AMG
Association Management Group

www.AMGWorld.com

AMG
Association Management Group

Guidance for Financial Management

www.AMGWorld.com

PREFACE

Volunteer Boards of condominiums and homeowners associations take on the stewardship of complicated, complex organizations with many potential pitfalls. Volunteer directors perform a number of functions vital to the successful governing of the association for the benefit of all owners: fostering community harmony, maintaining common areas, and establishing and enforcing rules.

The ability of the association to perform these functions depends on the association's success as a business. One of the most important business functions of the Board is to oversee the association's financial well-being. This booklet discusses "tips" to help protect association finances. Before implementing them, consider the obligations you have under the governing documents and state statutes and discuss with your Attorney and/or Certified Public Accountant.

REVIEW FINANCIALS

The management company, treasurer or accountant should submit financial statements, in most cases monthly, but at least quarterly. The report should include:

Balance Sheet:	A snapshot on a given day, typically the last day of the month, quarter or year, which shows assets and liabilities (based on method of accounting).
Change in Fund Balance: (also often called Profit and Loss or P & L)	A record of income and expenses for a certain period of time, typically published monthly, quarterly or annually. This report can often be combined with the budget comparison.
Budget Comparison:	Compares the association's budget to the actual expenses and income for a given period of time and often also illustrates the total annual budget for each line item.
Expense or Check Register:	Itemized listing of each expense, usually by invoice or check for a given period.
Delinquencies:	Lists accounts receivables of fees/funds the association is owed by the debtor.
Accounts Payable:	A listing of bills owed, but not yet paid.

The financial statements may be prepared on a Cash, Accrual, or Modified Accrual basis. The Accrual method is the most complete method because it accurately matches revenues to expenses incurred, however, many non CPA/accountant board members find Accrual Statements difficult to understand. Many associations opt for Modified Accrual because of its simplicity and understandability. Regardless of the accounting method used, the Board should monitor an aged list of Accounts Receivable (Delinquencies) and Accounts Payable (unpaid bills).

The financial report should be accompanied by an explanation of any significant variances, such as cash surpluses, shortages, excessive accounts payable or receivable, or major budget overruns. The Board should investigate any excessive variances and ask questions if the financial statements are not produced 30 days after the close of the period. The Board should closely review the income statement, compare it with the budget, and question any major differences.

RECONCILE BANK STATEMENTS

The Board should review bank statements for all accounts at least quarterly. The printed or electronic bank statements should be compared with the reconciliation to the financial statement. Often there are differences between the bank statement and the financial statement balance. The reconciliation should explain the difference. Someone other than the person who prepares the reconciliation should review the reconciliation. Be aware that persons committing fraud have sometimes falsified statements. If in doubt, call the bank for confirmation. In some cases, banks can provide duplicate statements for the treasurer.

CONDUCT AN ANNUAL COMPILATION, REVIEW OR AUDIT

A Certified Public Accountant (CPA) selected by the association board should conduct an annual analysis of the association's finances. The accountant should have access to original books and records. All personnel, contractors, and volunteers should cooperate fully during the course of the analysis.

The association board may request one of three levels of service from the accountant:

Compilation: The accountant presents the association's financial statements in a manner consistent with generally accepted accounting principles. A compilation involves little analysis and no confirmation of balances. Compilations provide no level of assurance and in general are not recommended for associations.

Review: The accountant investigates record-keeping practices and accounting policies and analyzes the statements. The accountant prepares disclosures on unusual items or trends that may require explanation.

Recommended by AMG and required by many HOA legal documents

Audit: The accountant performs a more thorough analysis that includes confirming bank balances, making physical inspections and tracing transactions to invoices and evidence of payments. Although an audit is a more comprehensive examination of the association's financial statements and provides the highest level of assurance, it is not an analysis of the Board's policy decisions and cannot necessarily detect fraud.

After the analysis is completed, the accountant expresses an opinion based on the results of the audit tests and examinations. The opinion is independent of the association and management.

Before deciding which method to use, check your association's documents as well as state statutes, in that a full audit may be required. Always consider conducting a review or audit when a major change is made in the way the association handles its finances (e.g., transition from developer to owner control or a change in management).

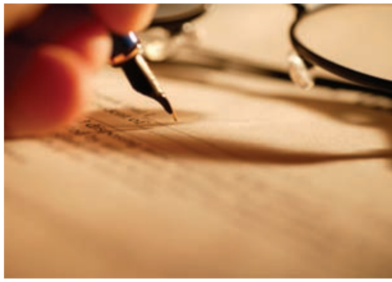
DO NOT COMMINGLE ASSOCIATIONS FUNDS

The association's funds should not be commingled with the funds of any other organization or person.

PREPARE WRITTEN COLLECTION POLICIES

The association should have a written collection policy for delinquent accounts receivable (the assessments). The use of a bank lockbox allows the association to deposit assessments directly into its account. This enhances collections and speeds up deposits. It also eliminates a number of "weak links" in the chain of financial management by ensuring that the vast majority of association funds are sent into the association's account without being handled by volunteers, employees, or agents. Collection policies should also discuss how unpaid accounts will be handled.

ESTABLISH A POLICY FOR SIGNATURE CONTROL



Associations should require two signatures on all reserve checks. For operating cash accounts, associations should consider requiring that two people sign all checks for non-recurring expenses or those above a certain dollar limit. Although obtaining a second signature for checks can be an inconvenience, associations should weigh the extra control and protection this procedure provides against any delays it may cause.

INSIST ON A FIDELITY BOND FOR MANAGERS AND/OR EMPLOYEES

Associations should have a fidelity bond and the manager should also have a dishonesty bond. These bonds should cover all association funds reasonably at risk. The association should also have its own fidelity bond to cover volunteers and any employees who either have access to or who handle funds. If possible, the association should add management employees and principals to the association's bond. Associations should require the agent providing the bond to provide at least 60 days' notice of cancellations or non-renewals on any bonds. The association should have its own policies and not strictly rely on the manager's.

PROHIBIT UNDISCLOSED COMPENSATION

Employment agreements and management contracts should specify that "kickbacks" or other forms of nondisclosed compensation are prohibited. Also, associations should establish in writing that any benefits, credits, discounts, or free services provided by a financial institution or contractor must benefit the association, not the management agent, employee, or individual contractor.

REQUIRE DISCLOSURE OF CONFLICTS OF INTEREST

Insist that Board members, officers, committee members, and the manager disclose any significant relationship they may have with prospective consultants, contractors, attorneys, accountants, etc. prior to retaining their services.

PURCHASE DIRECTORS & OFFICERS (D&O) LIABILITY INSURANCE

The association should provide the Board members with adequate D&O insurance to protect them against lawsuits alleging errors or omissions in the performance of their duties. But be warned, D&O insurance often excludes certain bad acts, such as discrimination.

MAINTAIN CONTROL OF ASSOCIATION DOCUMENTS AT ALL TIMES

Documents generated by the association and the manager in the course of the manager's work, as well as association books and records, are the property of the association. The Board should maintain copies of important documents for the association's permanent records.

ESTABLISH GOOD FINANCIAL PROCEDURES

The Board must ensure the safety of its financial systems by implementing effective internal control. Here are some examples of internal controls:

- ☑ Use multiple parties to handle cash, whether from assessments or from vending machines, guest fees, etc.
- ☑ Require two signatures on all checks over a certain amount or non-recurring expenses and on all reserve or investment transactions.

- ☑ Separate people approve invoices and write checks.
- ☑ The person recording receipts does not make deposits.
- ☑ Minimize cash transactions.
- ☑ Write all checks to the payee – not to "cash."
- ☑ Pay all employees and vendors with a check.
- ☑ Insist that all payments to the association are made out in the name of the association – not the manager, managing agent or Board member.
- ☑ Deposit checks directly to the association's account on a daily basis or store overnight in a fireproof safe. Reconcile bank statements monthly.
- ☑ Only use vendors with liability, fidelity and workers compensation insurances.
- ☑ Arrange for an annual audit, or at least a review or compilation. Also, obtain an engagement letter from the association's accountant that defines the work and fees.

- ☑ Conduct an annual review of all insurance policies, especially those relating to financial matters.
- ☑ Review the association's tax status and tax planning for the upcoming year with an accountant.
- ☑ Have a reserve study prepared at least periodically and annually review the adequacy of reserve funding.
- ☑ Communicate to the members the accurate financial status including reserves or lack thereof.

Guidance for Financial Management is the first in a series of HOA Guidance booklets prepared by Association Management Group (AMG) for clients of the firm and friends. It is intended to provide general information and does not constitute legal, accounting, tax or insurance advice. Specific questions should be directed to your association lawyer, accountant or insurance professional.

Compiled by:

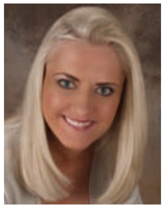
PAUL K. MENGERT, CMCA, PCAM

President and CEO Association Management Group. Faculty, Harvard Business School Alumni Program, McColl's School of Business, Queens University; National Senior Faculty Community Associations Institute.

Reviewers:

JIM SLAUGHTER

Attorney. Partner, Forman Rossabi Black, PA. Member, College of Community Association Lawyers. Certified Professional Parliamentarian and Professional Registered Parliamentarian. President, American College of Parliamentary Lawyers.



CAROLYN WOODRUFF

Attorney and Certified Public Accountant. Woodruff Law Firm, PA. Certified Valuation Analyst - National Association of Certified Valuation Analysts and Fellow of the American College of Tax Counsel.

AMG offers consistently higher quality service because of unique and proprietary systems it has developed. AMG companies manage over 250 condominiums, townhomes and planned unit developments throughout the Carolinas.

Each AMG office is an independently owned and operated company. Please consult www. AMGWorld.com or your community's Management Agreement for the name of the AMG corporation servicing your community.

Guidance for Financial Management is provided by Association Management Group as a community service and resource to its member communities. Other titles in the series include: A Guide to Parliamentary Procedure, A Guide to a Safer Home, A Guide to Collecting HOA Fees, Guide to NC Covenant Enforcement & Adjudicatory Hearings, Minute Taking Made Easy, and Selecting an Association Management Company. For a copy, please contact your account representative or visit www.AMGWorld.com.