

PM&P

**PETWAY
MILLS &
PEARSON, PA**

CERTIFIED PUBLIC ACCOUNTANTS

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Memberships:

North Carolina
Association of
Certified Public
Accountants

American Institute
of Certified Public
Accountants

Medical Group
Management
Association

Board of Directors
Lake Royale Property Owners Association, Inc.
Bunn, North Carolina

We have audited the financial statements of Lake Royale Property Owners Association, Inc. (the Association) for the year ended March 31, 2010, and have issued our report thereon dated September 12, 2010. Professional standards require that we provide you with information about our responsibilities under U.S. generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. Professional standards require that we provide you with the following information related to our audit.

Significant Accounting Policies

Qualitative Aspect of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Association are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. 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 estimate affecting the financial statements was:

Management's estimate of depreciation expense is based on estimated useful lives of property and equipment. We evaluated the key factors and assumptions used to develop the depreciation expense in determining that it 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 future major repairs and replacements in Note 7 to the financial statements addresses the Association's funding of future major repairs and replacements, based on a formal analysis, using the estimated remaining lives of common property as the basis for funding. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet future needs.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and

corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated September 12, 2010.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Association's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We 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 auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Directors and management of Lake Royale Property Owners Association, Inc. and is not intended to be and should not be used by anyone other than these specified parties.

Petway Mills & Pearson, PA
PETWAY MILLS & PEARSON, PA
Certified Public Accountants
Zebulon, North Carolina

September 12, 2010

**LAKE ROYALE PROPERTY
OWNERS ASSOCIATION, INC.**

FINANCIAL STATEMENTS

BUNN, NORTH CAROLINA

YEAR ENDED MARCH 31, 2010

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Independent Auditors' Report

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Bunn, North Carolina

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We have audited the accompanying balance sheet of Lake Royale Property Owners Association, Inc., as of March 31, 2010 and the related statements of revenues, expenses, and changes in members' equity and cash flows for the year then ended. These financial statements are the responsibility of Lake Royale Property Owners Association, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we 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. We believe that our audit provides 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 Lake Royale Property Owners Association, Inc., as of March 31, 2010, and the changes in members' equity and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The reserve study information in Note 7 is not a required part of the basic financial statements, and we did not audit and do not express an opinion on it. The American Institute of Certified Public Accountants has determined that supplementary information about future major repairs and replacements of common property is required to supplement, but not required to be a part of, the basic financial statements. The Association has not presented this supplementary information.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. We have not applied procedures to determine whether the funds designated for future major repairs and replacements are adequate to meet such future costs because that determination is outside the scope of our audit.

Petway Mills & Pearson, PA

PETWAY MILLS & PEARSON, PA
Certified Public Accountants
Zebulon, North Carolina

September 12, 2010

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LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
BALANCE SHEET
MARCH 31, 2010

Assets

Current assets	
Cash - undesignated	\$ 708,211
Cash - designated	291,386
Investments - designated	829,443
Dues and fees receivable, net of allowance for uncollectible accounts	791,950
Prepaid expenses	25,405
Land inventory	<u>592,658</u>
Total current assets	<u>3,239,053</u>
Fixed assets	
Property and equipment, net of accumulated depreciation	<u>2,961,667</u>
Total fixed assets	<u>2,961,667</u>
Total assets	<u><u>\$ 6,200,720</u></u>

Liabilities and Members' Equity

Current liabilities	
Dues received in advance	\$ 876,660
Accounts payable and accrued expenses	47,991
Income taxes payable	4,823
Wages payable	8,181
Accrued leave	14,856
Security deposits	2,622
Deferred revenue	33,080
Current portion of note payable	<u>149,516</u>
Total current liabilities	1,137,729
Long-term liabilities	
Note payable	<u>296,764</u>
Total long-term liabilities	<u>296,764</u>
Total liabilities	<u>1,434,493</u>
Members' equity	
Contributed capital	164,324
Undesignated	3,481,074
Designated for future major repairs and replacements	660,110
Designated for emergency disaster fund	200,000
Designated for road repairs	<u>260,719</u>
Total members' equity	<u>4,766,227</u>
Total liabilities and members' equity	<u><u>\$ 6,200,720</u></u>

See Accompanying Notes to Financial Statements.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
STATEMENT OF REVENUES AND EXPENSES
YEAR ENDED MARCH 31, 2010

Operating revenues	
Member dues - operations	\$ 1,870,926
Member dues - repairs and replacements	675,212
User fees	59,858
Other fees	402,396
Rental income - office	30,385
Other income	1,964
Total operating revenues	<u>3,040,741</u>
Operating expenses	
Salaries and wages	862,377
Payroll taxes	73,133
Employee benefits	189,034
Contracted services	187,020
Contracted labor	26,378
Depreciation	288,670
Insurance	54,239
Operating supplies	108,344
Utilities	128,014
Repairs and maintenance	268,888
Professional fees	58,276
Taxes and licenses	15,434
Vehicle expense	44,380
Communications	20,997
Postage and printing	14,101
Staff development and training	5,852
Board meeting expense	6,384
Special Projects	1,722
Other operating expenses	9,564
Total operating expenses	<u>2,362,807</u>
Net operating income (loss)	<u>677,934</u>
Foreclosure Income	
Land income	79,541
Foreclosure billed income	62,094
Received land foreclosure income	153,625
Total foreclosure income	<u>295,260</u>
Cost of foreclosures	
Cost of land inventory sold	104,718
Land sales expense	16,506
Foreclosure property taxes	8,615
Foreclosure legal fees	72,117
Miscellaneous foreclosure expenses	2,746
Total cost of foreclosures	<u>204,702</u>
Gain on foreclosures	<u>90,558</u>
Other Income (Expenses)	
Interest income	19,879
Uncollectible accounts	(345,675)
Penalties and Interest	(272)
Interest expense	(29,543)
Income tax expense	(41,961)
Total other income (expenses)	<u>(397,572)</u>
Excess of revenues over expenses	<u>\$ 370,920</u>

See Accompanying Notes to Financial Statements.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
STATEMENT OF CHANGES IN MEMBERS' EQUITY
YEAR ENDED MARCH 31, 2010

	Total	Undesignated	Designated for Future Repairs	Designated for Emergency Disaster	Designated for Road Repairs
Members' equity - April 1, 2009	\$ 4,230,983	\$ 3,166,630	\$ 693,854	\$ 200,000	\$ 170,499
Excess of revenues over expenses	370,920	370,920	-	-	-
Allocated to future repairs and replacements:					
Dues Collected	-	(675,212)	675,212	-	-
Major repairs/replacements:					
Land	-	-	-	-	-
Buildings	-	60,853	(60,853)	-	-
Furniture and equipment	-	12,830	(12,830)	-	-
Vehicles	-	47,187	(47,187)	-	-
Improvements	-	115,721	(115,721)	-	-
Principal paid on road loan	-	-	-	-	-
Transfer to (from) undesignated equity	-	382,145	(472,365)	-	90,220
Members' equity - March 31, 2010	4,601,903	\$ 3,481,074	\$ 660,110	\$ 200,000	\$ 260,719
Add contributed capital	164,324				
Total members' equity - March 31, 2010	\$ 4,766,227				

See Accompanying Notes to Financial Statements.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
STATEMENT OF CASH FLOWS
YEAR ENDED MARCH 31, 2010

Cash flows from operating activities	
Excess of revenues over expenses	\$ 370,920
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:	
Depreciation	288,670
Noncash adjustments	1,000
(Gain) on lot foreclosures	(90,558)
(Increase) decrease in:	
Dues and fees receivable	(216,718)
Prepaid expense	(4,844)
Prepaid income taxes	35,383
Increase (decrease) in:	
Dues received in advance	(4,290)
Accounts payable and accrued expenses	(9,549)
Income taxes payable	4,823
Wages payable	(22,490)
Accrued leave	(11,246)
Security deposits	780
Deferred revenue	12,848
Total adjustments	<u>(16,191)</u>
Net cash provided by operating activities	<u>354,729</u>
Cash flows from investing activities	
Purchase of investments	(829,443)
Proceeds from sale of property	41,651
Capital expenditures	<u>(236,591)</u>
Net cash used by investing activities	<u>(1,024,383)</u>
Cash flows from financing activities	
Principal payments on long-term debt	<u>(203,801)</u>
Net cash used in financing activities	<u>(203,801)</u>
Net decrease in cash and cash equivalents	(873,455)
Cash and cash equivalents, beginning of year	<u>1,873,052</u>
Cash and cash equivalents, end of year	<u>\$ 999,597</u>
Summary of Cash Accounts	
Cash - undesignated	\$ 708,211
Cash - designated	291,386
Total cash	<u>\$ 999,597</u>

See Accompanying Notes to Financial Statements.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2010

NOTE 1 – NATURE OF ORGANIZATION

Lake Royale Property Owners Association, Inc. (Association) located in Bunn, North Carolina was incorporated in January 1972 as a non-stock corporation in the State of North Carolina. The Association is responsible for the operation and maintenance of the common property within the development, which surrounds a 345-acre lake and consists of entrance gates, comfort centers, pool, miniature golf course and roads. There are approximately 4,700 current property owners. The majority of the owners permanently reside in North Carolina; however, there are some located throughout the United States and abroad.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The accompanying financial statements have been prepared on the accrual basis of accounting.

Dues and Fees Receivable – Association members are subject to annual dues to provide funds for the Association's operating expenses, future capital acquisitions and major repairs and replacements. Dues and fees receivable at the balance sheet date represent the annual assessments and other fees including late charges, lien fees, etc. due from property owners. The Association's policy is to retain legal counsel and place liens on members' property and proceed with foreclosures as warranted when dues are delinquent. Uncollectible accounts were estimated at \$2,118,692 as of March 31, 2010.

Income Tax Status – The Association is taxed as a regular corporation. As a regular corporation, membership income is exempt from taxation if certain elections are made, and the Association is taxed only on its nonmembership income, such as interest earnings and rental income, at regular federal and State corporate rates. Exempt function income, which consists primarily of member assessments, is not taxable.

Property and Equipment – Buildings, furniture, equipment, vehicles, and improvements are recorded at cost. If an expenditure results in an asset having an estimated useful life which extends substantially beyond the year of acquisition, the expenditure is capitalized and depreciated or amortized over the estimated useful life of the asset. Depreciation is calculated by the straight-line method over the useful lives of the assets as follows:

Buildings	30 years
Furniture and Equipment	5-15 years
Vehicles	5-7 years
Improvements	10-30 years

Maintenance and repairs are charged to expense as incurred. Property contributed to the Association by the developer is recorded at estimated fair value at the date of contribution.

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.

Cash and Cash Equivalents – The Association considers all cash and other highly liquid assets with maturities of three months or less at the date of acquisition to be "cash and cash equivalents."

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2010

NOTE 3 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following at March 31, 2010:

Land	\$ 36,363
Greenways	123,130
Buildings	588,913
Furniture and Equipment	400,788
Vehicles	215,551
Improvements	<u>4,238,260</u>
	5,603,005
Less Accumulated Depreciation	<u>(2,641,338)</u>
	<u><u>\$ 2,961,667</u></u>

NOTE 4 – REAL ESTATE ACQUIRED

The Association acquired the titles to various lots during the year through legal proceedings due to abandonment or foreclosure. These lots have been recorded at their fair value with a gain or loss recognized on the difference between the fair value of the property received and the delinquent assessments and related fees. Management has utilized property tax valuation to establish fair value.

NOTE 5 – CONCENTRATION OF CREDIT RISK FOR CASH HELD IN BANK

The Association maintains its cash balances in four financial institutions. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. As of March 31, 2010, the Association's uninsured cash balance was \$557,545. The Association does not believe that it is exposed to any significant credit risk on uninsured amounts.

NOTE 6 – CONTRIBUTED CAPITAL

Contributed capital consists of the estimated fair value of certain land and buildings transferred from National American Companies (NACO) to the Association at no cost during the 1993-1994 fiscal year.

NOTE 7 – FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association's governing documents require the Association to provide for future major repairs and replacements of common property, including the roads, pool and clubhouse.

During 2007, the Association hired a firm to perform a reserve study. The Association will contribute funds to its replacement fund based on this study. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the reserve fund may not be adequate to meet future needs. The Association is not required to accumulate funds for estimated future repairs and replacements; however, if additional funds are needed, the Association has the right, subject to member approval, to increase regular assessments, to levy special assessments, or it may delay major repairs and replacements until funds are available.

During the current fiscal year, the Association continued with its program to accumulate funds for future repairs and replacements. Of dues collected during the year, 18.4% of current dues collections and 100% of all prior years' dues collections were transferred to funds designated for future repairs and replacements. The cash available at March 31, 2010 designated for future major repairs and replacements is \$1,120,829 and is included in the balance sheet line items titled "Cash – designated" and "Investments – designated." The change in net equity is shown on the statement of changes in members' equity.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 MARCH 31, 2010

NOTE 8 – SECURITY DEPOSIT LIABILITY

Security deposits are received on camping rentals and business rentals. These deposits are refundable and as such are recorded as a liability by the Association. Outstanding security deposits held by the Association as of March 31, 2010 are \$2,622.

NOTE 9 – OPERATING LEASES

The Association leases office space to various organizations. The leases operate on an annual basis indefinitely until the Association gives the tenant thirty days notice to vacate the premises or the tenant gives the Association thirty days notice of its intention to vacate the premises. The total revenue received during the year from office space leases was \$30,385.

NOTE 10 – DEFERRED REVENUE

In prior years, the Association received funds from the North Carolina Division of Emergency Management to be used in establishing a Community Emergency Response Team (CERT). In addition to these grant funds, donations were also received for this purpose. As of March 31, 2010, there remains a balance of \$100 not yet spent and is included in "Deferred Revenue" on the balance sheet.

The Association also holds funds for several of its committees conducting projects during the year until needed. The total of these funds included in "Deferred revenue" at March 31, 2010 is \$32,980.

NOTE 11 – NOTE PAYABLE

Note payable consists of the following at March 31, 2010:

Note to bank with annual principal payments of \$149,516 and interest payments due monthly with final payment of all unpaid principal and interest due January 2014, interest at 6.5%, secured by assessments	<u>\$ 446,280</u>
Total Note Payable	<u><u>\$ 446,280</u></u>

Aggregate maturities of the note payable are as follows:

Year ended March 31	
2011	\$ 149,516
2012	149,516
2013	<u>147,248</u>
	<u><u>\$ 446,280</u></u>

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2010

NOTE 12 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

Cash - undesignated	\$ 708,211
Cash - designated for future major repairs and replacements	291,386
Total cash and cash equivalents	<u>\$ 999,597</u>

NOTE 13 – SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the year for:

Interest expense	<u>\$ 29,543</u>
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Schedule of Non - cash Investing and Financing Transactions

Fair value of lots acquired by abandonment/foreclosure	
Delinquent dues and fees satisfied due to abandonment/foreclosure	<u>\$ 153,625</u>

NOTE 14 – RETIREMENT PLAN

The Association maintains a SIMPLE IRA retirement plan for eligible employees. For those employees contributing a portion of their earning into the plan, the Association matched the employee deferral on a dollar-for-dollar basis up to 3% of allowed compensation. For the year ended March 31, 2010, retirement expense was \$18,126.

NOTE 15 – MARKET CONCENTRATIONS

The majority of the Association's members reside in Bunn, North Carolina and within the Lake Royale Development.

NOTE 16 – COMMITMENTS

On November 7, 2008, the Association entered into a contract with Progress Energy for surge protection services. The rental amount for the protection is \$6.36 per month, and the initial term of service is 24 months. The Association is obligated to pay \$45 during the year ended March 31, 2011 under this contract.

NOTE 17 – SUBSEQUENT EVENTS

The Association has evaluated subsequent events from the date of the balance sheet through the date the report is available to be issued which is the date of the independent auditors' report. The Association has not evaluated subsequent events after that date. There were no subsequent events during this period that require disclosure.

LAKE ROYALE PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2010

NOTE 18 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The Association's assets and liabilities are reported at fair value in the accompanying balance sheet.

	Fair Value	Fair Value Measurement Using:		
		Quoted Prices in Active Market for Identical Assets (Level 1)	Quoted Prices in Active Market for Similar Assets (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2010				
Assets:				
Cash - undesignated	\$ 708,211	\$ 708,211	\$ -	\$ -
Cash - designated	291,386	291,386	-	-
Investments - designated	829,443	829,443	-	-
Dues and fees receivable, net	791,950	791,950	-	-
Prepaid expenses	25,405	25,405	-	-
Land inventory	592,658	592,658	-	-
Property and equipment, net	2,961,667	-	2,961,667	-
Liabilities:				
Dues received in advance	876,660	876,660	-	-
Accounts payable and accrued expenses	47,991	47,991	-	-
Income taxes payable	4,823	4,823	-	-
Wages payable	8,181	8,181	-	-
Accrued leave	14,856	-	14,856	-
Security deposits	2,622	2,622	-	-
Deferred revenue	33,080	-	33,080	-
Note payable	446,280	446,280	-	-

The Codification of Professional Standards establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels: Level 1 inputs consist of values in active markets for identical assets and have the highest priority, Level 2 inputs consist of values in inactive markets and Level 3 assets and liabilities have values based on unobservable inputs and have the lowest priority. The Corporation uses appropriate valuation techniques based on the available inputs to measure the fair value of its assets. When available, the Corporation measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. Level 3 inputs were only used when Level 1 or Level 2 inputs were not available.

Level 1 Fair Value Measurement

Assets that can be priced in an active market.

Level 2 Fair Value Measurements

The carrying value of assets and liabilities that approximate fair value due to the short maturity of these items, however there is not an active market for these assets and liabilities.

Level 3 Fair Value Measurements

The carrying value of assets and liabilities that are not actively traded and significant other observable inputs are not available. Thus, the fair value is determined by the market value of the underlying property and is subject to significant measurement uncertainty in inactive markets.