

GUIDE TO
UNDERSTANDING
COMMUNITY ASSOCIATION
FINANCIAL REPORTS

by

DAVID REGENBAUM, PCAM

GUIDE TO UNDERSTANDING COMMUNITY ASSOCIATION FINANCIAL REPORTS

The financial management of every community association is ultimately the responsibility of its Board of Directors. Many of the decisions made by the Board have financial implications and understanding the association's financial reports is, therefore, a fiduciary obligation of each member of the Board. Understanding the financial reports will also facilitate the decision-making process of the Board as a whole. This guide has been prepared to assist association leaders in understanding financial reports and, as a result, becoming more informed and effective leaders.

Financial reports have two primary purposes:

- ☐ To provide users with the financial information needed to make decisions relating to the association's financial position; and
- ☐ To enable the Board of Directors to control the association's financial operations.

Financial reports are the primary source of information on an association's financial performance and condition. If you are an accountant, it is unlikely that you can learn anything from this guide. If you are not an accountant, and you find financial reports difficult to grasp, this guide is designed to help you understand and use the information contained in your financial reports. This is our principal aim in preparing the guide. We hope it serves your needs.

During 1991, the American Institute of Certified Public Accountants (AICPA) issued a guide for community association accounting. The guide states that financial reports for community associations should be prepared on an accrual basis using fund accounting. Accountants, like other professionals, have a specialized vocabulary. The following glossary of terms used by accountants is provided to briefly explain the basic concepts. Therefore, the Financial Statements Checklist will assist you in reviewing your association's financial statements.

GLOSSARY OF TERMS

ACCOUNTING CONCEPTS

CASH ACCOUNTING records income when received and expenses when paid. This is the way that most of us keep our personal checking accounts.

ACCRUAL ACCOUNTING records income when earned or billed (as opposed to when received) and

expense when incurred (as opposed to when paid).

MODIFIED ACCRUAL ACCOUNTING is a combination of cash and accrual accounting. Generally, assessment income is recorded on an accrual basis (i.e., when billed or earned) and most expenses are recorded on a cash basis (i.e., when paid). The modified accrual method of accounting has become an industry standard across the USA and is the form of accounting used by AMI.

FUND ACCOUNTING segregates the association's financial activities into two principal funds: the Operating Fund and a fund for future major repairs and replacements, the Replacement Fund.

BALANCE SHEET

The BALANCE SHEET is a summary of the association's assets, liabilities, and fund balances at a specific point in time. The purpose of a Balance Sheet is to show the financial position of the association on a specific date.

ASSETS include cash, investments, accounts receivable, prepayments, and anything else owned by the association that has a cash value and can be disposed of by the association.

THE OPERATING FUND reflects the cash and investments of the association available for paying the operating expenses.

Ideally, the cash in the *operating account* should equal approximately one month's operating assessment. The cash in this account bears interest at the bank's savings account rate. Additional operating funds should be placed in an investment account to receive the benefit of a higher rate of interest.

The TOTAL OPERATING FUND represents the total cash resources for the association's day-to-day operations. Surplus or discretionary operating funds, also referred to as working capital, can be calculated by deducting prepaid or unearned assessments from the total operating fund. As a rule of thumb, surplus or discretionary operating funds should be accumulated in an amount equal to approximately one month's assessments.

ACCOUNTS RECEIVABLE are assessments and other charges billed to owners that have not yet been received by the association. Details of the accounts receivable can be obtained from the Aged Analysis Report.

The REPLACEMENT FUND reflects cash invested by the association for future major repairs and replacements. The amount in the replacement fund should equal or exceed the amount shown as Replacement Reserves in the Equity portion of the Balance Sheet.

OTHER ASSETS include deposits for utilities, prepaid expenses such as insurance premiums, claims by the association, and property owned by the association that has a useful life of longer than one year and can be

disposed of by the association for cash, or property that produces significant income.

TOTAL ASSETS is the total of all the association's assets and includes the total operating fund, the total accounts receivable, the total replacement fund, and any other assets or claims that the association may have.

LIABILITIES include prepaid or unearned assessments, accounts payable and any debts incurred by the association, or claims against the association.

PREPAID ASSESSMENTS are assessments received during the current financial period for a future period. This will generally be found in associations having monthly assessments, e.g., assessments received at the end of September which are only due on October 1.

UNEARNED ASSESSMENTS are generally found in associations having annual assessments. The amount in unearned assessments is the amount billed for the remaining months of the year. The unearned assessment will be reduced by one twelfth of the annual assessment each month.

ACCOUNTS PAYABLE are liabilities incurred during the period which have not yet been paid.

The REPLACEMENT FUND is a list of the amounts allocated for major repairs and replacements. The total amount allocated should be fully funded. The amount in the replacement fund under the asset portion of the balance sheet should equal or exceed the total amount allocated.

The OPERATING SURPLUS/(DEFICIT) is made up of two amounts: Prior Year Operating Surplus/(Deficit) which is the total accumulated surplus or deficit of the operating fund from the inception of the association to the end of the previous fiscal year; and the Current Year Surplus/(Deficit) which is the surplus or deficit of the operating fund for the current fiscal year.

TOTAL EQUITY is the total of the amount allocated in the Replacement Fund and the total of the Operating Fund Balance. Total Equity is the difference between the association's assets and liabilities and represents the owner's equity in the association. In other words, if the association were to cease all operations, it is the amount which would be available for distribution to the owners after liquidating all assets and paying off all liabilities.

The TOTAL LIABILITIES AND EQUITY should equal the Total Assets.

STATEMENT OF INCOME AND EXPENSES:

The STATEMENT OF INCOME AND EXPENSES provides information on the association's income and expenses over a period of time (month, year to date) and compares the income and expenses to the budget for the same period.

OPERATING INCOME includes Residential Assessments (Earned), Developer Assessments, Late Fees, Interest Earned and Other Income.

OPERATING EXPENSES reflect the cost of goods and services used in operating the association.

OPERATING SURPLUS/(DEFICIT) is the difference between the Association's income and expenses for the month and year to date. The year-to-date difference should be the same as the current year Fund Balance reflected in the balance sheet.

REPLACEMENT FUND REPORT

The REPLACEMENT FUND REPORT provides information on the association's financial activities relating to major repairs and replacements during the current fiscal year. It is the Statement of Income and Expenses for the Replacement Fund.

AGED ANALYSIS REPORT

The AGED ANALYSIS REPORT provides details of assessments billed to owners that have not been received as of the date of the report.

CHECK REGISTER

The CHECK REGISTER is a listing, in numerical order, of all checks issued during the period.

GENERAL LEDGER

The GENERAL LEDGER contains the beginning balances and all the financial transactions of the association during the period.

BANK RECONCILIATION

The BANK RECONCILIATION reconciles the balance in the association's bank account with the balance shown in the association's financial statements. All outstanding checks, deposits, interest and charges are reflected.

FINANCIAL STATEMENTS CHECKLIST

1. Balance Sheet

- 1.1 Check that not more than \$100,000 is in any bank for any one association. This includes *all* of the association's accounts in the same bank. _____

- 1.2 Ensure that the association's operating account has sufficient funds to meet the anticipated monthly expenses. _____

- 1.3 "Total Accounts Receivable" on the balance sheet should equal the balance due on the Aged Analysis Report. "Clearing" and "Other" should be zero. Any credit balances under "Accounts Receivable" need to be investigated. _____

- 1.4 The "Total Replacement Fund" should equal "Total Replacement Reserves" under Liabilities. If they are not equal, the difference is usually interest income in the "Replacement Fund" bank/investment accounts and/or Replacement Reserve expenses. _____

- 1.5 "Total Assets" should equal "Total Liabilities and Equity." _____

- 1.6 "Prepaid Assessments" on the Balance Sheet should equal "Prepays" on the Aged Analysis Report. _____

- 1.7 "Unearned Assessments" will generally only be found in those associations having annual assessments. The amount of unearned assessments is the balance of the budget for the remainder of the current fiscal year and is generally based on 1/12 of the budget per month. The amount in the operating fund should exceed the unearned assessments to ensure adequate funds for the remainder of the fiscal year. _____

- 1.8 The "Total Replacement Reserves" should equal the Total ending balance on the Capital Expenditure Reserves report. _____

- 1.9 The variance column alongside the Operating Surplus/(Deficit) for the prior year should generally be zero. _____

1.10 The Current Month "Operating Surplus/(Deficit)" should equal the "Operating Surplus/(Deficit)" under the "YTD Actual" in the Statement of Income and Expenses. _____

2. Statement of Income and Expenses

2.1 The variance in regard to assessments on both the MTD Actual and YTD Actual should be zero. In accrual accounting, the assessments should equal the budget. _____

2.2 The "Operating Surplus/(Deficit)" under both the "MTD Budget" and "YTD Budget" should be zero if the budget is, in fact, a balanced budget. _____

2.3 Check the MTD and YTD variances under the income and expense categories for anything unusual. Investigate significant variances. _____

3. Income and Expense Spreadsheet

3.1 Scan all line items to determine trends and investigate discrepancies, e.g., failure to receive income such as interest, failure to pay a regular expense item, unusually high expense, particularly water, etc. _____

4. Replacement Fund Report

4.1 Scan report for any apparent discrepancies and for adequacy of funding. _____

5. Aged Analysis Report

5.1 Check report for delinquencies and follow up on any significant balances due. _____

6. Check Register

6.1 Review check numbers to ensure that they are in sequence and that all checks are accounted for. _____

6.2 Review each payee and description on each check for any apparent discrepancies. _____

7. **General Ledger**

7.1 Scan General Ledger for any apparent discrepancies. _____

7.2 Ending balances on the 1000 through 3000 accounts should equal the amounts shown on the Balance Sheet. _____

7.3 Ending balances on the 4000 through 5000 accounts should equal the Year to Date actual balances in the Statement of Income and Expenses. _____

7.4 Check the expense accounts for correct coding of the expenses. _____

7.5 The Total on the last page of the General Ledger should equal zero. _____

8. **Bank Reconciliations**

8.1 Check bank reconciliations against balances on financial statements. _____

8.2 Scan reconciling items for anything unusual or outstanding for longer than 60 days. _____
