

APPENDIX 37
AN OVERVIEW OF
ACCOUNTING STANDARDS FOR THE CIRA INDUSTRY

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1. CIRA BACKGROUND

Before 1991, uniform standards did not exist for the preparation of financial statements for Common Interest Realty Associations, known by the acronym "CIRAs". Consequently, accountants prepared financial statements in the way that each saw fit. As a result of the lack of uniform accounting principles, it was very difficult to assess the comparative financial health of associations. In 1991, in response to industry needs and after almost a decade of debate, the American Institute of Certified Public Accountants (AICPA) issued an audit and accounting guide, *Audits of Common Interest Realty Associations*, commonly referred to as the CIRA Guide. This guide had been subsequently amended with conforming changes through May 2008. Effective July 1, 2009, the accounting guidance has been incorporated into the Financial Accounting Standards Board Codification at FASB ASC 972.

FASB ASC 972 sets the accounting standards for all certified public accountants (CPAs) to utilize when preparing or reporting on financial statements of CIRAs. By definition, CIRAs include: condominium associations, homeowner associations, cooperatives, timeshare associations and planned unit developments. Unit owners, prospective unit owners and lenders are concerned about the financial health of an association. The accounting standards specify certain disclosures about common property and other mandatory disclosures which are to be included in the financial statements. In addition, they outline certain supplemental information that must be included as part of a CIRA's financial statements.

The primary unique requirement is the required supplementary information discussed below.

2. ACCOUNTING METHODOLOGY

Accounting standards make two primary recommendations related to accounting methodology. First, for all CIRAs with the exception of cooperatives, they recommend the use of fund accounting. Since CIRAs assess its members for various separate activities (e.g. daily operations, deferred maintenance, long-term major repairs and replacements, etc.), the use of fund accounting is believed to be the most informative method of presenting these separate activities. In addition, fund accounting allows a user of financial statements to determine whether assessments were used for the designated purpose.

Second, it reinforces the fact that accounting principles generally accepted in the United States of America (GAAP) require the use of the accrual basis of accounting. Under the cash basis of accounting, revenues are recognized when *received* and expenses recognized when *paid*. Under the accrual basis, revenues are recognized when *earned*, while expenses are recognized when *incurred*. Financial statements prepared using the cash basis of accounting which may differ materially from the accrual basis are not considered to be in conformity with GAAP, since they do not accurately reflect the revenues earned and expenses incurred by the association for the reporting period. Financial statements presented on an accrual

basis are particularly useful for CIRAs, which assess members based on annual budgets, because they include information about amounts payable and assessments receivable from members and thus enable the users to compare the results of operations to budgeted amounts.

3. COMMON PROPERTY DISCLOSURES

Most CIRAs, other than cooperatives, do not recognize common real property as assets on their financial statements. Based upon industry practice and as set forth in FASB ASC 972-360, most homeowner and condominium associations treat common property as follows:

- Assets that are directly associated with a unit, such as decks or driveways, are not recognized as an asset on the association's financial statements.
- Property not directly associated with the units, such as clubhouses, swimming pools, tennis courts, etc., are also usually not recognized as an asset of the association unless the CIRA can dispose of the property at the discretion of its board of directors for cash or claims to cash with the CIRA retaining the proceeds, or if that property is used to generate significant cash flows from members on the basis of usage or from non-members.
- Finally, common personal property, such as furnishings, recreational equipment, maintenance equipment vehicles, etc., that is used by the CIRA in operating, preserving, maintaining, repairing or replacing common property and providing other services usually is included as assets on the association's financial statements.

As a result, the FASB directs preparers of financial statements to ensure that the following information about a CIRA's common property be disclosed in the notes to its financial statements:

- The accounting policy for recognition and measurement of common property;
- A description of common property recognized as assets in the CIRA's balance sheet;
- A description of common property to which the CIRA has title or other evidence of ownership that is not recognized as assets in the CIRA's balance sheet;
- The CIRA's responsibility to preserve and maintain the common property;
- Terms and conditions of existing land or recreation leases;
- Restrictions on the use or disposition of the common property.

As a result of these disclosures, a reader can ascertain the accounting policy that a CIRA utilizes relative to the recognition of common property. Of greater importance, a reader can more readily ascertain what common property is part of the CIRA and is part of the Association's obligation to preserve and maintain.

4. FUTURE MAJOR REPAIRS AND REPLACEMENTS

In addition to the common property disclosures discussed above, a CIRA's financial statements are required to include information about its funding for future major repairs and replacements. Disclosures about such funding are to include the following:

- Requirements, if any, in statutes or the CIRA's documents to accumulate funds for future major repairs and replacements and the CIRA's compliance or lack of compliance with them;
- A description of the CIRA's funding policy, if any, and compliance with that policy;
- A statement that funds, if any, are being accumulated based on estimated future (or current) costs, that actual expenditures may vary from these estimates, and that the variations may be material;
- Amounts assessed for major repairs and replacements in the current period, if any.
- A statement indicating whether a study was conducted to estimate the remaining useful lives of common property components and the costs of future major repairs and replacements.

Additionally, CIRAs that fund future major repairs and replacements by special assessments or borrowings when needs occur shall also disclose that information.

Although it is not a requirement, CIRAs may also consider disclosing the type of funding plan goal that was used in the "Reserve Study" so the readers of the financial statements are able to understand the implications of the method chosen to make informed and educated decisions. The three types of non-statutory funding plans are full funding, threshold funding and baseline funding. Depending on the method used, there could be significant fluctuations in assessment levels. When the threshold method is used, the CIRA may also consider disclosing the threshold level dollar amount that is being utilized. If averaging techniques are used, CIRAs may consider disclosing that fact as well.

Another disclosure that is not a requirement that may also be considered by the CIRA is the disclosure of the level of service used to perform the “Reserve Study.” The National Reserve Study Standards include three levels of service, which are (1) Full, (2) Update, with a site-visit/on-site review, and (3) Update, without a site-visit/or an on-site review. Disclosure will let the reader know what level of service was performed, as they vary greatly in detail.

5. REQUIRED SUPPLEMENTARY INFORMATION - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The most significant requirement is the unaudited required supplementary information which must be included as part of a CIRA’s financial statements. This required supplementary information is comprised of:

- Estimates of current or future costs of future major repairs and replacements of all existing components such as roofs, including estimated amounts required, methods used to determine the costs, the basis for calculations (including assumptions, if any, about interest and inflation rates), sources used, and the dates of studies, made for this purpose, if any (There is no requirement for the CIRA to obtain studies prepared by professional engineers). The estimates may be made by the board of directors or estimates obtained from licensed engineers.
- A presentation of components to be repaired and replaced, estimates of the remaining useful lives of those components, estimates of current or future replacement costs, and amounts of funds accumulated for each component to the extent designated by the Board.
- As can be seen in the exhibit below, this information emanates from the Association's capital replacement study.

XYZ Condominium Association, Inc.

Supplementary Information on Future Major Repairs and Replacements December 31, 20XX.
(Unaudited)

The ABC Consulting Company conducted a study in November 20XX to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs.

The following table is based on the study and presents significant information about the components of common property.

Components	Estimated Remaining Useful Lives (Yrs)	Estimated Current Replacement Costs	Components of Fund Balance at Dec. 31, 20XX*
Roofs	5 to 14	\$3,023,000	\$154,000
Streets	5 to 14	179,000	57,000
Recreation facilities	2 to 11	180,000	55,000
Exterior Siding	7 to 11	1,256,000	48,000
Pools, spas, solar equipment	2 to 14	174,000	39,000
Tennis Courts	5 to 10	97,000	14,000
Furniture and Equipment	3 to 7	<u>107,000</u>	<u>12,000</u>
		\$5,016,000	\$379,000

*Optional disclosure - The amounts accumulated for each component are required to be displayed to the extent designated by the Board. If the Board has not allocated the fund balance, this information is not required and just the total fund balance can be shown.

6. AUDITOR'S PROCEDURES - REQUIRED SUPPLEMENTARY INFORMATION

The auditor should apply the following procedures to the required supplementary information:

a. Inquire of management about the methods of preparing the required supplementary information, including (i) whether it has been measured and presented in accordance with prescribed guidelines, (ii) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and (iii) whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information

b. Compare the required supplementary information for consistency with (i) management's responses to the foregoing inquiries, (ii) the basic financial statements, and (iii) other knowledge obtained during the audit of the basic financial statements

c. Obtain written representations from management (i) that it acknowledges its responsibility for the required supplementary information; (ii) about whether the required supplementary information is measured and presented in accordance with prescribed guidelines; (iii) about whether the methods of measurement or presentation have changed from those used in the prior period and, if so, the reasons for such changes; and (iv) about any significant assumptions or interpretations underlying the measurement or presentation of the required supplementary information

7. AUDITOR'S OPINION- FUTURE MAJOR REPAIRS AND REPLACEMENTS

Since the supplementary information is required to be part of every CIRA's financial statements, a reference to the required supplementary information must be made in the auditor's report. Since usually the auditor has not been engaged to audit the required supplementary information, the following would be the typical paragraph included in the auditor's report:

Accounting principles generally accepted in the United States of America require that Supplemental Information on Future Major Repairs and Replacements on page X 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 their 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.

It should be noted that the supplementary information is required even if a CIRA's governing documents and state statutes do not require the CIRA to fund systematically for future major repairs and replacements. The following is the suggested language that should be used in the circumstances where the information is not available when a study has not been prepared:

Management has omitted the Supplemental Information on Future Major Repairs and Replacements that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by the missing information.

In addition, certain circumstances may require an emphasis of matter paragraph which can be added to the auditor's opinion to draw the reader's attention to the note discussing funding for future major repairs and replacements. An emphasis of a matter paragraph rather than a discretionary paragraph is included based upon the auditor's judgment. Two illustrations of common occurrences follow:

Illustration #1 - the following illustrates a paragraph that may be added to the standard report if the board of directors decides to only partially adopt the recommendations of a study:

As more fully explained in Note X to the financial statements, the board of directors has elected to only partially adopt the funding recommendations of a study conducted to determine current estimates of major repairs and replacements required in the future.

Illustration #2 - the following illustrates a paragraph that may be added to the standard report if owners vote not to fund for major repairs and replacements:

As more fully explained in Note X to the financial statements, the majority of the unit owners voted not to fund the Association's future needs for major repairs and replacements through systematic assessments.

Below provides disclosures for situations which may be encountered relative to the quality of the required supplementary information. The following is illustrative wording to be included in the auditor's opinion for three situations:

- The supplementary information materially departs from information required by GAAP:
Accounting principles generally accepted in the United States of America require that Supplementary Information on Future Major Repairs and Replacements on page X 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. Although our opinion on the basic financial statements is not affected, the following material departures from the prescribed guidelines exist [Describe the material departures from the prescribed guidelines.] We do not express an opinion or provide any assurance on the information.
- The procedures prescribed were not completed:
Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Major Repairs and Replacements on page X 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 were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because [State the reasons.] We do not express an opinion or provide any assurance on the information.
- The auditor has unresolved doubts about the adherence of the information to the information required:
Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Major Repairs and Replacements on page X 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 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. Although our opinion on the basic financial

statements is not affected, the results of the limited procedures have raised doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by the Financial Accounting Standards Board. (The auditor may consider including in the report the reason(s) he or she was unable to resolve his or her doubts.)

It should be noted that the profession's Statements on Standards for Accounting and Review Services (SSARSs) also require that the required supplementary information accompany compiled or reviewed financial statements. When the compiled or reviewed financial statements are not accompanied by this information, a paragraph should be added to the report indicating that the information has been omitted. An example of such a paragraph follows:

Management has omitted supplementary information about Future Major Repairs and Replacements of common property that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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.

8. OTHER SUPPLEMENTARY INFORMATION

Although budget information is not a required part of the basic financial statements, many associations find the inclusion of budget information very useful because CIRAs use the budgeting process to determine the required assessments from owners. If budget information is presented, that information should be identified as supplementary and clearly marked as not covered by the independent auditor's report.

The budgets of CIRAs are the monetary expression of their goals and objectives and emphasize the stewardship responsibility of their board of directors. According to FASB Statement of Financial Accounting Concepts No. 4, Objectives of Financial Reporting by Non-Business Organizations, budgets are used to allocate and control the use of resources. Budgets are also used to obtain resources. For example, budgets are pivotal in establishing levels of maintenance assessments, as well as, allocations for replacement and deferred maintenance funding.

It is useful to present the financial statements of CIRAs in a format that is consistent with budgets and comparable with actual expenditures for the budget period. Budget to actual comparisons are useful in assessing the performance of a board of directors and/or management and to monitor the ability of CIRAs to provide acceptable levels of service.

9. IMPACT ON MARKETABILITY OF UNITS

The author of this overview believes that the adoption of uniform reporting standards as required by GAAP has some impact on the marketability of units. By allowing unit owners, potential unit owners and lenders the ability to understand and analyze the financial health of an association, we believe that this understanding translates into one of the factors that is used to evaluate the value and thus the price of a given unit.

One of the key areas that is being utilized for this valuation is the understanding of what an association is responsible for relative to replacement funding and how much has been -set aside to date. The less an Association is prepared for future costs, the more a prospective owner may be required to pay additional amounts at the time of major repair or replacement.

In addition, information regarding the Association's approach to replacement funding, together with other information contained in the financial statements, may reflect the philosophies in use relative to fiscal management. As a result, astute purchasers will take the information into account when determining the price that they would be willing to pay for a unit.