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Is Your Payroll Under Control?

By Carol Koransky, CPA, MBA

For many cooperatives and high rise condominium associations who employ concierge, maintenance and other service workers, payroll is frequently their largest single expense. Since this expense could create financial exposure for an Association, it is advisable that the Association have certain controls in place to reduce that possibility. What follows is a discussion of the three main aspects of payroll controls:

- Separation of duties
- Proper authorization of staff and procedures for payroll processing and changes
- Report and documentation reviews/reconciliations.

Separation of Duties

Although it may seem obvious to separate the duties of employees so that no one individual has complete control, or access over the entire payroll process, it doesn't always happen in practice. To ensure proper separation of duties, at a minimum, we recommend:

- Separate the responsibilities of preparing the payroll from other personnel duties such as timekeeping, distribution of checks, and hiring employees. This includes restricting the preparer's access to other payroll data or cash accounts

- A separate payroll checking account should be used whenever possible. Transfers to the payroll account should be monitored and agree with the payroll reports.

Proper Authorization of Staff and Procedures for Payroll Processing and Changes

There should be adequate authorization, approval, and documentation procedures regarding establishment or changes in payroll records related to:

- Employment—additions and terminations
 - Require and retain copies of government-issued documents from new hires
 - Maintain a weekly count of the number of people on payroll. Compare the number of payroll checks to that number.
- Salary and wage rates, and amounts of payroll deductions
 - Payroll rates should only be changed by an authorized individual
 - Require documentation of supervisory approval for changes in wage rates
 - Require supervisory approval for changes in amounts of payroll deductions.
- Vacation, holiday, and sick leave compensation.



Association Surpluses, Deficits and Working Capital

By Edward Guttenplan, CPA, MBA

When discussing surpluses, deficits and working capital, an Association's budget can serve as a frame of reference.

Despite an Association's best efforts to use effective long-term planning and prudence in developing a budget, the reality is that a budget is an educated guess. In a perfect world, an Association's revenues and expenses would precisely mirror the budget. However, in the real world an Association's operations inevitably generate a surplus or a deficit.

Accordingly, underlying causes of a deficit in a given year must be well-understood by the Board, so it can take action to prevent a magnification of the financial impact on the Association in the year(s) following the occurrence of the surplus or deficit. However, there are circumstances where deficits or surpluses are planned. (Note: This article is focused on the Operating Fund's surpluses and deficits-rather than the deferred maintenance or replacement funds.)

With this in mind, this article will provide some guidance to help Boards understand surpluses and deficits in greater detail by exploring the following concepts:

- Working Capital
- Role of Working Capital Funds
- Approaches to Deficit Reduction/Elimination
- Opportunities Created by a Surplus
- Circumstances of Controlled Associations and Developer-Subsidized Deficits
- Tax Implications of Surpluses and Deficits.

Working Capital

The long-established practice in CIRA budgeting is that an Association needs to fund the peaks and valleys in its cash flow; typically, this is through the use of working capital. Most Associations target approximately two months of expenses for working capital. This is typically funded by

Working Capital fund contributions, Accumulated Surpluses or a combination of both.

There are several reasons why Associations require working capital, including:

- Accumulating funds to pay vendors on a timely basis
- Providing a "cushion" against the potential for adverse impacts of the seasonal nature of cash flows or expenses (e.g., a large insurance bill)
- Funding unanticipated major expenses, i.e. excessive snow clearing, etc.
- Keeping maintenance fees level over time.

Role of Working Capital Funds

It is crucial that Board Members understand the permitted uses of working capital funds as delineated by the Association's governing documents. It is generally unwise to use working capital to offset an operating deficit, unless there is substantially more than two months of expenses in the Association's working capital account. Such a strategy is not usually in the best long-term financial interest of the Association.

The Association's accumulation and use of working capital funds beyond the typical two month's expenses should be dictated by the Community's governing documents and operating needs, but I would also suggest that Associations consult with their attorney, as well as, review their policies and governing documents to ensure they are following the law's intent.

Approaches to Deficit Reduction/Elimination

The first thing a Board must do in addressing a deficit is to understand why the deficit occurred. This can help the Board prevent a recurrence of the deficit while considering approaches to reduce or eliminate it, including:

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Association Surpluses, Deficits and Working Capital *(continued from page 2)*

- Budget a surplus in the subsequent year. If the deficit is significant, create a multi-year plan to reflect annual budgeted surpluses to address the deficit. The Board should also ensure that no additions to the deficit are incurred.
- Consider a special assessment. This may be appropriate for unusual circumstances, such as severe winters with substantially greater than average snowfall.

Whatever approach the Board uses, they should solve the budget issue which created the deficit, while also implementing a plan to eliminate it.

Opportunities Created by a Surplus

One possibility for the use of a surplus is to return it to the unit owners. I would recommend against this. If the surplus is consistent with the forecasted budget, then the Board should use the surplus in the manner anticipated by the budget. Other approaches include:

- Spread the surplus out over several years to mitigate otherwise necessary maintenance fee increases
- Leave it untouched until a compelling need emerges
- Budget the use of the surplus in a future year as an allocation to another fund, such as the replacement or deferred maintenance fund.

Circumstances of Controlled Associations and Developer-Subsidized Deficits

Before the transition from developer to unit owner control, there should not be a deficit. If the

developer is subsidizing the deficit, the Association will likely struggle without surplus funds, and may actually find itself short of cash, while awaiting payments from the developer.

In these situations, working capital funds can be useful in helping the Association fund their obligations until unit owners assume control of the community and the Association begins to accumulate the funds it needs to sustain itself. Additionally, the Board should ensure that reserves are funded during the period of developer control, because this may be the only source of cash available to the Association, especially if the budget is being subsidized to eliminate a deficit.

Tax Implications of Surpluses and Deficits

A detailed discussion of the tax implications of surpluses and deficits is beyond the scope of this article. However, in general, a key tax issue relates to whether the Association files a Form 1120 or an 1120H. Associations that file a Form 1120 must be cognizant of a surplus when trying to use the 15% tax rate. I urge individual Associations to consult their tax advisors for guidance related to their own specific situation.

Conclusion

It's essential that an Association Board understand the reason for a surplus or deficit. The Board should address the surplus or deficit through a careful budgeting process. An important corollary is to "know your documents." They often contain important guidelines for the use of working capital.



NEWS AT THE FIRM

EMPLOYEE ANNIVERSARIES (April – June)

24 years
21 years

Gary Rosen
Sara Gierloff

APPOINTMENTS, COMMITTEES, PRESENTATIONS, PUBLICATIONS...

NJBiz named Wilkin & Guttenplan, P.C. one of the **Best Places to Work in New Jersey** for the fourth year in a row.



Is Your Payroll Under Control? *(continued from page 1)*

Report and Documentation Reviews/Reconciliations

Even when the preceding safeguards are implemented, their effectiveness can be limited, if payroll records and documentation are not reviewed or reconciled by a designated management representative. We recommend:

- Regardless of whether payroll is processed internally or externally
 - Procedures be established and followed to ensure that the time records submitted for processing are complete and accurate and the payroll register produced agrees with the time records submitted
 - Payroll registers be reconciled to control totals, and approved by the manager, or if appropriate, a board member
- Periodically, paychecks should be physically distributed to the employees to ensure paychecks are only issued to legitimate employees

- Variations in weekly payroll should be reviewed to determine what caused the differences; those attributable to overtime should be supported by properly authorized overtime forms
- Total disbursements for paychecks and/or direct deposits should reconcile with payroll registers to ensure all payroll has been properly reported.

The preceding outline of effective payroll controls is a starting point. Using these and other relevant procedures, Associations can help minimize the potential for financial exposure.

UPCOMING ISSUES:

- **Tax Law Change for Cooperatives**
- **Considerations in Becoming or Being a Board Member**

This publication is prepared quarterly by Wilkin & Guttenplan, P.C. For further information or for complimentary copies or subscriptions, you may contact Jules C. Frankel at:

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