



QUARTERLY
NEWSLETTER OF
WILKIN &
GUTTENPLAN, P.C.

Community Property Advisor

VOLUME 26
ISSUE 1
WINTER 2012



this issue

Why Don't My Financial Statements Agree? P.1

A Primer on Bankruptcy P.2

News from the Firm P.3

Why Don't My Financial Statements Agree?

*The differences between internally generated
and audited financial statements*

by Amanda Brady, CPA

Most associations have financial statements prepared on a monthly basis by either their managing agent or, if self-managed, by an internal employee. In either case for this article, we will use the term "management" for the preparer of the internally generated financial statements. The purpose of these financial statements is to provide timely information about an association's financial position such as, cash balances, unit owner assessments receivable, and payables owed. They are also meant to provide information on actual vs. budgeted monthly and year-to-date revenues and expenses. Internally generated financial statements enable the board of directors to make sound financial decisions on an ongoing basis. On an annual basis, these financial statements are audited by your accountant which at times results in a set of financial statements with significant differences. The financial statements may differ for a variety of reasons including the timing of the audit, management's method of accounting, circumstances arising after year end or standards placed on an auditor that are not required of internally generated financial statements. The purpose of this article is to provide board members and property managers

with a deeper understanding of these differences.

Recording Accruals

An accountant generally audits the records of an association approximately six to ten weeks after the year end. The start of the audit is usually dependent on when the managing agent has closed the books and records of the association and when they are ready for the auditor to perform the audit. The increased amount of time enables the accountant to obtain information from management and the board that was not available at the time internally generated financial statements were prepared. The association often receives invoices such as utility bills, or late December snow clearing bills in mid- or late January. Often internally generated financial statements will be finalized before these invoices are received from the vendor and therefore have not been recorded in the financial statements prepared by management. An auditor typically examines check registers and unpaid invoices for the period after year end and will include accruals for those expenses which relate to the year under audit.

Wilkin &
Guttenplan, P.C.

certified public accountants
and consultants

1200 Tices Lane
East Brunswick, NJ 08816

T 732.846.3000

F 732.846.0618

www.wgcpas.com

(Continued on page 2)

Financial Statements *(cont. from page 1)*

Resolution of Items

There are many instances where the increased amount of time provides additional valuable information, especially as it pertains to the resolution of open items. When examining the estimated allowance for doubtful accounts, an auditor will examine the balance owed by a unit owner several weeks after year end, compared to management who will base their estimate on the owner assessment receivable balances as of the association's year end. If a unit owner has paid their balance subsequent to year end, the audit will reflect a lower estimated allowance. Another example may be an association that is in negotiations with a vendor due to disputed invoice amounts. These negotiations may not be settled at year end, however, by the time an association's books are audited the dispute may be settled resulting in the auditor making an adjustment for a check that was voided after year end, or increasing or reducing an accrual that was booked. As the saying goes, "hindsight is 20/20," and your auditor has an advantage based on the increased amount of time to examine the records.

Accounting Method

At times differences arise due to a difference in the accounting method used by management compared to the basis of accounting used to prepare your audited financial statements. There are circumstances where an association's books are maintained on a cash or modified cash basis. Audited financial statements must be prepared on an accrual basis, to be in accordance with generally accepted accounting principles (GAAP). Therefore, a difference in the accounting method used requires the auditor to propose various journal entries in order to present the financial statements appropriately on an accrual basis.

Auditors' Opinion

One important item of note that you will not receive in your internally generated financial statements is the auditor's

opinion. The objective of an audit is the expression of an opinion about whether the association's financial statements are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. The auditor's opinion is the first item that can be found in your audited financial statements and explains which statements were audited, the period being audited, a general explanation of the work performed and most importantly, the auditor's opinion indicating whether your financial statements are presented fairly, in all material respects.

GAAP Requirements

GAAP also requires the auditor to ensure that items are included that are generally not included in internally generated financial statements. Some of the items include a statement of cash flows, statement of changes in fund balances, footnote disclosures and a summary of the replacement fund study. We'll discuss some of these below.

A significant requirement of GAAP is footnote disclosures. These disclosures are required in an effort to ensure that users of the financial statements are properly informed. Typical disclosures would include a description of the association, a summary of significant accounting policies, a description of the method used to prepare the association's tax return, any contingencies that may exist and subsequent events. The description of the association will include the number of units in the association, the types of amenities within the community and the location of the association. The significant accounting policies of an association will include the types of funds the association has, along with a description of the purpose of each fund.

Footnote disclosures are also designed to inform the users of financial statements about items that may or may not occur, for example, if your association is being sued for damages, the audited financial statements would include information on

that lawsuit and it would be identified as a contingency. The disclosure would be based on the information known at the time the financial statements are prepared. An auditor is also required to ensure that information about events happening after the association's year end are included if they are deemed to have a financial impact. This would include items such as a special assessment, a substantial insurance claim or refinancing of association debt.

Replacement Fund Disclosures

In New Jersey, most condominium and homeowner associations are required by their governing documents to set aside monies for future major repairs and replacements of the common elements. The monies earmarked for the replacement fund is often the association's most significant asset. An association's audited financial statements must include numerous disclosures about the replacement fund. In general, associations set aside monies in the replacement fund based on a study performed by an engineer. The statements are required to disclose who performed the study and the date that the study was prepared. Additionally, since there are numerous methods of funding for the future major repairs and replacements of the common elements, the audited financial statements often will disclose the method of funding used by the association. The financial statements are required to include a summary of the replacement fund study that includes the components that are being funded through the replacement fund, the estimated remaining useful lives of those components (at the time the study was prepared) and the estimated future replacement cost of those components. In short, this allows readers to assess where an association is relative to funding for future major repairs and replacements and what an association will ultimately need.

(Continued on page 3)

A Primer on Bankruptcy by Hubert C. Cutolo, Esq.

In the current economic climate, common interest communities are finding that many unit owners are experiencing financial distress. In that regard, some unit owners cannot meet their financial obligations and, as a result, those unit owners are seeking relief under the Bankruptcy Code. Generally, the types of relief that a unit owner may seek under the Bankruptcy Code are either a Chapter 7 bankruptcy or a Chapter 13 bankruptcy.

A Chapter 7 bankruptcy is a liquidation proceeding. The person filing the bankruptcy petition (i.e. the petitioner) surrenders control over all of his/her assets to a bankruptcy trustee. The petitioner's assets are referred to as the bankruptcy estate. Thereafter, the bankruptcy trustee converts the bankruptcy estate to currency and distributes said currency to all of the petitioner's creditors on a prorated basis. Significantly, the petitioner in a Chapter 7 bankruptcy would receive a discharge of all dischargeable debts incurred prior to the date of the bankruptcy filing ("*Pre-petition debt*"). It takes only a few months after the Chapter 7 bankruptcy filing for a petitioner to receive a discharge of all *Pre-petition* debt by the bankruptcy Court.

A Chapter 13 bankruptcy is a reorganization of the petitioner's *Pre-petition debt*. A petitioner would elect to file a Chapter 13 bankruptcy in the event he/she sought to keep certain assets that would be not be exempt from distribution by the bankruptcy trustee to creditors in a Chapter 7 bankruptcy. For example, the petitioner may elect to keep his/her home outside of the bankruptcy estate by filing a Chapter 13 bankruptcy. (A Chapter 7 bankruptcy would ordinarily require the home to be liquidated so that the proceeds can be distributed to the petitioner's creditors.) The petitioner would then be

required to remit reduced payments pursuant to a plan to all creditors named in the Chapter 13 petition on a prorated basis (the "Chapter 13 Plan") if the Court ratifies the Chapter 13 Plan. The Chapter 13 Plan's duration can either be three (3) or five (5) years.

In the common interest community context, a unit owner who files a Chapter 7 bankruptcy or Chapter 13 bankruptcy remains responsible for his/her customary monthly assessments, special assessments, late fees and other charges that are incurred after the date of filing the respective bankruptcy. See 11 U.S.C. 523 (a)(16). The United States Bankruptcy Code states in pertinent part:

(a) A discharge under section 727...does not discharge an individual debt for any debt...

(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or in a homeowners association, for as long as the debtor or the trustee has legal, equitable or possessory ownership interest in such unit, such corporation or lot.

[11 U.S.C. 523 (a)(16)]

Filing a bankruptcy petition does not extinguish the petitioner's legal, equitable or possessory ownership interest in the unit. However, once a petitioner files either a Chapter 7 or Chapter 13 bankruptcy, all creditors must cease any and all collection activities, including but not limited to, recording liens against the petitioner's property. A common interest

(Continued on page 4)

Financial Statements (cont. from page 2)

Conclusion

While there are numerous differences between audited financial statements when compared to internally generated financial statements, they both provide valuable information to the intended users. Without internally generated financial statements it would be difficult for a board to run their association efficiently and effectively on a day to day basis.

However, the audited financial statements provide an independent opinion on the financial statements as well as significant replacement and footnote disclosures explaining the financial statements.

Amanda Brady, CPA is a manager at Wilkin & Guttenplan, P.C. She can be reached at 732-846-3000 or abrady@wgcpas.com

News from the Firm

Employee Anniversaries

5 Years

Lauren Landolfi

11 Years

Mohammed Salyani

12 Years

Patty Hernandez

13 Years

Amanda Brady
Len Nitti

15 Years

Brian Geissler
Bill McDevitt

19 Years

Carol Koransky

24 Years

Kristine Flores

25 Years

Michael LoVerde

26 Years

Sefi Silverstein

Way to Go!

Congratulations to Jessica Chelkowski on passing the CPA exam!

This publication is prepared quarterly by Wilkin & Guttenplan, P.C. For further information, you may contact Avery Quayle at aquayle@wgcpas.com.

Information contained in this publication should not be construed as accounting advice. It is not intended, and should not be used, as a substitute for consultation with an accounting professional.

©2011 Wilkin & Guttenplan, P.C.



Bankruptcy (cont. from page 3)

community may commence collection action contingent upon one of the following: (i) after the Chapter 7 bankruptcy is discharged; (ii) after the Chapter 13 Plan expires; (iii) at any time after the bankruptcy Court dismissed the bankruptcy filing; or (iv) by leave of the bankruptcy Court. Common interest communities may only seek arrears that are incurred after the filing date of the bankruptcy (“*Post-petition debt*”), provided that the bankruptcy filing was not dismissed by the bankruptcy Court. In the event the bankruptcy Court dismissed the bankruptcy filing, the petitioner will be liable for all *Pre-petition debt* and *Post-petition debt*.

Occasionally, a petitioner will dispute his/her legal, equitable or possessory ownership interest in the unit by claiming that the unit was abandoned pursuant to 11 U.S.C. 554 during the bankruptcy, thereby extinguishing his/her liability for *Post-petition debt*. Importantly, abandonment in the bankruptcy context means the unit is abandoned as part of the bankruptcy estate because the unit is “of inconsequential value and benefit to the estate.” See 11 U.S.C. 554. By way of example, if the petitioner’s mortgage exceeds the value of unit then the

bankruptcy Court or bankruptcy trustee may abandon the unit. In that regard, the bankruptcy trustee would not be able to convert the unit to currency as the unit would be underwater, i.e. of no value to the creditors. Stated differently, the petitioner remains the owner of record of the unit, and is liable for *Post-petition debt*.

Common interest communities should be aware the implications of any unit owner filing a Chapter 7 bankruptcy and Chapter 13 bankruptcy. *Post-petition debt* owed to the associations is so unique and important that in many cases it is deemed non-dischargeable. See 11 U.S.C. 523(a)(16). We suggest that if your association has any questions concerning the implications of bankruptcy that it consult its counsel concerning same. If your association learns about a bankruptcy filing by a debtor, it should immediately notify its counsel and halt all collection activities.

Hubert Cutolo, Esq. is a member of the Cutolo Law Firm, LLC. He can be reached at 732-414-1170 or hcutolo@cutololaw.com.

Upcoming Issues

- Allocating Federal Taxes to the Replacement Fund
- W&G Financial Survey for Community Associations



Wilkin & Guttenplan P.C.

Certified Public Accountants and Consultants

1200 Tices Lane
East Brunswick, NJ 08816
732.846.3000 ph
732.846.0618 fax
www.wgcpas.com

PRST STD
U.S. POSTAGE PAID
NEW BRUNSWICK, NJ
PERMIT NO. 16021