INFORMATION

TAHOE DONNER

March 15, 2018

Financial Reporting: Net Operating Results (NOR)

The purpose of this discussion is to get Board insights into the feasibility of expanding NOR so that it would also include the 1) allocation of Overhead (NRAO)and 2) related depreciation and other charges (NRAOC) and thus provide Members with a stronger perspective on amenity profitability.

Background:
Current financial management reporting presents each amenity's Net Operating Results (NOR) which is simply operating revenues less operating costs. 2004 and prior, the association's annual report was simply a glossy of the auditor's report and audited financial statements and a one page of narrative. Starting in 2005, the association's annual report was expanded to include departmental results, which is the 1st noted introduction of the term 'Net Operating Results'. Current NOR does not fully reflect the overall costs of amenities financial performance, as current NOR does not include an overhead or capital cost charge, which are both real costs of the amenities.

Operating Fund and Overhead Charge to Amenities
There are certain operating costs of the association which are operating activities that service the entire association and are accounted for as a distinct operating unit., The services are for all of the operating amenities of the association. Allocated overhead is common in management accounting, particularly in certain industries such as manufacturing, financial services and many others Through 2008, the association allocated certain of these costs ($1,440,000 in 2008) to amenities receiving the services. This was a separate cost element, and therefore was reported as Net Operating Result Before Overhead (NORBO) less Allocated Overhead = Net Operating Result (NOR). This had the effect of moving $1.4 million from HOA grouping to Amenities grouping in the financials. During 2008, the Finance Committee recommended and Board approved elimination the Allocated Overhead cost charge to amenities starting in 2009. The overhead charge was deemed to not be adding value nor influencing decision making.

One of the cited benefits of allocating overhead costs to operating departments is to assist in pricing decisions and gain a better understanding of an amenities overall contribution. Further, with amenities reporting NOR without any overhead, their respective financial results are not wholly complete, as there is no administrative departments costs (nor capital costs). Users of financials solely focused on the NOR of an amenity can mistakenly take that NOR result as the operations net all-in result, which is not the case. For the cited drawbacks of allocating overhead costs is the lack of understanding by department managers and others, as well as, the cost/benefit of calculating and reporting with reasonable accuracy.

The annual review and establishment of amounts in Budget adds some complexity to budget process.
The monthly recording of allocated overhead to budget amount is simple. If a overhead charge was reported, said would be after NOR, wherein, NOR minus Overhead Charge equates to Net Result after Overhead (NRAO). Allocating overhead is a Board decision, based on the pros and cons of adding value to decision making.

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Operating Fund and Capital/Depreciation Charge to Amenities

The cost of capital or depreciation has been generally viewed as a cost burden for all members. Capital investments benefit all members, whether participants or not in the specific amenity investment. However, by not showing a capital/depreciation charge at the amenity performance level, the amenities overall financial cost is not fairly presented.

T**he Annual Report has consistently included a capital charge** for the cost of replacement reserve funding (RR funding) by amenity/hoa operation as a reference and for information purposes. It historically has not been shown with NOR. This funding amount is greater than depreciation expense, as certain assets are fully depreciated. However, the reserve funding does not include building replacement. Further Land is not a depreciable asset. The question of rent (land and building) arises when conceptualizing a capital cost and or depreciation charge. Using the replacement reserve funding level provides consistency in analysis over time, versus actual expenditures, which can vary widely year to year.

Using the RR funding is also relevant, in that this is what drives the Annual Assessment. In other words, the Operating NOR drives Assessment operating portion, and capital funding level drives Assessment capital portion (not capital spend in the particular year). Although there would be intent to allocate depreciation from a management reporting perspective TD would not be changing the principles used in its legal accounting.
If a capital and or a depreciation charge was reported, said would be after NOR and Overhead, wherein, NOR minus Overhead and Capital/Depreciation Charge equates to Net Result after Overhead and Capital (NRAOC).

Allocating a capita/depreciation charge to amenities is a Board decision, based on the pros and cons of adding value to decision making.

Summary

Charging amenities for overhead and capital/depreciation costs adds additional financial performance and 'all-in' costs visibility for each amenity and can potentially serve as an important tool in providing the additional full 'complete picture' understanding of amenities financial performance. It may also lead to a greater pricing perspective as the total cost picture is better understood.
The next page Addendum provides certain additional overall financial accounting information regarding the association.

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Board Meeting Review Date: March 24, 2018

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ADDENDUM

Overview
The association maintains and reports its financial activities in accordance with Generally Accepted Accounting Principles (GAAP). The Association's governing documents provide certain guidelines for governing its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

Operating Fund – Used to account for financial resources available for the general operations of the Association.

Replacement Reserve Fund – Used to account for financial resources designated for the repair, restoration, replacement or maintenance of, or litigation involving repair, restoration, replacement or maintenance of, major components which the Association is obligated to repair, restore, replace or maintain and for which the replacement reserve fund was established.

New Equipment Fund – Used to account for financial resources designated for the purchase of new equipment, furnishings and fixtures.

Development Fund – Used to account for financial resources designated for use in the acquisition and enhancement of facilities, equipment and other resources.

Property Fund – Used to account for the Association's investment in its common property and equipment, and other Association real property. Accounts for the fixed assets and associated accumulated depreciation and depreciation expense.

Key Financial Reports
There are three key financial management reports produced for the Association.

1. Monthly Financials Report - comprehensive summary and detailed reports providing financial results as well as, numerous other information on a timely basis. [issued monthly via website]

2. Annual Report – a comprehensive summary report of actual financial results for the past year and includes the annual audited financials and auditor's report. [issued with May TDNews and website]

3. Budget Report – a comprehensive summary report of board approved upcoming budget year. [issued with December TDNews and website]