

ASSOCIATION FINANCIAL STATEMENTS

**FOCUSING ON
FINANCIAL
HEALTH**

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OBJECTIVES AND GOALS OF TODAY'S PRESENTATION

- Gain an Understanding of the Auditors Report
- The differences between cash and accrual basis financial statements
- Analysis that can be performed on the financial statements
- What footnote disclosures tell you and the owners
- Supplementary information and how it can be used to help your Association

INTERESTING FACTS

- RCW requires audits for Homeowner Associations with \$50,000 or more of assessments
- RCW requires audits for Condo Associations with 50 or more units

- HOA's were first established in the middle 1800 but didn't take off until the 1960's
- There were approximately 340,000 associations representing 26 million households in 2015
- 4 States account for 38% of all Associations
- Homeowner Associations account for over half of all Associations
- Washington has over 10,000 Associations Oregon has under 4,000
- Over \$23 Billion was contributed to Replacement Reserves in 2015 (Average \$884/household)
- Over \$85 Billion of assessments collected (Average \$3,269/household)
- \$1.76 Billion is the estimated value of volunteer board time spent on Association business

- Source Community Associations Institute (caionline.org)

THE AUDITORS' REPORT

We have audited the accompanying financial statements of **The Association** which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenues, expenses and changes in fund balances and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair representation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of the internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

THE AUDITORS' REPORT

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of **The Association** as of December 31, 2015 and 2014 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.

OR

Basis for Qualified Opinion

As more fully described in Note 4 to the financial statements, the Association has estimated an allowance for doubtful accounts of \$0, related to the past due members' assessments receivable as of December 31, 2015. In accordance with the accounting principles generally accepted in the United States of America, an allowance for doubtful accounts is to be a reasonable estimate so that the net receivable balance is likely to be collected in the near-term which is considered by this report date to be December 31, 2016. On the basis that approximately \$10,000 of the receivable balance at December 31, 2015 won't be collected in 2016, in our opinion the Association should have increased the allowance for doubtful accounts to \$10,000, reducing the revenues over expenses by \$10,000 in 2015 by that amount.

Qualified Opinion

In our opinion, except for the effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, the financial position of **The Association** as of December 31, 2015 and 2014 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.

THE AUDITORS' REPORT

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule on Future Repairs and Replacements (Component Inventory by Remaining Life Expectancy) on page 7 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

ANNUAL FINANCIAL STATEMENTS

- Accrual Basis
 - Show revenues when earned
 - Show expenses when incurred
 - Show non-cash assets
 - Show liabilities
- Statements
 - Balance Sheet
 - Statement of Revenues and Expenses and Changes in Equity
 - Statement of Cash Flows
 - Notes to the Financial Statements
 - Supplementary Information

BASICS OF FUND ACCOUNTING

- Each Fund is a separate, legal, self-balancing set of accounts
- Total Assets for each fund should equal total liabilities and equities
- Revenues and Expenses need to be assigned to correct fund
- For Associations
 - Operating Fund typically for next twelve months of activity
 - Reserve Fund for future repairs and maintenance
 - Can have more than the two funds

MANAGER STATEMENTS

Balance Sheet

Your Association

12/31/2016

Operating Checking	65,000
Reserve Money Market	120,000
Accounts Receivable	-
Prepaid Insurance	-
Prepaid Other	-
Total Assets	<u>185,000</u>
Accounts Payable	-
Accrued Expenses	-
Assessments Paid in Advance	-
Total Liabilities	-
Equity	
Operating Account	58,000
Reserve Fund	127,000
Total Equity	<u>185,000</u>

The balances should agree



IMPROVED MANAGER STATEMENTS

Balance Sheet
Your Association
12/31/2016

Operating Checking	65,000
Reserve Money Market	120,000
Accounts Receivable	-
Prepaid Insurance	-
Prepaid Other	-
Total Assets	<u>185,000</u>
Accounts Payable	-
Accrued Expenses	-
Assessments Paid in Advance	-
Total Liabilities	-
Equity	
Operating Account	58,000
Reserve Fund	127,000
Total Equity	<u>185,000</u>

The balances
should agree

Balance Sheet
Your Association
12/31/2016

Operating Checking	65,000
Reserve Money Market	120,000
Accounts Receivable	-
Prepaid Insurance	-
Due From Operating	7,000
Total Assets	<u>192,000</u>
Accounts Payable	-
Due To Reserve	7,000
Assessments Paid in Advance	-
Total Liabilities	7,000
Equity	
Operating Account	58,000
Reserve Fund	127,000
Total Equity	<u>185,000</u>

The Funds
transferred
money
between
them which
should be
recognized

CASH BASIS REVENUE AND EXPENSE

Revenues

Assessments	133,000
Reserve Assessments	100,000
Fines	2,500
Late charges	<u>1,000</u>

Total Revenues 236,500

Expenses

Manager	18,000
Audit	5,000
Landscaping	39,500
Maintenance	36,000
Replacement Fund Maintenance	-
Utilities	6,000
Insurance	<u>23,500</u>

Total Expenses 128,000

Net Profit 108,500

Beginning Fund Balance

Operating	49,500
Reserve	<u>27,000</u>

Total Fund Balance 185,000

Missing promised assessments and billed but unpaid fines and charges

Missing committed expenses, ie Accounts Payable

Can give a false sense of available funds

BETTER MANAGER STATEMENT

Balance Sheet

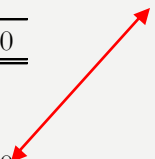
Your Association Operating Fund
12/31/2016

Operating Checking	65,000
Reserve Money Market	-
Accounts Receivable	-
Prepaid Insurance	-
Prepaid Other	-
Total Assets	<u>65,000</u>
Accounts Payable	-
Due to Reserve	7,000
Assessments Paid in Advance	-
Total Liabilities	7,000
Equity	
Operating Account	58,000
Reserve Fund	-
Total Equity	<u>65,000</u>

Balance Sheet

Your Association Reserve Fund
12/31/2016

Operating Checking	-
Reserve Money Market	120,000
Accounts Receivable	-
Prepaid Insurance	-
Due From Operating	7,000
Total Assets	<u>127,000</u>
Accounts Payable	-
Accrued Expenses	-
Assessments Paid in Advance	-
Total Liabilities	-
Equity	
Operating Account	-
Reserve Fund	127,000
Total Equity	<u>127,000</u>



PROBLEMS WITH THESE STATEMENTS

- Cash Basis
 - No Accounts Receivable for uncollected assessments
 - No Prepaid Insurance if paid in full
 - No Accounts Payable for bills received but not yet paid
 - No Prepaid Assessments for owners who pay their assessments early
- This information typically provided in other statements
 - Schedule of delinquencies
 - Unpaid bills
- For Condos, RCW's require Accrual Basis statements be provided for resale

ACCRUAL BASIS STATEMENT

Balance Sheet

Your Association Operating Fund

12/31/2016

Operating Checking	65,000
Reserve Money Market	-
Accounts Receivable	35,000
Prepaid Insurance	11,000
Prepaid Other	-
Total Assets	<u>111,000</u>

Accounts Payable	21,000
Due to Reserve	7,000
Assessments Paid in Advance	18,000

Total Liabilities	46,000
Equity	
Operating Account	65,000
Reserve Fund	-
Total Liabilities and Equity	<u>111,000</u>

Balance Sheet

Your Association Reserve Fund

12/31/2016

Operating Checking	-
Reserve Money Market	120,000
Accounts Receivable	-
Prepaid Insurance	-
Due From Operating	7,000
Total Assets	<u>127,000</u>

Accounts Payable	60,000
Accrued Expenses	-
Assessments Paid in Advance	-

Total Liabilities	60,000
Equity	
Operating Account	-
Reserve Fund	67,000
Total Liabilities and Equity	<u>127,000</u>

COMPARISON OF ACCRUAL TO CASH

Revenues		Operating		Reserve Fund
Assessments	133,000	Assessments	150,000	
Reserve Assessments	100,000	Reserve Assessments	-	100,000
Fines	2,500	Fines	2,500	-
Late charges	1,000	Late charges	1,000	-
	<hr/>		<hr/>	<hr/>
Total Revenues	236,500	Total Revenues	153,500	100,000
Expenses		Expenses		
Manager	18,000	Manager	18,000	
Audit	5,000	Audit	5,000	
Landscaping	39,500	Landscaping	44,500	
Maintenance	36,000	Maintenance	46,500	
Replacement Fund Maintenance	-	Replacement Fund Maintenance	-	60,000
Utilities	6,000	Utilities	12,000	
Insurance	23,500	Insurance	12,000	
	<hr/>		<hr/>	<hr/>
Total Expenses	128,000	Total Expenses	138,000	60,000
Net Profit	108,500	Net Increase/(Decrease) to Fund	15,500	40,000
Beginning Fund Balance		Beginning Fund Balance		
Operating	49,500	Operating	49,500	
Reserve	27,000	Reserve	-	27,000
	<hr/>		<hr/>	<hr/>
Total Fund Balance	185,000	Total Fund Balance	65,000	67,000

WHAT TO LOOK FOR AT YEAR END

- Months of Operating Cushion
 - Divide Operating Cash balance by the monthly average spend
 - Using the accrual statements $\$65,000 / (\$138,000 / 12) = 5.65$ months
 - Is this amount too much or too little to pay bills timely?
- Working Capital Cushion
 - Net operating cash divided by average monthly spend
 - Cash plus A/R minus A/P and Prepaid Assessments = Net Operating Cash
 - $\$65,000 + 35,000 - 21,000 - 18,000 = 71,000 / (\$138,000 / 12) = 6.17$ months
 - If all cash collected and bills paid, how many months can bills be paid?

WHAT TO LOOK FOR AT YEAR END

- Days of Assessments Uncollected
 - Divide Accounts Receivable by (Assessments /365)
 - Using the accrual statements $\$35,000 / (\$150,000/365) = 85$ days
 - Is there a collection problem? Are notices being sent and followed up on?
- Replacement Reserve Coverage
 - Net Reserve Cash / Next Years Expected Replacement Expenditures
 - $\$60,000 / \$30,000$ (from replacement study) = 2:1
 - Is there a short term problem with the reserve?

WHAT TO LOOK FOR AT YEAR END

- Long-Term Replacement Coverage
 - Cash on Hand / Weighted Present Value of Future Replacement Expenditures
 - \$60,000/\$75,000 (total replacement expenditure weighted by years used) = .8:1
 - Is there a long-term reserve funding problem?

FOOTNOTE DISCLOSURES

- Nature of the Organization
 - Describes the number of units in your Association and year you began. Can be used for analysis to break down costs and assessments by door.
- Date of Management Review
 - This is the date that the draft was provided to either the Board or the Manager.
 - Used for subsequent event cut-off
- Summary of Significant Accounting Policies
 - Describes the funds kept by the Association
 - Explains the assessments and collection policies for the Association
 - Describes the Association's tax position
 - Provides summary information on the Replacement Reserves

FOOTNOTE DISCLOSURES

- Summary of Significant Accounting Policies
 - Property and Equipment
 - Describes Association's policies regarding the purchase and depreciation of specific assets
 - Estimates
 - Informs the reader about the use of estimates and the potential impact of this
 - Cash and Cash Equivalents
 - Describes what investments are being accounted for as cash for
 - Balance sheet
 - Statement of Cash Flows

FOOTNOTE DISCLOSURES

- Specific Footnotes to Watch For
 - Related Party Transactions
 - Identifies actual or potential transactions between the Association and the board
 - Designed to inform reader of possible conflicts of interest
 - Accounts Receivable Footnote
 - May describe certain issues pertaining to collectability of past due assessments.
 - May describe the estimate for uncollectible assessments and if this was recorded against the A/R
 - Significant Non-Cancelable Contracts
 - Will highlight long-term commitments
 - Debt
 - Explains the monthly loan amortization, interest rate and collateralization of any borrowings by Association

SUPPLEMENTARY INFORMATION

- Summary of the Replacement Reserve Study
 - Will recommend the Reserve Assessment amounts to be charged to the owners
 - Will summarize the expected replacement expenditures by year and/or asset over next 30 years
 - Designed to highlight potential funding shortfalls
- Detailed Schedules of Association Expenses or specific funds
 - Not required to be reported
 - Often useful for analytical purposes

IN CONCLUSION

- The Auditors' Report is an Opinion on the Fair Presentation of the Financial Statements
 - It is not a check on the internal control function of the Manager
 - It is not suited for discovering fraud or immaterial errors
- Accrual Financial Statements can Provide Better Oversight Information
 - Provides a statement of all the assets and liabilities
 - Reports expenses when incurred
- Using Analytical Tools can Help You Identify Potential Issues
 - Can cut down on the time spent investigating details
 - Allows for more effective questioning of the Manager
- Footnote Disclosures and Supplementary Info can Help Understand Risks and Potential Issues
 - Look for related party transactions
 - Analyze the reserve report and compare it to current and expected financial position

THANK YOU FOR ATTENDING

- Questions?
- Additional Resources
- Feel free to contact me at johncaughell@currie-mclain.com
- Or by Skype [johncaughell@currie-mclain.com](https://www.skype.com/people/johncaughell@currie-mclain.com)
- PDF of this slideshow is available upon request and will also be posted at
- www.linkedin.com/in/johncaughellcpa

Our July Lunch and Learn is “Internal Control – How Boards, Managers and Accountants can ensure effective safeguards over Association and Non-Profit Finances” If you are or know a board member, director or manager of an Association or Non-Profit Organization, this seminar can help you evaluate and update your internal control structure to better suit your needs.

July 19, 2017 11:30-1:30.