

Understanding Your Community's Financials



Presented By

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For

NowackHoward, LLC



NOWACKHOWARD
COMMUNITY ASSOCIATION ATTORNEYS

Disclaimers



- * The information in this presentation is for informational purposes only and not for the purpose of providing any legal advice.
- * The information included in this presentation is solely the opinion of the speaker, an independent contractor, who is not an employee of NowackHoward.

Board Responsibility



- Duty of Care
 - Good business judgment at all times
 - Due diligence in decision making
- Duty of Loyalty
 - Act in the best interest of the organization and membership
 - Avoid conflicts of interest
- Duty of Obedience
 - Faithful to the mission and goals
 - Follow the governing documents

Treasurer's Role



- * Serves as Chief Financial Officer
- * Maintain accounting records
- * Safeguard assets
 - * Cash
 - * Risk management (insurance)
- * Prepare annual operating budget



Treasurer's Role



- * Collect delinquent accounts
- * File income tax returns
- * Present association's financial position at each board/annual meeting
- * Cause financial audits to be performed when required or needed

Treasurer's Role



- * Establish a replacement reserve program
 - * Future, major capital expenditures
 - * Not to be used as operating funds
 - * Not excess funds available for emergencies

Types of Reporting Methods



- * Commercial Accounting
 - * Combines operating and reserve transactions in the same column

- * Fund Accounting
 - * Segregates financial statement amounts into grouping based on entity's specific activities / separate columns for operating and reserve funds
 - * Best for non-profit entities with multiple funds

Terminology



* For Profit

* Income

* Expense

* Net Income

* Retained Earnings

* Non-profit

Revenue

Expense

Revenue in Excess of Expense

Member's Equity

Methods of Accounting



- * Accrual basis - Generally accepted accounting principles (GAAP)
- * Cash basis - Other comprehensive basis of accounting
 - * Is not in accordance with GAAP
- * Modified accrual/cash basis – varying degrees of use

Methods of Accounting



- * Accrual method - most complicated to understand
 - * Revenues recorded when ***Earned*** (not received)
 - * Pre-Paid Assessments on B/S
 - * Expenses recorded when ***Incurred*** (not paid)
 - * Transactions are immediately recorded into an A/R or A/P account until cash is paid out or received

Methods of Accounting



- * Cash Method - simple to understand
 - * Revenues recorded when **Received**
 - * Expenses recorded when **Paid**
 - * Effective for tracking cash flow, not designed to match revenue & expenses

Methods of Accounting



- * Modified accrual - relatively simple to understand
 - * Revenues may be recorded when ***Earned***
 - * Assessments (portion not collected recorded on B/S)
 - * Pre-paid assessments (recorded on B/S)
 - * Expenses may be recorded when ***Incurred***
 - * Some expenses may be accrued (recorded on B/S)
 - * Some pre-paid expenses may be deferred (recorded on B/S)

Where is Financial Information Recorded



- * Ledgers or journals (known as “the books”)
- * General Ledger – chronological record of all transactions

General Ledger is Divided (into Five Baskets)



* Assets -

* Liabilities =

* Owners' Equity



* Balance Sheet

* + Revenue

* - Expenses



* Revenue and Expense
Statement

Balance Sheet



Summarizes the financial condition as of a *specific date*

- * **Assets**
 - * Owned (owner has legal title to asset)
 - * Provides benefit now and in future
 - * Values reported represent original cost
- * **Liabilities** (claims of creditors / what is owed)
- * **Member's Equity** (claims of owners)

Balance Sheet Common Assets



Accrual Method

- * Cash
- * MMA
- * Prepaid Assessments
- * Assessments receivable (A/R)
- * Prepaid Insurance

Cash Method

- * Cash
- * MMA
- * Prepaid Assessments (modified)

Balance Sheet Common Assets



- * Question....what asset is generally NOT on the books?
 - * Condominium?
 - * Common Law HOA or HOA subject to the POAA?

Balance Sheet Common Liabilities



Accrual Method

- * Note payable
- * Insurance settlement account
- * Prepaid assessments
- * Accounts payables

Cash Method

- * Note payable
- * Insurance settlement account

Balance Sheet



* **Member's Equity**

- * Basically the net worth of the Association or accumulated earnings since the entity began

Revenue & Expense Statement



- * Shows the results of operations, including replacement fund activity, during a period of time such as a month or a year

Types of Revenues



- * Member assessments
- * Special assessments
- * Specific assessments
- * Interest income
- * Penalty fees
- * User fees
- * Cable agreements



Types of Expenses



- * **Operating** - Expenses that occur on a regular annual basis such landscaping and insurance
- * **Replacement (reserve)** Major expenses to maintain the community's existing common property such as roof replacement
- * **Major Improvement** – Expenses incurred to improve the property with a new asset such as adding a clubhouse or pool

Financial Statement Comparison Assumptions



- * Regular annual assessment budget is \$160K, expect \$10K uncollected, received \$150.5K
- * Monthly landscape expense of \$1K, December bill not paid before year end
- * Annual insurance expense of \$6K, policy renews on February 1
- * Incurred unexpected gate repair of \$1.5K, invoice not paid before year end

Balance Sheet - Full Accrual Method
ACB Community Association
31-Dec-18

	Operating	Reserve	Total
Assets:			
Current assets:			
Cash - Operating Fund	4,000		4,000
Cash - MMA operating	10,000		10,000
Cash - Reserve Fund	-	200,000	200,000
Assessment Receivable	10,000		10,000
Prepaid Insurance	500		500
Total Current Assets:	24,500	200,000	224,500
Liabilities & Equity			
Current Liabilities:			
Accounts Payable	2,500		2,500
Prepaid Assessments	500		500
Total Current Liabilities:	3,000	-	3,000
LT Liabilities:			
Note Payable		50,000	50,000
Total LT Liabilities:	-	50,000	50,000
Member's Equity:			
Member's Equity - Operating	7,400		7,400
Member's Equity - Reserve		145,000	145,000
Total member's Equity:	7,400	145,000	152,400
Net Revenue / Loss - Operating	14,600		14,600
Net Revenue / Loss - Reserve		5,000	5,000
Total Liabilities & Equity	25,000	200,000	225,000

Balance Sheet - Cash Method
ACB Community Association
31-Dec-18

	Operating	Reserve	Total
Assets:			
Current assets:			
Cash - Operating Fund	4,000		4,000
Cash - MMA operating	10,000		10,000
Cash - Reserve Fund	-	200,000	200,000
<i>Assessment Receivable</i>	-		-
<i>Prepaid Insurance</i>	-		-
Total Current Assets:	14,000	200,000	214,000
Liabilities & Equity			
Current Liabilities:			
<i>Accounts Payable</i>	-		-
<i>Prepaid Assessments</i>	-		-
Total Current Liabilities:	-	-	-
LT Liabilities:			
Note Payable		50,000	50,000
Total LT Liabilities:	-	50,000	50,000
Member's Equity:			
Member's Equity - Operating	6,400		6,400
Member's Equity - Reserve		145,000	145,000
Total member's Equity:	6,400	145,000	151,400
Net Revenue / Loss - Operating	8,100		8,100
Net Revenue / Loss - Reserve		5,000	5,000
Total Liabilities & Equity	14,500	200,000	214,500

Revenue & Expense Statement / Operating - Full Accrual Method
ACB Community Association
31-Dec-18

	Actual	Budget	Variance
Operating Revenue			
Owner Assessment:			
Reguar Assessment	160,000	160,000	-
Total Assessment Revenue:	<u>160,000</u>	<u>160,000</u>	<u>-</u>
Interest	100	-	100
Penaly Fees	500	-	500
Total Operating Revenue	<u>160,600</u>	<u>160,000</u>	<u>600</u>
Operating Expense			
G&A	72,000	78,000	6,000
<i>Bad Debt</i>	-	10,000	10,000
Building Exterior	25,000	22,000	(3,000)
Landacaped Areas	12,000	12,000	-
Insurance	5,500	6,000	500
Gate Repair	1,500	-	(1,500)
Interest on loan	10,000	12,000	2,000
Total Operating Expense	<u>126,000</u>	<u>140,000</u>	<u>14,000</u>
Reserve Expense			
Transfer to Reserve	20,000	20,000	-
Total Expenses	<u>146,000</u>	<u>160,000</u>	<u>14,000</u>
Excess of Revenue over Expense	<u>14,600</u>	<u>-</u>	<u>14,600</u>

Revenue & Expense Statement / Operating - Cash Method
ACB Community Association
31-Dec-18

	Actual	Budget	Variance
Operating Revenue			
Owner Assessment:			
Regular Assessment	150,500	160,000	(9,500)
Uncollected Assessment	(10,000)		10,000
Total Assessment Revenue:	<u>150,500</u>	<u>150,000</u>	<u>500</u>
Interest	100	-	100
Penalty Fees	500	-	500
Total Operating Revenue	<u>151,100</u>	<u>150,000</u>	<u>1,100</u>
Operating Expense			
G&A	72,000	78,000	6,000
Building Exterior	24,000	22,000	(2,000)
Landscaped Areas	11,000	12,000	1,000
Insurance	6,000	6,000	-
Interest on loan	10,000	12,000	2,000
Total Operating Expense	<u>123,000</u>	<u>130,000</u>	<u>7,000</u>
Reserve Expense			
Transfer to Reserve	20,000	20,000	-
Total Expenses	<u>143,000</u>	<u>150,000</u>	<u>7,000</u>
Excess of Revenue over Expense	<u>8,100</u>	<u>-</u>	<u>8,100</u>

Revenue & Expense Statement / Reserve - Full Accrual Method
 ABC Community Association
 31-Dec-18

	Actual	Budget	Variance
Reserve Revenue			
Reserve Assessment - from Operating	20,000	20,000	-
Reserve Expense			
Roof Replacement	15,000	14,000	(1,000)
Excess of Revenue over Expense	5,000	6,000	(1,000)

Revenue & Expense Statement / Reserve - Cash
 ABC Community Association
 31-Dec-18

	Actual	Budget	Variance
Reserve Revenue			
Reserve Assessment - from Operating	20,000	20,000	-
Reserve Expense			
Roof Replacement	15,000	14,000	(1,000)
Excess of Revenue over Expense	5,000	6,000	(1,000)

Relationship of Statements



- * The interrelationship of these two statements is important to understand.
- * The balance sheet depends on the results of the revenue and expense statement

Relationship of Statements



BLUE SKY HOMEOWNERS ASSOCIATION, INC.

Balance Sheet As of July 31, 20xx

Revenue & Expense Statement For month end July 31, 20xx

<u>Assets</u>		<u>LIABILITIES</u>		<u>Revenue</u>	
Cash	\$5,000.00	Bank Loan	\$3,000.00		
A/R	\$1,000.00	A/P	\$1,750.00	Member Assessments	\$6,000.00
Equipment	\$2,500.00	Total Liabilities	\$4,750.00		
				<u>Expenses</u>	
				Landscaping	\$700.00
		<u>EQUITY</u>		Utilities	\$3,000.00
		Member's Equity Prior Year	\$2,450.00	Insurance	\$1,000.00
		Excess of Revenue over Expenses	\$1,300.00		
		Member's Equity	\$3,750.00	Total Expenses	\$4,700.00
Total Assets	\$8,500.00	Total Liabilities and Member's Equity	\$8,500.00	Excess of Revenue over Expenses	\$1,300.00

Other Financial Reports



- * Accounts Payable
- * Accounts Receivable (aging report)
- * Cash Disbursements
- * Cash Receipts
- * Bank Statements
- * Bank Statement Reconciliation

Review of Balance Sheet



- * Compare asset and liability/equity balances to ensure they are the same amount ($A=L+E$) or ($A-L=E$)
- * Ensure that all cash accounts have a positive balance
- * Is there sufficient cash to meet your monthly cash requirements?

Review of Balance Sheet



- * Operating cash should not be less than $1/12^{\text{th}}$ of the annual assessments
- * Operating cash should not exceed approximately 10-15% of annual assessments
- * Assume \$100K annual assessments:
 - * Minimum - \$8,333 or 8.3%
 - * Maximum - \$15,000 or 15%

Key Performance Indicator



Current Ratio

- * Measures the financial health of an organization
- * Ratio >1 represents the ability to meet short term financial obligations and upcoming operating expenses
- * **Current Assets/Current Liabilities = Current Ratio**
- * **10,000 / 11,000 = .90**

Delinquencies as a % of Annual Assessments



% Delinquent

3% or Less

4% to 5%

6% to 10%

> 10%

> 15%

Rating

Excellent

Good

Poor

Be Concerned

Be Very Concerned



A/R over 30 days / Annual Assessments = % Delinquent

\$6,000 / \$100,000 = .06 or 6%

Key Performance Indicator



Aged Assessments Receivable (Aged A/R)

- * Measures the super delinquent assessments
- * **A/R over 90 days old / Total A/R = Aged A/R Ratio**
- * **\$1,500 / \$6,000 = .166 or 16.6%**

Review of Balance Sheet



- * Review bank statements
- * Review bank statement reconciliations – any old reconciling items, such as outstanding checks?
- * If there is an insurance settlement account, ensure that any disbursements related to the claim were charge against this account rather than an operating expense on the revenue & expense statement

Review of Revenue & Expense Statement



- * Review each revenue & expense line for the current period & YTD
 - * Compare to budgeted amount
 - * Investigate large variances – including budgeted accounts without activity
- * Review transfers to replacement fund to ensure that any budgeted transfer to reserves was recorded
- * Confirm that any charges to replacement fund are actually reserve type expenses

Review of Revenue & Expense Statement



- * Does the actual assessment revenue agree with the budgeted amount?
 - * Cash method
 - * Accrual method

- * Review cash disbursement journal
 - * Check paid invoices against checks paid and the original receipts for credit card accounts, if any

- * Are bills being paid on a timely basis?

Replacement Fund



- Funds collected and saved, “in reserve”
- For the replacement of major components of a community’s common property
 - Such as roofs, tennis court re-surfacing, pool re-plastering, etc.
- Conceptually, saving funds overtime to equal the depreciation of major components so that when the time comes to replace the item, you have the money

Key Reasons to Maintain a Replacement Fund



- * Meets legal, fiduciary and professional requirements (fiscally responsible)
- * Plans for the replacement of major assets at the end of their useful life (sufficient funds when required)
- * Equalizes the expense contributions of current and future owners

Key Reasons to Maintain a Replacement Fund



- * Minimizes the need for special assessments
- * Special assessments result in a disproportionate burden for repairs and maintenance being borne by current owners rather than having properly raised the funds from past owners
- * Enhances resale values

2 Parts of Reserve Study



- * The Physical Analysis
 - * Component Inventory
 - * Condition Assessment
 - * Life and Valuation Estimates

- * The Financial Analysis
 - * Fund Status (KPI)
 - * Funding Plans (4 options)



Reserve Funding Plan



- * How should the association fund the reserve?



RESERVE STUDY RESULTS

Reserve Funding Plan



Sufficient Cash

Stable Contribution Rate

Evenly Distributed

Fiscally Responsible

RESERVE FUNDING PRINCIPLES

Key Performance Reserve Indicator



Replacement Fund - % Funded

- * Measures the required fund balance to the actual fund balance

Total reserve \$

Accumulated Required \$

= Percent Funded Ratio

- * $500,000 / 700,000 = .71$ or 71% Funded

Reserve Funding Plans



- * Component Funding Method (*line item budget*):
 - * **Fully Funding Objective** – Keep the replacement fund at or near 100% funded

Reserve Funding Plans



- * Cash-Flow Funding Method (monetary/aggregate pool):
 - * **Baseline Funding Objective** – Keep the replacement fund balance above zero
 - * **Threshold Funding Objective** – Keep the replacement fund balance above a specific dollar or percent funded amount

Reserve Funding Plans



- * **Statutory Funding Objective:** A reserve funding goal of setting aside the specific minimum amount of reserves required by federal, state or local statutes

Scope of Reserve Study



- Intent is to assist the association with establishing an appropriate reserve funding plan for replacement expenses
- Not intended to address or discover construction defects, asbestos, mold, water or moisture intrusion, or lead paint
- Project design or management costs are normally not included

Scope of Reserve Study



- * Useful life estimates assume proper design, construction, installation, and preventive maintenance in accordance with manufacturers' recommendations
- * Remaining useful life estimates assume normal weather conditions and do not make allowances for damage from storms, floods, wind, earthquakes, or insurable events

Q & A



- * Thanks for attending today, we hope you enjoyed the class and take away some new information that will contribute to your success as a Board Member!