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Purpose: Tahoe Donner & Homeowner Association Finances Related to General Accepted Accounting Principles (GAAP)

Background: Several questions related to Tahoe Donner accounting practices and financials related to GAAP. This Information Paper address some of those questions that have surfaced from a variety of sources.

Discussion: The following information is provided to clarify questions that have been presented related to that attached 2020 budget presentation.

#1 – TDA utilizes Fund Accounting in accordance with Generally Accepted Accounting Principles (GAAP). We have for over 25 years, annually had an Independent Auditor issue a statement to that effect. Restating page 35 of G01.4 for 9-20-2019 board meeting:

Fund-based accounting, or fund accounting, is a system used by nonprofit organizations and government agencies to manage their money. Fund accounting differs in purpose from the system used in regular for-profit businesses because the goal is to maintain accountability and track how funding is used rather than monitor the profitability of a company.

Fund accounting is unique to nonprofit organizations. Most readers of commercial financial statements are not familiar with this type of accounting. As a result, fund accounting, while adding financial transparency, can be confusing to new readers of nonprofit financial statements.

http://www.calassoc-hoa.com/Homeowners-Association/Financial-Reports-Information/Accounting-Concepts-and-Principles.aspx The California Association of Homeowners Association excerpt…

> **This guide recommends fund reporting, which is commonly used by not- for-profit organizations, because the AICPA Task Force on Accounting for Common Interest Realty Associations believes that it is the most informative method of presenting these separate activities.**

#2 – Technically, both Net Operating Results (NOR) and Earnings Before Interest Taxes Depreciation Amortization (EBITDA) are non-GAAP financial measures. The Consolidated P&L's found in the audited financial statements are GAAP, as they are all in, once all funds combined.

Both NOR and EBITDA are management reporting tools. "In short, EBITDA is a moderately useful, quick-and-easy measure that is a general indicator of a company's operational results."

TDA uses the term Net Operating Results instead of Earnings ……, because prior Boards/Finance Committee thought the term more meaningful to our owners and TDA.

#3 – EBITDA specifically 'excludes' Depreciation (Capital Costs).

#4 – TDA's OPF NOR is identical to an OPF EBITDA, sans our NOR includes Income Tax Expense (B'19 $45,000).

TDA's Operating Fund NOR does exclude major expenses, which are in the Replacement Reserve Fund, per plan and Budget.

This is per Fund Accounting (which is GAAP for HOAs) and per the RRF's Policy and has been consistent over time. Also refer to #9 below.

#5 – Overhead. At a consolidated company level, NOR or EBITDA, Overhead is a moot point, nets to zero.

At an individual department level or at TDA by Fund, NOR or EBITDA may or may not include Overhead.

Overhead is not a GAAP requirement. Some companies allocate overhead to departments/funds, some do not.

Overhead is a management/Board decision. TDA has had Overhead in past, did not do so for 10 years, now it's back.

Overhead does not change the bottom-line company-wide, and not the Annual Assessment.

Currently, we are reporting department results before Overhead (NORBO) and after Overhead (NOR).

Overhead Allocation for Tahoe Donner Association includes cost of providing services to other departments/amenities operations from the following support departments: Administration, Marketing/Communications Accounting/Finance/Purchasing, Human Resources, Information Technology, Facilities Administration/Risk Management, Member Services, and Maintenance.

#6 – The 2018 Annual Report and 2019 Budget Report present Departmental results, before Capital Charge and after Capital Charge. The plan is to continue this annual reporting.

#7 – Reporting Results. Performance results are generally discussed as a 'variance to Budget', not the specific result amount. By reporting the 'variance', this provide context to performance.

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Each department budgeted result amount varies monthly, for many the budgeted results vary widely by season/month. In the year reporting, performance to budget in terms of variances.

Reporting the variance to that month's budget provides context. Overhead and Capital Charge do not vary over the course of the year, so whether we are reporting NORBO, NOR, or EBITDA…the variance to Budget is the same.

#8 – For over 45 years, Tahoe Donner capital costs have been a responsibility of all Owners (protects property values and fundamentally why all capital costs are incurred). TDA provides both perspectives, with and without capital costs, in the budget report and annual report.

#9 – Replacement Reserve Accounting – attached is PPC's accounting guide for HOA excerpt of subject.

Consistency is important, as followed by Tahoe Donner. It's a Board decision what to charge or not charge to Reserve Fund, management makes those recommendations during the budget process and throughout the years as necessary.

The Governing Docs update budgeted to RRF was a NEW thing, so consistency was not applicable. Board directed to Budget in RRF, Board change direction mid-year to charge Operating Fund.

GAAP dictates Governing Docs update to be Expensed, not Capitalized. That is how the item was budgeted - RRF, an expense. Now an expense of OPF.

#10 - The governing docs and survey in capital and our current auditors. The Board approved in 2019 Budget for these to be in Capital Funds, not Operating Fund. GAAP dictates Expense these 2 items, GAAP does not dictate what Fund to expense to. The Board approved expensing to Capital Funds. Gilbert (or other firm) has not audited 2019, as we are still in the year. Gilbert is an excellent firm with broad ranging clients, while the world of HOA accounting is quite small and not so unique in the big picture of accounting.

Prepared By: Michael Salmon, Director of Finance & Accounting 9/19/2019

Board Meeting Date: September 20, 2019

General Manager Approval: ________________________________

306 FUNDS FOR FUTURE MAJOR REPAIRS AND REPLACEMENTS

306.1 As explained in paragraph 100.3, one of the principal objectives of CIRAs is to maintain the development's common property. CIRAs may accumulate funds for future major repair and replacement of the common property through the following ways:

- Funding through periodic assessments over the estimated life of common property
- Funding through special assessments at the time a major repair or replacement of common property is needed
- Borrowing
- Seeking grants or other kinds of programs from governmental entities (such as, energy retrofits, landscape plantings, etc.)
- Seeking assistance from governmental agencies, for example, financial programs geared toward low to moderate income homeowners, are sometimes available
- A combination of those options

Accounting for Assessments and Expenses

306.2 As explained in paragraph 303.10, assessments for major repairs and replacements are reported separately from assessments for operations in the period assessed as specified in the budget. If the CIRA reports its financial positions and results of operations using fund accounting, FASB ASC 972-205-45-2 also requires amounts assessed for future major repairs and replacements to be reported in a separate fund. Some CIRAs, however, also segregate expenses for repairs and replacements if they fund those costs through special assessments since the excess of special assessments over costs incurred may be refunded to members. (For tax purposes, capital and noncapital items must be accounted for separately. See the discussion at paragraph 308.38.) As discussed beginning in paragraph 501.11, under certain circumstances, assessments collected for specific repairs are not includable in the CIRA's taxable income; rather they are treated as contributions of capital for *tax* purposes. For *financial reporting*, however, the assessments are recorded as revenue. In those cases, a permanent difference between financial and tax reporting is created since the assessments will never be reported as income in the CIRA's tax return, and deferred income taxes are not required.

306.3 The types of expenses that are appropriately charged against assessments for future major repairs and replacements and, thus, replacement fund expenses, vary among CIRAs. Generally, however, they consist of the following:

- Direct costs incurred for repairing or replacing the common property, including wages if the repairs are made with association personnel
- Indirect costs related to maintaining the common property, including insurance and the costs of litigating warranty claims against builders or developers
- Allocated costs, such as income taxes
- Any other repair and replacement costs contemplated by the reserve study.

The principal decision to charge the replacement fund or the operating (or other) fund for certain expenses is governed by state statutes or the CIRA's board (or members, as state law dictates) when they adopt the CIRA's annual budget. Provided budgeted amounts do not conflict with provisions of the CIRA's governing documents, reserve study, and state statutes, the authors believe that expenses should be reported in the fund in which they were budgeted. However, the authors recommend that CIRAs adopt a consistent policy for charging expenses to particular funds so that operating results of the funds will be comparable from year to year. Having a formal policy for determining replacement fund items is especially important since CIRAs often change reserve study preparers and should seek a consistent method of determining what is included in the reserve study. In the authors' opinion, expenses incurred during the year that have not been budgeted should be reported in the fund that most closely relates to the nature of the expense. Occasionally uncertainty may exist over the allocation of expenditures between operating and reserve. Because of the fiduciary duty that CIRAs have over replacement fund monies, when such situations arise, the CIRA's board of directors generally is involved in making those decisions.

306.4 Reporting common property acquisitions that are purchased with replacement funds is discussed in paragraph 306.12.

Interfund Transactions

306.5 If the CIRA uses fund accounting, interfund receivables and payables are recognized between the operating, replacement, and any other funds when one fund pays amounts that are proper expenses of another fund. For example, if the operating fund pays expenses for replacing the heating system, the operating fund would record a receivable from the replacement fund, and the replacement fund would record the expense and a payable to the operating fund. Interfund receivables and payables also may result from collections of assessments or interest income earned by one fund but not transferred to another fund. The AICPA guide provides the following example in Paragraph 4.09:

> A CIRA's budget includes an annual assessment of $80,000 for future major repairs and replacements, which is reported as revenue of the replacement fund. However, due to an unexpected increase in operating costs, the CIRA's board of directors transferred only $50,000 of the $80,000 to the replacement fund. Under these circumstances, the CIRA's financial statements should reflect $30,000 as a receivable from the operating fund and as a payable to the replacement fund.

Thus, using replacement funds for operations would not result in a reduction of revenue in the replacement fund. In other words, amounts assessed for replacement funds as indicated in the budget should be recorded as revenue even if the cash transfer has not occurred. The following entries should be made:

Replacement Fund

Cash	$ 50,000	
Due from Operating Fund	30,000	
Member assessments		$ 80,000

Operating Fund

Cash	$ 30,000	
Due to Replacement Fund		$ 30,000

306.6 FASB ASC 972-205-45-10 states that interfund borrowings should be considered permanent and recorded as transfers when the borrowing fund is not able or does not intend to repay the loan. Thus, in the preceding example, if the operating fund does not intend to repay the $30,000 to the replacement fund, the following entries should be recorded:

Replacement Fund

Transfer to Operating Fund	$ 30,000	
Due from Operating Fund		$ 30,000

Operating Fund

Due to Replacement Fund	$ 30,000	
Transfer from Replacement Fund		$ 30,000