,605 |
| Prepaid assessments | 157 | | 157 | 149 |
| Deferred income, note 1 | 1,182,987 | | 1,182,987 | 1,182,750 |
| Total current liabilities | 1,229,182 | 0 | 1,229,182 | 1,228,504 |
| COMMITMENTS, NOTE 3 | - | - | - | - |
| FUND BALANCES | | | | |
| Accumulated excess of revenues (expenses) | 464,473 | | 464,473 | 341,248 |
| Accumulated other comprehensive income (loss): | | | | |
| Net unrealized losses on investments, note 1 | 0 | | 0 | 0 |
| Replacement reserve funds, notes 1 and 6 | | 158,986 | 158,986 | 158,009 |
| TOTAL LIABILITIES AND FUND BALANCES | \$ 1,693,655 | \$ 158,986 | \$ 1,852,641 | \$ 1,727,761 |

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

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For Discussion Purposes Only

**ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION
STATEMENTS OF REVENUES AND EXPENSES**

For The Year Ended December 31, 2010

(With Comparative Totals for 2009)

| | 2010 | | | 2009 |
|--|--------------------------|----------------------|--------------------------|------------------------|
| | Operating Fund | Reserve Fund | Total | Total |
| Revenues | | | | |
| Maintenance fees, interest charges and other revenue, note 1 | \$ 1,199,467 | \$ 0 | \$ 1,199,467 | \$ 1,071,149 |
| Less: | | | | |
| Operating and administrative expenses | 1,066,727 | 0 | 1,066,727 | 1,055,834 |
| Depreciation expense, notes 1 and 2 | 12,654 | | 12,654 | 17,547 |
| Income (loss) from operations | <u>120,086</u> | <u>0</u> | <u>120,086</u> | <u>(2,232)</u> |
| Interest and investment income | 3,139 | 977 | 4,116 | 10,700 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES | <u>\$ 123,225</u> | <u>\$ 977</u> | <u>\$ 124,202</u> | <u>\$ 8,468</u> |

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

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**ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION
STATEMENTS OF CHANGES IN FUND BALANCES**

For The Year Ended December 31, 2010

(With Comparative Totals for 2009)

| | 2010 | | | 2009 |
|--|-------------------|-----------------|------------|------------|
| | Operating Fund | Reserve Fund | Total | Total |
| Fund balances at January 1 | \$ 341,248 | 158,009 | \$ 499,257 | \$ 488,289 |
| Interfund transfers | | | 0 | 0 |
| Comprehensive income: | | | | |
| Net unrealized gain(loss), note 1 [see disclosure] | | | 0 | 2,500 |
| Excess (deficiency) of revenues over expenses | 123,225 | 977 | 124,202 | 8,468 |
| Fund balances at December 31 | \$ 464,473 | \$ 158,986 | \$ 623,459 | \$ 499,257 |

Disclosure of Unrealized Losses

Applicable to Atascocita Community Improvement Association

| | | | |
|---|---|---|---------|
| Unrealized gains (losses) at January 1 | 0 | 0 | (2,500) |
| (Gains) Losses realized during the year | 0 | 0 | 0 |
| Decrease in unrealized losses during the year | 0 | 0 | 2,500 |
| Prior year reclassifications | | 0 | 0 |
| Net unrealized losses on investments | 0 | 0 | 0 |

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

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**ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION
STATEMENTS OF CASH FLOWS**

For The Year Ended December 31, 2010

(With Comparative Totals for 2009)

| | 2010 | | | 2009 |
|--|-------------------|-------------------|-------------------|-------------------|
| | Operating Fund | Reserve Fund | Total | Total |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | | |
| Excess (Deficiency) of Revenues over Expenses | \$ 123,225 | \$ 977 | \$ 124,202 | \$ 8,468 |
| Adjustment to reconcile excess of revenues over (under) expenses to net cash provided by operating activities: | | | | |
| Depreciation | 12,654 | | 12,654 | 17,547 |
| (Increase) Decrease in assessments receivable | (30,914) | | (30,914) | (149,385) |
| (Increase) Decrease in Interest receivable | 137 | | 137 | 759 |
| (Increase) Decrease in accounts receivable | 749 | | 749 | 1,351 |
| (Increase) Decrease in prepaid expenses | (6,115) | | (6,115) | (271) |
| Increase (Decrease) in accounts payable | 433 | | 433 | (6,456) |
| Increase (Decrease) in prepaid assessments | 8 | | 8 | (6,087) |
| Increase (Decrease) in deferred income | 237 | | 237 | 124,712 |
| Total Adjustments | (22,811) | 0 | (22,811) | (17,830) |
| Cash flows provided (used) by operating activities | 100,414 | 977 | 101,391 | (9,362) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | |
| (Increase) Decrease in certificates of deposit | (101,014) | 0 | (101,014) | 58,000 |
| (Increase) Decrease in marketable securities | 49,899 | 158,009 | 207,908 | (161,863) |
| (Increase) Decrease in unrealized losses on investments | 0 | | 0 | 2,500 |
| Cash flows provided (used) by investing activities | (51,115) | 158,009 | 106,894 | (101,363) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | |
| Interfund transfer | 0 | 0 | 0 | 0 |
| Cash flows provided (used) by financing activities | 0 | 0 | 0 | 0 |
| NET INCREASE (DECREASE) IN CASH | 49,299 | 158,986 | 208,285 | (110,725) |
| CASH AT BEGINNING OF YEAR | 161,554 | 0 | 161,554 | 272,279 |
| CASH AT END OF YEAR | \$ 210,853 | \$ 158,986 | \$ 369,839 | \$ 161,554 |

SUPPLEMENTAL DISCLOSURE

| | | |
|---|------|------|
| Federal income taxes paid during the year | \$ 0 | \$ 0 |
| Interest expense paid during the year | \$ 0 | \$ 0 |

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

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ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2010

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Atascocita Community Improvement Association (Association) is a Texas nonprofit corporation organized to provide for the recreation, health and welfare of its members and to promote and preserve the value of their property. The affairs of the Association are managed by a Board of five trustees who are elected by members of the Association. The Association is located in Harris County, Texas and contains approximately 2,530 lots, 2,483 that are billable. A summary of the Association's significant accounting policies follows:

.. DATE OF MANAGEMENT'S REVIEW

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through September 8, 2011, the date the financial statements were available to be issued.

.. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, except for donated assets which are stated at approximate fair market value. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, on a straight-line basis.

As more fully described in note 6, the Association has set aside reserve funds for future repair and replacement needs. (Such a program is not required by the Association's deed covenants nor Texas state statutes.)

.. FEDERAL INCOME TAX

The Internal Revenue Service has determined that the Association is exempt from federal income taxes under Code Section 501(C)(4). Accordingly, no provision for income taxes is included in the financial statements.

Although exempt from Federal Income Taxes, the Association adopted ASC 740 on January 1, 2007. ASC 740 clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return. The Interpretation also provides guidance on the measurement, recognition, classification, and disclosure of tax positions, along with accounting for the related interest and penalties. Adoption of ASC 740 did not have a material effect on the Association's accompanying financial statements. The Association's policy is to include tax related penalties and interest in the related tax expense category. [continued on next page]

.. FEDERAL INCOME TAX [continued]

The Association had no unrecognized tax benefits as of the January 1, 2007 adoption date or as of December 31, 2010. The Association expects no significant increases or decreases in unrecognized tax benefits due to change in tax positions within one year of December 31, 2010.

The Association has no tax related penalties or interest for the year ended December 31, 2010. As of December 31, 2010, tax exempt information returns for the calendar years ending December 31, 2007 through 2010 remain subject to Federal examination. The Association is exempt from Texas State Franchise Tax. As of December 31, 2010, the Association's exempt status for the calendar years ending December 31, 2006 through 2010 is technically subject to Texas State examination.

.. DEFERRED INCOME

The Association has adopted a policy of recognizing maintenance fee assessments receivable in the year in which the fees are billed. Revenue is recognized in the year in which the revenue is earned. Unearned revenue represents assessment fees payable January 1st, that were billed prior to December 31st.

.. ACCRUAL METHOD

The Association uses the accrual method of accounting for revenue and expenses. Late fees charged on delinquent assessments are recognized into income when received.

.. FUND ACCOUNTING

The Association's governing documents provide certain guidelines for governing its financial activities. To ensure the observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for reporting purposes in two funds established according to their nature and purpose:

The Operating Fund is used to accumulate financial resources available for the general operations of the Association.

The Reserve Fund is used to accumulate financial resources designated for future major repairs and replacements.

.. ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is based on management's past experience in collecting its accounts and the association's historical foreclosure rate.

.. STATEMENT OF CASH FLOWS

The Association uses the indirect method of presenting cash flows. 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.

.. DONATED CAPITAL

The Association has adopted the policy of recording all significant fixed assets, including assets donated to the Association by the developer. Fund balance includes the value of donated assets, capitalized in the current period and in prior years. The value of the recreation assets was determined by the developer and approximated fair market value. The value of the land was based upon the assessed value of the land for ad valorem tax purposes, and approximated fair market value.

.. MAINTENANCE FEES

Basic provisions of billings provided for in the deed covenants are as follows:

The maximum annual assessment of \$500.00. per lot may be increased by the assent of 51% of the members or by 51% of the votes of members of the Association who are present and voting in person or by proxy at a special meeting called for such purpose.

The annual assessment for builder and developer lots is 20% of the assessment amount (referred to above) prior to completion of a residential structure and the passage of three months time. The annual assessment for lots owned by owners other than builders and developers is 50% of the assessment amount (referred to above) prior to the completion and occupancy of a residential structure. The maintenance fee assessment for 2011 and 2010 was \$475 per residence and \$237.50 per unimproved lot.

.. MARKETABLE SECURITIES and FAIR VALUE MEASUREMENTS

Marketable debt and equity securities are considered as *available-for-sale* and are reported at fair market value. Unrealized gains and losses are reported as other comprehensive income (loss) in the statement of fund balances. The Association did not have any material fair value measurement adjustments.

.. 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.

.. ADVERTISING COSTS

The Association does not have any capitalized advertising costs at December 31, 2010. The Association's policy is to charge expense for advertising costs as incurred. There was no advertising expense for the year ended December 31, 2010.

NOTE 2 RECREATION ASSETS

Assets and accumulated depreciation are summarized as follows:

| | Donated Value or Cost | Useful Life | Accumulated Depreciated |
|---|--------------------------|-------------|----------------------------|
| Land | \$233,000 | — | — |
| Fences & landscaping | 28,220 | 5 years | 28,220 |
| Furniture & fixtures | 4,387 | 5 years | 4,387 |
| Playgrounds & Improvements | 150,222 | 15 years | 143,171 |
| Pool Facilities & Equipment | 593,031 | 15 years | 573,665 |
| Tennis Courts | 145,952 | 15 years | 140,612 |
| Marina Improvements | 47,483 | 10-15 yrs | 47,483 |
| Lighting, irrigation system and signage | 21,332 | 10-15 yrs | 20,441 |
| Total | <u>\$1,223,627</u> | | <u>\$957,979</u> |

NOTE 3 COMMITMENTS

The Association has entered into various maintenance and service contracts which are generally subject to cancellation based on non-performance by either party or upon a certain number of days notice.

NOTE 4 MANAGEMENT SERVICES/RELATED PARTY TRANSACTIONS

The Association has contracted with a management company to provide accounting, billing, collecting, administrative and deed restriction supervision services. A stockholder of the management company owns two rental properties in the Association. The Board has ruled that this does not constitute a conflict of interest.

The landscaping company that the Association contracts with for landscaping maintenance services, is owned by a relative of one of the stockholders of the management company. This service contract is competitively bid under the supervision of the board of trustees.

NOTE 5 MARINA

During 1995, the Board voted to record the marina on the Association's books at its approximate fair market value.

NOTE 6 RESERVE FUND

The Association has reserved \$130,986 for future major repairs and replacements and \$28,000 for marina improvements. These monies are deposited in a money market account. The Association has not conducted an independent study to determine the adequacy of the reserve funding program. Accordingly, the amount reserved may not be adequate to meet future repair and replacement needs. If additional funds are needed, however, the Association has the right, subject to membership approval, to increase regular assessments or levy special assessments or it may delay major repairs and replacements until funds are available. Comprehensive income and earnings on reserve fund investments are reported as income in the operating fund.

SUPPLEMENTARY INFORMATION

NOTE 7 RISKS, UNCERTAINTIES AND INSURED LIMITS ON BANK DEPOSITS

The Association maintains its cash balances in both interest bearing and non-interest bearing bank accounts. FDIC currently insures non-interest bearing bank accounts for unlimited amounts. This coverage is scheduled to return to \$250,000 maximum coverage in January 01, 2013. Interest bearing bank accounts are presently insured for amounts up to \$250,000. During 2010, the Association's deposit balances never exceeded insured limits.

The Association maintains a portion of its funds at a financial institution that invests these monies in money funds and mortgage backed securities. The accounts are not F.D.I.C. insured. In accordance with AICPA Statement of Position #94-6, disclosure of certain significant risks and uncertainties is required of a risk concentration noted during the audit examination.

NOTE 8 LEGAL EXPENSE

The Association has a policy of charging back legal fees incurred to the respective homeowners when applicable. In the current audit period, \$11,265 of legal fees paid previously by the Association for collection and deed restriction enforcement were recovered. The Association incurred \$30,562 in legal expenses for the current year.

ATASCOCITA COMMUNITY IMPROVEMENT ASSOCIATION
SUPPLEMENTARY INFORMATION
SCHEDULES OF OPERATING AND ADMINISTRATIVE EXPENSES
For The Year Ended December 31, 2010
(With Comparative Totals for 2009)

| | <u>2010</u> | | | <u>2009</u> |
|--|-----------------------|---------------------|---------------------|---------------------|
| | <u>Operating Fund</u> | <u>Reserve Fund</u> | <u>Total</u> | <u>Total</u> |
| Administrative expense | \$ 22,117 | \$ | \$ 22,117 | \$ 16,723 |
| Auditing and accounting | 5,210 | | 5,210 | 4,785 |
| Bad debt expense | 15,504 | | 15,504 | 6,222 |
| Community events | 6,250 | | 6,250 | 1,772 |
| Deed Restriction management | 23,450 | | 23,450 | 23,400 |
| Electricity | 16,504 | | 16,504 | 14,887 |
| Insurance expense | 31,203 | | 31,203 | 28,252 |
| Legal and collection expenses, net | 16,797 | | 16,797 | 12,254 |
| Legal expense - Pinehurst Litigation Contribution | 2,500 | | 2,500 | 0 |
| Maintenance and landscaping expense, net | 143,891 | | 143,891 | 145,292 |
| Management fees | 47,400 | | 47,400 | 47,400 |
| Marina expense, net | 1,167 | | 1,167 | 2,010 |
| Newsletter expense | 1,372 | | 1,372 | 10,759 |
| Pest control | 7,022 | | 7,022 | 7,022 |
| Pool management, repairs and operating expense, net | 105,074 | | 105,074 ✓ | 120,503 ✓ |
| Property tax | 48 | | 48 | 48 |
| Security expense | 140,622 | | 140,622 | 144,501 |
| Street lights | 130,108 | | 130,108 | 127,269 |
| Telephone | 2,369 | | 2,369 | 2,883 |
| Tennis courts, rec center and playground maintenance | 17,842 | | 17,842 ✓ | 13,534 |
| Trash service, net of rebates | 314,691 | | 314,691 | 309,536 |
| Water and sewer | 15,586 | | 15,586 | 16,782 |
| | <u>\$ 1,066,727</u> | <u>\$ 0</u> | <u>\$ 1,066,727</u> | <u>\$ 1,055,834</u> |

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