

# Goldklang, Cavanaugh & Associates, P.C.

## Certified Public Accountants

### Principals

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### MEMBERS OF

American Institute of CPAs  
Virginia Society of CPAs  
Greater Washington Society of CPAs  
Maryland Society of CPAs  
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### Managers

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### Independent Auditor's Report

Board of Directors  
Charlestown Owners Association, Inc.  
Springfield, Virginia

We have audited the accompanying Balance Sheets of the Charlestown Owners Association, Inc. as of December 31, 2008 and 2007, and the related Statements of Income, Members' Equity, and Cash Flows for the years then ended. These financial statements are the responsibility of the Association. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we express no such opinion. 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 the Association, 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 referred to above present fairly, in all material respects, the financial position of the Charlestown Owners Association, Inc. as of December 31, 2008 and 2007, 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.

Charlestown Owners Association, Inc raises funds for its operations and replacement reserve program through assessment of its members. As of December 31, 2008, the Association had a total members' equity deficit of \$259,630. This deficit is related to asphalt renovations and the related loan. In order for the Association to maintain financial stability, it must be able to raise and collect sufficient funds from its members to fund an adequate replacement reserve program and meet its operational needs.

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The supplementary information on future major repairs and replacements on page 13 is not a required part of the basic financial statements of the Charlestown Owners Association, Inc., 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.

April 2, 2009

*GoldKlang, Cavanaugh & Associates, P.C.*

CHARLESTOWN OWNERS ASSOCIATION, INC.  
BALANCE SHEETS  
DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
<u>ASSETS</u>		
Cash and Cash Equivalents	\$ 235,068	\$ 168,593
Assessments Receivable - Net	22,047	19,668
Accounts Receivable - Other	3,200	1,957
Prepaid Expense	246	-
Deferred Tax Asset	7,222	-
Fixed Assets - Net	<u>9,338</u>	<u>11,843</u>
 Total Assets	 <u>\$ 277,121</u>	 <u>\$ 202,061</u>
 <u>LIABILITIES AND MEMBERS' EQUITY</u>		
Accounts Payable	\$ 17,296	\$ 8,609
Prepaid Assessments	36,282	40,959
Loan Payable	<u>483,173</u>	<u>526,421</u>
Total Liabilities	<u>\$ 536,751</u>	<u>\$ 575,989</u>
 Replacement Reserves (Deficit)	 \$ (10,574)	 \$ (567,365)
Special Project Fund (Deficit)	(483,173)	-
Unappropriated Members' Equity	<u>234,117</u>	<u>193,437</u>
Total Members' Equity (Deficit)	<u>\$ (259,630)</u>	<u>\$ (373,928)</u>
 Total Liabilities and Members' Equity	 <u>\$ 277,121</u>	 <u>\$ 202,061</u>

See Accompanying Notes to Financial Statements

CHARLESTOWN OWNERS ASSOCIATION, INC.  
STATEMENTS OF INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
<u>INCOME:</u>		
Assessments	\$ 1,115,580	\$ 1,078,920
Interest	3,501	10,304
Deferred Tax Benefit	7,222	-
Late Fees	7,600	6,062
Bad Debt Recovery	4,913	-
Other	6,601	1,607
Total Income	\$ 1,145,417	\$ 1,096,893
<u>EXPENSES:</u>		
Management	\$ 57,646	\$ 57,900
Legal, Audit and Tax Preparation	16,535	20,917
Printing and Copying	14,383	10,993
Insurance	5,193	7,211
Payroll Reimbursement and Related	103,538	59,635
Postage	914	1,184
Other Administrative	7,687	5,229
Utilities	21,092	15,632
Grounds	112,514	127,182
Snow Removal	-	5,314
Exterior Painting	130,340	139,018
Trash	92,727	86,031
Roof Repairs	2,500	18,312
Property Repairs	46,041	28,088
Drainage Repairs	4,079	500
Depreciation	2,505	2,500
Loss on Early Sale of Investments	-	531
Bad Debt	-	1,098
Income Taxes	-	2,243
Total Expenses	\$ 617,694	\$ 589,518
Net Income before Contribution to Reserves and Special Project Fund	\$ 527,723	\$ 507,375
Contribution to Reserves	(385,304)	(456,148)
Contribution to Special Project Fund	(101,739)	-
Net Income	\$ 40,680	\$ 51,227

See Accompanying Notes to Financial Statements

CHARLESTOWN OWNERS ASSOCIATION, INC.  
STATEMENTS OF MEMBERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	Replacement Reserves (Deficit)	Special Project Fund (Deficit)	Accumulated Other Comprehensive Income (Loss)	Unappropriated Members' Equity	Total Members' Equity (Deficit)
Balance as of December 31, 2006	\$ (36,910)	\$ -	\$ (2,135)	\$ 132,705	\$ 93,660
Additions:					
Contribution to Reserves	456,148				456,148
Unrealized Gain on Investment			2,135	51,227	2,135
Net Income					51,227
Deductions:					
Roofs	(429,954)				(429,954)
Roads and Sidewalks	(533,032)				(533,032)
Patio Walls	(14,112)				(14,112)
Truck	(9,505)			9,505	
Balance as of December 31, 2007	\$ (567,365)	\$ -	\$ -	\$ 193,437	\$ (373,928)
Additions:					
Contribution to Reserves	385,304				385,304
Contribution to Special Project Fund		101,739			101,739
Net Income				40,680	40,680
Inter-Equity Transfer	526,421	(526,421)			
Deductions:					
Roofs	(238,788)				(238,788)
Roads and Sidewalks	(27,513)				(27,513)
Interest	(35,688)				(35,688)
Patio Walls	(47,538)				(47,538)
Stoops	(5,407)				(5,407)
Asphalt		(58,491)			(58,491)
Balance as of December 31, 2008	\$ (10,574)	\$ (483,173)	\$ -	\$ 234,117	\$ (259,630)

See Accompanying Notes to Financial Statements

CHARLESTOWN OWNERS ASSOCIATION, INC.  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>		
Net Income (Loss)	\$ 40,680	\$ 51,227
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation	2,505	2,500
Decrease (Increase) in:		
Assessments Receivable - Net	(2,379)	(7,387)
Accounts Receivable - Other	(1,243)	22,908
Prepaid Expense	(246)	5,500
Deferred Tax Asset	(7,222)	-
Increase (Decrease) in:		
Accounts Payable	8,687	4,896
Prepaid Assessments	(4,677)	9,611
Net Cash Flows from Operating Activities	<u>\$ 36,105</u>	<u>\$ 89,255</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Received from Assessments (Reserves)	\$ 382,621	\$ 447,700
Received from Assessments (Special Projects Fund)	101,739	-
Received from Interest (Reserves)	2,683	8,448
Disbursed for Reserve Expenditures	(354,934)	(1,013,109)
Disbursed for Special Project Fund Expenditures	(58,491)	-
Received from Interest-Bearing Deposits/Investments	-	38,105
Unrealized Gain/(Loss) on Investment	-	2,135
Net Cash Flows from Investing Activities	<u>\$ 73,618</u>	<u>\$ (516,721)</u>

See Accompanying Notes to Financial Statements

CHARLESTOWN OWNERS ASSOCIATION, INC.  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007  
(CONTINUED)

	<u>2008</u>	<u>2007</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Received from Note Payable	\$ 58,491	\$ 526,421
Disbursed for Note Payable	<u>(101,739)</u>	<u>-</u>
Net Cash Flows from Financing Activities	<u>\$ (43,248)</u>	<u>\$ 526,421</u>
 Net Change in Cash and Cash Equivalents	 \$ 66,475	 \$ 98,955
 Cash and Cash Equivalents at Beginning of Year	 <u>168,593</u>	 <u>69,638</u>
 Cash and Cash Equivalents at End of Year	 <u>\$ 235,068</u>	 <u>\$ 168,593</u>
<u>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</u>		
 Cash Paid for Income Taxes	 <u>\$ 3,200</u>	 <u>\$ 4,200</u>
 Cash Paid for Interest	 <u>\$ 35,688</u>	 <u>\$ -</u>

See Accompanying Notes to Financial Statements

CHARLESTOWN OWNERS ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007

NOTE 1 - NATURE OF OPERATIONS:

The Association organized under the laws of the Commonwealth of Virginia in 1969 for the purposes of maintaining and preserving the common areas of the Association. The Association is located in Springfield, Virginia and consists of 500 townhomes. The Board of Directors administers the Association operations.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

A) Method of Accounting - The financial statements are presented on the accrual method of accounting in which revenues are recognized when earned and expenses when incurred, not necessarily when received or paid.

B) Member Assessments - Association members are subject to assessments to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable at the balance sheet date represent fees due from homeowners. The Association's policy is to retain legal counsel and place liens on the properties of owners whose assessments are delinquent. Any excess assessments at year-end are retained by the Association for use in future years. The Association utilizes the allowance method to account for bad debt.

C) Common Property - Real property and common areas acquired from the declarant and related improvements to such property are not recorded in the Association's financial statements because those properties are owned by the individual unit owners in common and not by the Association. Common property includes, but is not limited to the exterior structures, mechanical equipment and recreational facilities.

D) Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. Such estimates affect the reported amounts of assets and liabilities. They also affect the 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.

E) Cash Equivalents - For purposes of the statement of cash flows, the Association considers all highly liquid investments and interest-bearing deposits with an original maturity date of three months or less to be cash equivalents.

F) Depreciation - Fixed assets are carried at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets.

CHARLESTOWN OWNERS ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007  
(CONTINUED)

NOTE 3 - REPLACEMENT RESERVES:

The Association's governing documents require that funds be accumulated for future major repairs and replacements. Accumulated funds are generally not available for expenditures for normal operations.

The Association had a replacement reserve study conducted in 2006. The table included in the Supplementary Information on Future Major Repairs and Replacements is based on the study.

The 2006 study does not disclose a recommended annual contribution. For 2008, the Association budgeted to contribute \$484,360 to replacement reserves. The budgeted reserve contribution was reduced by loan principal payments and \$382,621 was contributed to replacement reserves in 2008. The Association elected to contribute an additional \$2,683 of interest income.

Funds are being accumulated in replacement reserves based on estimates of future needs for repair and replacement of common property components. Actual expenditures may vary from the estimated future expenditures and the variations may be material; therefore, amounts accumulated in the replacement reserves may or may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Board of Directors, on behalf of the Association may increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

As of December 31, 2008 and 2007, the Association had a deficit of \$10,574 and \$567,365, respectively, in replacement reserves.

NOTE 4 - INCOME TAXES:

For income tax purposes, the Association may elect annually to file either as an exempt homeowners association or as an association taxable as a corporation. As an exempt homeowners association, the Association's net assessment income would be exempt from income tax, but its interest and rental income would be taxed. Electing to file as a corporation, the Association is taxed on its net income from all sources (to the extent not capitalized or deferred) at normal corporate rates after corporate exemption, subject to the limitation that operating expenses are deductible only to the extent of income from members. For 2008 and 2007, the income taxes were calculated using the corporate and exempt method, respectively.

CHARLESTOWN OWNERS ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007  
(CONTINUED)

NOTE 4 - INCOME TAXES: (CONTINUED)

In accordance with accounting standards, a deferred tax asset has been recorded in the financial statements. Deferred assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. That is, the interest expense deductions currently exceed taxable income, and a deferred tax asset will be shown until this excess is applied to future years' taxable income

The Association had a non-membership loss carry forward of \$35,933 as of December 31, 2008. This is related to the interest expense incurred on the note payable in prior years. As of December 31, 2008, the Association had a deferred tax asset of \$7,222. For 2008, the asset represents \$5,066 for federal and \$2,156 for Virginia income taxes. The non-membership loss carry forward will expire in 2028.

NOTE 5 - CASH AND CASH EQUIVALENTS:

As of December 31, 2008, the Association maintained its funds in the following manner:

<u>Institution</u>	<u>Type Account</u>	<u>Cash and Cash Equivalents</u>
Petty Cash	Imprest	\$ 200
Virginia Commerce	Checking	60,677
Morgan Stanley	Money Market	<u>174,191</u>
	Total	<u>\$ 235,068</u>

The Association has a repurchase agreement with Virginia Commerce as part of the checking account. The repurchase account is collateralized at 100% of the account balance by U.S Government Treasury or Agency Securities. As of December 31, 2008 the balance of the repurchase agreement account was \$52,174 and the checking account was \$8,503.

NOTE 6 - ASSESSMENTS RECEIVABLE - NET:

The Association utilizes the allowance method of accounting for bad debt. Individual receivables are written off as a loss when a determination is made that they are non-collectible. Under the allowance method, collection efforts may continue and recoveries of amounts previously written off are recognized as income in the year of collection.

CHARLESTOWN OWNERS ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007  
(CONTINUED)

NOTE 6 - ASSESSMENTS RECEIVABLE - NET: (CONTINUED)

	2008	2007
Assessments Receivable	\$ 25,045	\$ 27,863
Less: Allowance for Doubtful Assessments	(2,998)	(8,195)
Assessments Receivable - Net	\$ 22,047	\$ 19,668

NOTE 7 - FIXED ASSETS:

The Association owned one building, office equipment and a truck. Total costs related to the acquisition of this property were included in the capitalization of the assets. Fixed assets are carried at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets. The current year depreciation expense was \$2,505. The Association's fixed assets are as follows:

	2008	2007
Building and Improvements	\$ 26,920	\$ 26,920
Office Equipment	-	3,000
Truck	9,506	9,506
Less: Accumulated Depreciation	(27,088)	(27,583)
Fixed Assets - Net	\$ 9,338	\$ 11,843

NOTE 8 - MANAGEMENT SERVICES:

The Association retains Cardinal Management Group, Inc. (CMG) as its management agent. Cardinal Management Group, Inc. shares common ownership interests with other entities. During 2008 and 2007, the Association paid \$772 and \$130, respectively, to these other entities for general repair and maintenance fees. No amounts were due at year-end.

In addition to the payment of management fees, the Association reimbursed CMG for wages, payroll taxes, workers compensation and payroll administrative costs for employees that performed work for the Association. During 2008 and 2007, the Association reimbursed CMG for personnel costs in the amount of \$92,529 and \$55,876, respectively. Amounts of \$0 and \$1,851, respectively, were owed for these payroll services as of December 31, 2008 and 2007.

CHARLESTOWN OWNERS ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2008 AND 2007  
(CONTINUED)

NOTE 9 - LOAN PAYABLE:

During 2007, the Association obtained a line of credit from Virginia Commerce Bank in the amount of \$584,912 to provide funding for asphalt renovations. During 2007, the Association received \$526,421 and the remaining \$58,491 was received in 2008. The loan is for a term of 7 years at 6% interest. The loan is collateralized by priority liens on all assets of the Association and one assignment of the condominium association's monthly dues. The Association began paying interest during 2008 and will continue paying interest only for another year. During 2008, the Association opted to make principal payments of \$101,739. As of December 31, 2008 and 2007, the balance of the loan was \$483,173 and \$526,421, respectively.

Estimated principal curtailment of the amount borrowed for the next five years is as follows:

2009	\$ 9,795
2010	60,246
2011	62,857
2012	65,581
2013	68,423
Thereafter	<u>216,271</u>
Total	<u>\$ 483,173</u>

NOTE 10 - SPECIAL PROJECT FUND:

During 2008, the Association elected to establish a special project fund to record activity associated with the asphalt renovations loan as discussed in the previous note. Loan principal payments are being contributed to the special project fund and expenditures made as a result of loan proceeds are deducted from this account. As of December 31, 2008, the special project fund had a deficit of \$483,173. The fund deficit will be eliminated once the loan is paid in full.

CHARLESTOWN OWNERS ASSOCIATION, INC.  
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR  
REPAIRS AND REPLACEMENTS  
DECEMBER 31, 2008  
(UNAUDITED)

The Association had a replacement reserve study conducted in 2006 to estimate the remaining useful lives and 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 replacement costs do not take into account the effects of inflation between the date of the study and the date the components will require repair or replacement. The study does not present the estimated remaining useful lives in a format that can be summarized. Therefore, the estimated remaining useful lives of the common property are not presented below.

The following has been extracted from the Association's replacement reserve study and presents significant information about the components of common property.

<u>Component</u>	<u>2006 Estimated Replacement Cost</u>
Roofs	\$ 3,835,501
Exterior Walls	612,400
Roads and Sidewalks	4,016,039
Patio Walls	5,518,000
Front Stoops	1,500,000
Playgrounds	44,000
Equipment	15,000
Other Site Improvements	307,500
Community Building	50,000