

PROPERTY OWNERS' ASSOCIATION  
OF TERLINGUA RANCH, INC.

FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Year Ended December 31, 2007

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## **INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Property Owners' Association of Terlingua Ranch, Inc.

I have audited the accompanying balance sheet of Property Owners' Association of Terlingua Ranch, Inc. as of December 31, 2007 and the related statement of revenues and expenses, changes in members' equity, 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 of America. 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 statement 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 Property Owners' Association of Terlingua Ranch, Inc. as of December 31, 2007 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.

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.

Joe L. Torres, P.C.

Odessa, Texas  
March 14, 2008

Property Owners' Association of Terlingua Ranch, Inc.  
 Balance Sheet  
 December 31, 2007

|  | <u>2007</u>                |
|--|----------------------------|
| <b>ASSETS</b>  |                            |
| Cash-undesignated                                      | \$ 20,940                  |
| Cash-designated for future repairs<br>and replacements | 80,235                     |
| Accounts Receivable-Members' Assessments               | 1,413,251                  |
| Allowance for Doubtful Accounts                        | ( 354,202)                 |
| Inventories  | 23,010                     |
| Prepaid insurance and other receivables                | 30,117                     |
| Property, Fixtures, and Equipment, Net                 | 588,519                    |
| Deferred Tax Asset                                     | <u>50,000</u>              |
| <b>TOTAL ASSETS</b>                                    | <b><u>\$ 1,851,870</u></b> |
| <b>LIABILITIES AND MEMBERS' EQUITY</b>                 |                            |
| Accounts payable and accrued expenses                  | \$ 73,677                  |
| Deferred maintenance fee income (2008)                 | 632,927                    |
| Line of Credit   | -                          |
| Notes Payable  | <u>110,442</u>             |
| <b>TOTAL LIABILITIES</b>                               | <b>817,046</b>             |
| Contingency  | -                          |
| Members' Equity  |                            |
| Undesignated   | 954,589                    |
| Designated for future repairs and replacements         | <u>80,235</u>              |
| <b>TOTAL MEMBERS' EQUITY</b>                           | <b><u>1,034,824</u></b>    |
| <b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>           | <b><u>\$ 1,851,870</u></b> |

See accompanying notes to financial statements.

Property Owners' Association of Terlingua Ranch, Inc.  
Statement of Revenues and Expenses  
Year Ended December 31, 2007

|   | <u>2007</u>              |
|---|--------------------------|
| <b>REVENUES</b>   |                          |
| Members' assessments – operations                             | \$1,172,712              |
| Lodge and Resort Operations, Net                              | 227,835                  |
| Interest and other miscellaneous income                       | 4,014                    |
| Property Auction Proceeds, Net                                | <u>-</u>                 |
|   | 1,404,561                |
| <b>EXPENSES</b>   |                          |
| Payroll and Benefits  | 267,926                  |
| Telephone, Utilities, and Garbage                             | 55,194                   |
| Insurance   | 29,193                   |
| Supplies and Equipment expenses                               | 19,204                   |
| Repairs and Maintenance                                       | 66,557                   |
| Professional Fees   | 118,364                  |
| Property Taxes  | 8,921                    |
| Advertising and Newsletter Expenses                           | 23,458                   |
| Postage, Printing, and Internet Expenses                      | 19,588                   |
| Travel and Lodging  | 423                      |
| Vehicle Expense   | 23,865                   |
| Interest  | 16,256                   |
| Promotion   | 14,184                   |
| Credit Card, Collection Agency Fees, and Foreclosure Expenses | 21,995                   |
| Licenses, Fees, and Permits                                   | 3,424                    |
| Office Supplies and Leased Equipment                          | 6,850                    |
| Other Miscellaneous Expenses                                  | 2,434                    |
| Software Maintenance  | 10,694                   |
| Depreciation Expense  | 88,955                   |
| Federal Income Tax Benefit                                    | ( 15,000)                |
| Bad Debt Expense  | <u>177,000</u>           |
|   | <u>959,485</u>           |
| <b>EXCESS OF REVENUES OVER EXPENSES</b>                       | <u><u>\$ 445,076</u></u> |

See accompanying notes to financial statements.

Property Owners' Association of Terlingua Ranch, Inc.  
 Statements of Changes in Members' Equity  
 Year Ended December 31, 2007

|   | <u>Total</u>        | <u>Undesignated</u> | <u>Desingated<br/>for Future<br/>Repairs and<br/>Replacements</u> |
|---|---------------------|---------------------|---|
| MEMBERS' EQUITY – January 1, 2007               | \$ 589,748          | \$ 572,004          | \$ 17,744   |
| Excess of revenues over<br>expenses             | 445,076             | 444,912             | 164   |
| Allocated to future repairs<br>and replacements | -                   | (62,327)            | 62,327  |
| Major replacements & additions                  | <u>-</u>            | <u>-</u>            | <u>-</u>  |
| MEMBERS' EQUITY-December 31, 2007               | <u>\$ 1,034,824</u> | <u>\$ 954,589</u>   | <u>\$ 80,235</u>  |

See accompanying notes to financial statements

Property Owners' Association of Terlingua Ranch, Inc.  
Statement of Cash Flows  
Year Ended December 31, 2007

|  | <u>2007</u>       |
|--|-------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                   |
| Excess of revenues over expenses   | \$ 445,076        |
| Adjustment to reconcile excess of expenses<br>over revenues to net cash provided by<br>operating activities: |                   |
| Depreciation   | 88,955            |
| Deferred Income Tax Benefit  | ( 15,000)         |
| (Increase) decrease in:  |                   |
| Assessments receivable – members' assessments, net   | (251,920)         |
| Prepaid insurance and other receivable   | ( 6,112)          |
| Inventories  | ( 719)            |
| Increase (decrease) in:  |                   |
| Accounts payable and accrued expenses  | ( 44,711)         |
| Assessments received in advance  | -                 |
| Deferred maintenance fee income  | <u>( 12,322)</u>  |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>   | <u>203,247</u>    |
| <br><b>CASH FLOWS (FOR) INVESTING ACTIVITIES</b>   |                   |
| Acquisition of property, equipment, and software   | <u>( 38,639)</u>  |
| <b>CASH FLOWS (FOR) INVESTING ACTIVITIES</b>   | <u>( 38,639)</u>  |
| <br><b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                   |
| Proceeds from borrowings   | -                 |
| Debt repayment   | <u>(138,622)</u>  |
| <b>CASH FLOWS (FOR) FINANCING ACTIVITIES</b>   | <u>(138,622)</u>  |
| <b>NET INCREASE IN CASH</b>  | <u>25,986</u>     |
| <br><b>CASH AT BEGINNING OF YEAR</b>   | <u>75,189</u>     |
| <b>CASH AT END OF YEAR</b>   | <u>\$ 101,175</u> |
| <br><b>SUMMARY OF CASH ACCOUNTS</b>  |                   |
| Undesignated   | \$ 20,940         |
| Designated for future repairs and replacements   | <u>80,235</u>     |
|  | <u>\$ 101,175</u> |
| <br><b>SUPPLEMENTAL DISCLOSURE</b>   |                   |
| Income taxes paid  | <u>\$ -</u>       |
| Interest Paid  | <u>\$ 16,256</u>  |

See accompanying notes to financial statements.

#### NOTE A – NATURE OF ORGANIZATION

Property Owners' Association of Terlingua Ranch, Inc. is incorporated as a not-for-profit corporation in the State of Texas for the purposes of protecting the personal and property rights of all members and their families and guests; promoting the safety and welfare of all members, families and guests; and operating and maintaining the common property of Property Owners' Association of Terlingua Ranch, Inc. Property Owners' Association of Terlingua Ranch, Inc. consists of 4863 property owners on approximately 188,383 acres located in Brewster County, Texas. The association maintains over 1000 miles of roadways for its members. The Association began its operations in November 1976.

#### NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Accounts Receivable – Members' Assessments

Association members are subject to monthly assessments to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Accounts receivable at the balance sheet date represents fees due from property owners. The allowance for doubtful accounts as of December 31, 2007 was \$354,202. This balance represents Management's estimates of Owner's Assessments from 2004 to 2007 deemed uncollectible. In 2004, the Organization took complete responsibility for the collection of these assessments.

Members are billed annually in December for their annual assessments, which are due and payable in March.

Members Assessments receivable at the balance sheet date represent the total annual assessments billed to owners less the amount of assessments paid. Deferred maintenance fee income at the balance sheet date represents assessments billed, but not yet earned.

The Organization has the right to foreclose on property for non-payment of Assessments and has the ability to auction this property, paying any outstanding assessments associated with the property.

##### Basis of Presentation

The Organization follows the financial reporting practices of Common Interest Realty Association (CIRA) as presented in the AICPA Audit and Accounting Guides for CIRA's (AICPA Guide). The AICPA Guide defines as common property, property such as the Organization's, wherein title or other evidence of ownership is held directly by a CIRA.

Property Owners' Association of Terlingua Ranch, Inc.  
Notes to Financial Statements

Cash and Cash Equivalents

For purposes of the statement of cash flows, the organization considers all highly liquid investments with an initial maturity of the three months or less to be cash equivalents.

Income Taxes

The Association is classified as a nonexempt membership organization for federal tax and is tax exempt for state franchise tax purposes for the year ended December 31, 2007. It does not qualify as an exempt organization for federal income tax purposes. The Association is subject to specific rulings and regulations applicable to nonexempt membership organizations. In general, the Association is required to separate its taxable income and deductions into membership transactions, nonmembership transactions, and capital transactions.

For federal tax purposes, the Association is taxed on all net income from nonmembership activities reduced only by losses from nonmembership activities for which a profit motive exists. Nonmembership income may not be offset by membership losses, and any excess membership deductions may only be carried forward to offset membership income of future tax periods. Any net membership income not applied to the subsequent tax year is subject to taxation. The Association files form 1120, which has graduated tax rates of 15% to 39% that are applied to net taxable income.

Property and Equipment

Real property and common areas acquired from the developer and related improvements to such property are recorded in the Association's financial statement at fair market value. The Association capitalizes personal property to which it has title at cost. All acquisitions of property and equipment in excess \$1,000 and all expenditures for repairs, maintenance, renewals and betterments that materially prolong the useful lives of assets are capitalized.

Depreciation

The Association's furniture and equipment are depreciated using the straight-line and the double declining balance method. The building and improvements are depreciated using the straight-line and double declining balance methods.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Property Owners' Association of Terlingua Ranch, Inc.  
Notes to Financial Statements

Inventories

Inventories are stated at the lower of cost or market determined by the first-in first out method.

NOTE C - PROPERTY, FIXTURES, AND EQUIPMENT

Property, Fixtures, and Equipment consists of the following:

|                          | <u>2007</u>       |
|--------------------------|-------------------|
| Land                     | \$ 125,169        |
| Building and Structures  | 218,232           |
| Improvements             | 94,976            |
| Maintenance equipment    | 335,476           |
| Furniture and Fixtures   | 267,810           |
| Vehicles                 | 130,796           |
| Software                 | <u>93,375</u>     |
|                          | 1,265,834         |
| Accumulated depreciation | <u>( 677,315)</u> |
|                          | <u>\$ 588,519</u> |

NOTE D – CONCENTRATION OF CREDIT RISK

Owners' assessments are owed by economically diverse individuals principally in Texas; the Organization has indicated that it will sell foreclosed properties for any unpaid assessments.

The Organization has a demand account on hand in a financial institution, which exceed depositors insurance provided by the applicable guarantee agency.

NOTE E – NOTES PAYABLE

8.9% installment note payable to a bank, in monthly payments, including interest, of \$767 for 48 months; due in December 2010. The note is collateralized with a secured interest in a 2003 Chevrolet Silverado and a 2005 Ford F-250. \$ 23,994

7.02% installment note payable to an equipment company, in monthly payments including interest, of \$2,729 for 48 months; due in May 2009. The note is collateralized with a secured interest in a Caterpillar Motor Grader \$ 43,961

Property Owners' Association of Terlingua Ranch, Inc.  
Notes to Financial Statements

NOTE E – NOTES PAYABLE (Continued)

7.80% installment note payable to an equipment company, in monthly payments including interest, of \$2,306 for 48 months; due in August 2009.

The note is collateralized with a secured interest in a Caterpillar Motor Grader \$ 42,487

\$ 110,442

Principal maturities of the mortgage note payable during the next four years are as follows:

| <u>Year Ending<br/>December 31,</u> |                   |
|-------------------------------------|-------------------|
| 2008                                | \$60,840          |
| 2009                                | 42,089            |
| 2010                                | <u>7,513</u>      |
|                                     | <u>\$ 110,442</u> |

Interest expense for the year ended December 31, 2007 was \$16,256.

REVOLVING LINE OF CREDIT

The association has a \$100,000 revolving line of credit, of which \$100,000 was unused at December 31, 2007. Bank advances of the credit line are payable on demand and carry interest rate at 2% over prime. The credit line is secured by the Association's assessment receivables.

NOTE F – CONTINGENCY

On March 20, 2007, the Organization was named as a nominal defendant to a lawsuit that originated against five current directors, two former directors, the general manager and two attorneys who previously provided legal counsel to the Organization. The lawsuit was non-suited on February 29, 2008.

## **SUPPLEMENTARY INFORMATION**

SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS  
AND REPLACEMENTS (UNAUDITED)  
DECEMBER 31, 2007

The Association board of directors conducted a study in March 2003 to estimate the replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair or 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 or replacement.

The following information is based on the study and presents significant information about the components of common property. (Amounts are rounded to the nearest thousand dollars.)

| <u>Components</u>             | <u>Estimated<br/>Remaining Useful<br/>Life (Years)</u> | <u>Estimated Current<br/>Replacement Cost</u> |
|-------------------------------|--|---|
| Cabins                        | 2  | \$ 200,000                                    |
| Restaurant/Gift Shop          | 2  | 173,000                                       |
| Furniture – Cabins/Restaurant | 1 to 2   | 180,000                                       |
| Other Buildings               | 2  | 166,700                                       |
| Other Equipment               | 1 to 2   | <u>\$ 91,200</u>                              |
| TOTALS                        |  | <u><u>\$ 810,900</u></u>                      |