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**COMMUNITY
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“What Did I Get Myself Into?”

Understanding Association Financial Statements

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What did I get myself into?

- What is a Balance Sheet & Income Statement
- Cash vs. Accrual Accounting/Why it Matters
- What to look for in the numbers
- Treasurer's Responsibilities
- What goes in the Treasurer's Report
- What are "Internal Accounting Controls"
- What happens in a CPA Audit
- Do we need to have an Audit
- Tax Basics (as time allows)
- Reserve Accounting (as time allows)



Format

- Question and Answer (Evelyn and Cathy)
- Questions from the floor (for each topic) – See us afterward with more lengthy questions
- Questions at the end (as time allows)

Who knew I had to learn what a Balance Sheet and Income Statement Is?? I didn't take accounting in school on purpose!

Balance Sheet and Income Statement tell the “Story”

Think of it as a great “Mystery Novel” to be unwrapped!

Balance Sheet – Statement of Assets, Liabilities, and Net Worth, at a POINT in TIME (such as December 31)

Income Statement – Revenue and Expenses over a PERIOD of TIME (such as 1 year)

Balance Sheet Defined:

Assets = Liabilities + Equity (Net Worth)

Or

Assets – Liabilities = Equity

Assets – What You OWN

Liabilities – What You OWE

Equity – Also called Members' Equity, Operating Fund, or Retained Earnings

Two Types of Equity/Fund Balances in an Association:

Operating

Replacement



Let's look at samples in your handouts (simple to more complex formats)

- Cash Basis
- Accrual Basis – Operating Format
- Accrual Basis – Reserves Format

BALANCE SHEET ITEMS:

ASSETS:

Cash- We all know what that is and need as much as possible!

- Operating Cash
- Reserve Cash

Accounts (Assessments) Receivable - “Yet to be Received” – Typically past due accounts (billed at 1st of month)

Other Owners Receivables – Water billed separately, Expenses billed back to Owner

Prepaid Insurance - Insurance premium paid in advance of when it is used (asset)

LIABILITIES:

Accounts Payable – “To be paid”

Prepaid Assessments – Assessments that are paid in before they are owed to the Assn

“Due between Funds” - Can be an asset or a liability depending on the Fund

INCOME STATEMENT ITEMS:

Assessments Income/Revenue - Should be total budgeted assessments for the year (accrual basis) Some allocated to operations, some to reserves

Interest income (operating and reserve)

Expenses – We all know what that is!

“Net Income” Revenue Minus Expenses (Hopefully positive!)

Reserve Net Income can be positive or negative--- OKAY

Final Point



FORMAT of FINANCIAL STATEMENTS is
DRIVEN BY the BOARD

Make them meaningful and useful to you

Cash vs. Accrual

- What is cash vs. accrual basis

Checkbook Accounting

Matching Income with Expense as incurred

- Why do I care

Enron has an affect on you as a Board Member. SOX

The numbers need to be meaningful

- What is the right thing to do

RCW is accrual

GAAP is accrual



RCW 64.34.372 (Condos)

- (1) The association shall keep financial records sufficiently detailed to enable the association to comply with RCW 64.34.425. All financial and other records of the association, including but not limited to checks, bank records, and invoices, are the property of the association, but shall be made reasonably available for examination and copying by the manager of the association, any unit owner, or the owner's authorized agents. At least annually, the association shall prepare, or cause to be prepared, a financial statement of the association in accordance with **generally accepted accounting principles**. The financial statements of condominiums consisting of fifty or more units shall be audited at least annually by a certified public accountant. In the case of a condominium consisting of fewer than fifty units, an annual audit is also required but may be waived annually by unit owners other than the declarant of units to which sixty percent of the votes are allocated, excluding the votes allocated to units owned by the declarant.



RCW 64.38.045 (HOA)

(3) At least annually, the association shall prepare, or cause to be prepared, a financial statement of the association. The financial statements of associations with annual assessments of fifty thousand dollars or more shall be audited at least annually by an independent certified public accountant, but the audit may be waived if sixty-seven percent of the votes cast by owners, in person or by proxy, at a meeting of the association at which a quorum is present, vote each year to waive the audit.



Now that I'm on the Board, what should I look for in the numbers?

- YTD Net Income
- Budget vs. Actual Variances
 - Is the variance explainable?
 - Is the budget realistic? i.e. seasonal changes
- Balance Sheet
 - What's in the accounts?
 - AR Trending
 - AP Trending
- Net Worth/Members Equity
 - 1 to 3 months of operation expense.
- Reserve Income Statement
 - It's a 30 year time period for Income and Expenses
 - One year is not relevant for Reserves



What's the responsibility as the Treasurer?

- Financial voice for the Board of Directors and the Community
- Board's liaison to the Auditor
- Responsible for a Reserve Program implementation
- Responsible for annual budget process
- Protect the assets of the Association

Now that I understand the Monthly Financial Statements, what should I have in my monthly Treasurer's Report? (aka Does anyone read these??)



C&C National Survey on Treasurer's Report: Question- How many minutes are spent each month on Treasurer's Report?

Answer?? You may (or may not be) surprised

Spend some time!! "Multi Million Dollar Business" you are running!!

Unwrap the "Mystery" for others, but it doesn't need to be a NOVEL!

Monthly Financial Statements (Balance Sheet and Income Statement)

Balance Sheet:

- Significant Trends
- Delinquent Accounts Receivable and action needed, follow up from last month

Income Statement:

- Significant Variances between actual and budget – then, action steps needed
- Follow up from prior period variances noted
- APPROVAL for large or unusual OPERATING expenses and ALL RESERVE EXPENSES (Document in the minutes!!!)
 - Reserve expenses can change from when first approved to the final cost – make sure to document any changes in the minutes

EDUCATE your fellow BOARD Members. ALL of you are responsible for the FINANCIAL STATEMENTS!

I have heard the term “Internal Controls” but have no idea what it means!

- Series of “Checks and Balances” in the accounting function to keep the financial statements fairly stated
- ENTIRE Board REVIEWS the Monthly/Quarterly Financial Statements! (Thus, the reason for this class!)
- Treasurer/Board – review bank statements and reconciliations
- Approval/documentation of major expenses
- More than one person should be involved in the overall financial function

See “Ten Commandments -Internal Controls Checklist” in handouts

An “Audit” is another mystery to me.

- What is an audit and what does the auditor do??

- “INDEPENDENT” analysis of financial statements
- CPA
- “Materially Correct” (Not every penny)
- “GAAP” (In accordance with “Generally Accepted Accounting Principles)
- Adequate Disclosures (Footnotes)

“GAAP” Means:

- Accrual Basis
- Full Disclosures
- Supplementary Disclosures on Replacement Fund (Reserve Study)
- Replacement Fund Presentation Recommended (Two Balance Sheets: Operating, Reserves)



What does a CPA Do? Do we have all day?

– A few highlights:

- Verifies accuracy of the Balance Sheet accounts/looks at account reconciliations
- Segregation of Operating and Reserve Transactions
- AR Delinquencies - Allowance sufficient?
- Test Assessment income against the budget
- Test actual reserve allocation against the budget; determine if cash got transferred to reserves
- Track reserve/special assessment/settlement monies
- Test expenses for proper accrual (helpful for budgeting purposes)
- Test standard expenses against the budget, evaluate unusual expenses
- Read board minutes; scan governing documents, to determine full disclosures made



Note:

The only item in the Audit Report that the AUDITOR OWNS is the 1st PAGE- Audit Report. Financial Statements and Disclosures are the property/responsibility of the BOD.

Management company can be agent to assist in compiling financial statements, but BOD cannot abdicate responsibility for the financial statements.

Why go through an Audit? Can't imagine it is fun!



May be Washington State Law-

Old Act Condominiums (prior 7/1/90):

- 64.32.170 RCW- Used to require an audit once/year for ALL condominiums. SUPERSEDED by new law. HOWEVER, if your governing docs require an audit, these prevail

New Act Condominiums:

- More than 50 units must be audited annually
- Less than 50 units – audit required, however can be WAIVED by 60% of OWNERS

Homeowners Associations:

- Assessments (not total income) over \$50,000 annually, must be audited annually. Can be WAIVED by 67% of OWNERS

Other Reasons:

- Fiduciary Duty/Accountability to Homeowners
- Run Association like a Business
- Oversight/Complete and Materially Accurate Financials
- Improve Internal Controls
- Disclosure to Potential Owners

Taxes

- Yes, you have to file a return with the IRS!!

- Don't try this at home



Reserve Accounting?

Who invented that??

Two Buckets of Money

- Operations – One year time horizon
- Reserves – 30 year time horizon

Important to keep the 2 separate – many associations are low on reserve funds

Reserve Accounting allows BOD members to see if operating had to borrow money from reserves (Due between Funds)

Did the budgeted savings plan actually get transferred to reserves for the year?

Annual Audit Report: NOT REQUIRED (by AICPA); but RECOMMENDED



Questions...

THANK YOU!!

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