What is an Audit and When Should an Association Consider Having One?

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Picture this: You just bought the last unit in a newly developed condominium association from that fancy developer that's been advertising on the radio. Recently, the developer has turned over control of your association to a board of directors made up of unit owners. You're a friendly person, and you've just been asked to serve on the board of directors. However, the developer just dropped off five boxes of financial records going back to when the first condominium unit was purchased three years ago. You've seen the last set of financial statements that the developer provided, but how do you know that the developer turned over all of the association's cash? Did the Association pay for any expenditures that were for other communities being built by the developer? Uh-oh… w*hat to do??*

Or maybe you're involved with this scenario: You serve on your association's board of directors, and recently your association has changed management providers. You feel refreshed by this, and are more confident that now your association can move forward and operate more effectively. However, you've seen the current financial statements, and you're not quite sure that all financial activity has been reported. Other board members share these concerns. You've heard them muttering and you've caught the word "audit" in their conversations. *What to do??*

The first thing to realize is that the responsibility for an association's financial statements belongs to the board of directors. It is the board's responsibility to issue financial statements, even if a management company is utilized to prepare the actual statements. If a third-party prepares the financial statements, it is the responsibility of the board of directors to review the financial statements, and to make decisions based on the statements.

A board may feel the time has come to have an audit done. Perhaps one was never done in the past, and the board is looking to rectify this. Or maybe a bank or other third-party is requesting the association have an audit. From time to time, it may be necessary for an association to have its financial statements prepared or audited by an independent accountant. Perform research and select a public accounting firm that is experienced in the association industry. They have the knowledge and understanding of all of the unique traits of associations, and are skilled at issuing financial statements and reports tailored to associations.

An annual audit of an association's financial statements is a high level of service that an accountant provides. An audit requires additional procedures that are not mandated in the performance of a review or compilation. An audit involves testing of transactions and balances, communication with third-parties, an understanding of internal controls, and other procedures. The conclusion and objective of an audit is to issue an opinion as to whether the association's financial statements are free from material misstatement, and are presented fairly, not that every single line on the financial statements is perfect.

Annual reviews and compilations are the middle- and lower levels of accounting services, respectively. At the conclusion of a review, the accountants state whether the financial statements are in need of significant adjustments in order to be in conformity with accounting principles generally accepted in the United States of America. No opinion is expressed on the financial statements as a whole. A compilation involves very limited procedures, and simply presents the association's financial statements, without the expression of any opinions or assurance on the financial statements. Reviews and compilations are less costly alternatives to annual audits.

When determining what type of year-end accounting services an association should have performed by a public accountant, the following should be considered:

- **Does the Association have a bank loan?** Some banks demand an annual audit or an annual review every year as part of the loan requirements. If an Association has a bank loan, it should check with the bank or the loan documents to determine if a specific report or level of accounting is required. Failure to provide the correct type of report may lead to additional loan fees, recalling of a loan, or other actions.
- **Management transition** – If an association changed management companies during the year, it may decide to obtain a higher level of accounting service to ensure that all bank accounts were transferred over and that homeowner and other account balances were properly recorded.
- **Developer turnover** – It is important to have an audit when control is being transferred from the developer to the unit owners of the Association. The audit will cover the initial operating period from inception (date of the first unit closing) through the date of turnover from the developer. A turnover audit will focus on initial capital contributions, assessment calculation, and any developer responsibilities. Obtaining an audit from day one helps an association begin with accurate financial balances.

What's needed for an audit?

Let's assume that in the examples provided at the start of this article, the associations felt that an audit was necessary. The boards shopped around and selected a public accounting firm that specializes in the industry, and who was highly recommended by their attorney.

The auditor will usually provide a list of items they will need in order to begin the audit. It is most efficient to the auditor to have all of the information provided up front, at the same time. Information commonly requested for an annual audit includes the following:

- Financial statements, check registers, and detailed general ledger reports
- Bank statements and reconciliations
- Paid and unpaid bills
- Deposit documentation
- Budget
- Loan statements, loan draws, and loan agreement documents
- Minutes for all board meetings that occurred
- Contracts and insurance policies
- Declaration and any amendments
- Reserve study, if one was done

- Details of any lawsuits or legal disputes
- Details of any insurance claims

If the auditor is to perform a turnover audit, the CPA may also request the following items:

- List of closings on all units from inception forward
- List of monthly assessments for all units from inception forward
- List of any payments made by the developer to the association
- Transition study, if one was performed
- Details of any issues or concerns the board may have with the developer

Let's assume that your association didn't just turn over from the developer, or change management companies, but rather that a few board members had concerns about the financial statements. Maybe something "just didn't seem right," or owners had doubts about management's financial procedures and practices. What are a few warning signs that might indicate it might be time for an independent accountant to perform some level of accounting services on your association's financial statements?

Perhaps the association has a construction loan note for a major project, but the loan is not reported anywhere on the financial statements. This could be an indicator that not only the bank loan liability, but related expenditures are missing from the association's financial reports.

Perhaps the association hasn't reviewed or updated its signature cards on all of its bank accounts in a few years, or a former board member who has since moved away was responsible for monitoring the reserve bank accounts. It may be time to confirm that all of the association's money is in possession and properly accounted for on the financial statements.

Perhaps the association's bank accounts haven't been reconciled in months, or the reconciliations have been prepared, but there are various deposits in transit and outstanding checks that were present on the reconciliation reports for more than a year. The cash balances as reported on the financial statements might be significantly misstated.

Perhaps the association has high delinquencies, or various delinquent receivable accounts on their books for former owners who moved away years ago.

Perhaps the association's declaration has a cost-sharing agreement that calls for a specific calculation of various expenditures to be charged to and collected from other entities.

All of the above are examples of instances where it might be time to have an independent accountant take a look at the association's financial statements and perform some level of service, be it a compilation, review, audit, or other agreed-upon procedures.

Other Benefits to Having an Audit Done

Many auditors in the association industry may provide recommendations, where they discuss opportunities to strengthen controls and procedures, or to better the financial reporting process. If an association has an audit performed, not only will they receive the actual audit report, but they may also have an opportunity to discuss any recommendations the auditor may have. The board of directors would do well to consider any and all recommendations suggested by their auditor.

It is significant to note that the financial controls and success of the Association's operations are the responsibility of the Association. Most importantly, the Association should have a good set of on-going internal controls and oversight in place. There should be a system of checks and balances in place and accountability by those with financial responsibilities. The best oversight is more than one set of eyes reviewing everything. A good working relationship between the board and the association's accountant can assist the Association in understanding the different levels of accounting services and which is right for your association.