1992

Comment letters on proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations

American Institute of Certified Public Accountants. Accounting and Review Services Committee

December 17, 1992 File Ref. No. 2000

To the Accounting and Review Services Committee:

Re: Exposure Draft of proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations

Here are the additional comment letters received to date on the proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations. You should have already received letters 1 through 3 in a previous mailing.

	Name/Affiliation	Location
1.	Jerry E. Serlin Arthur Andersen & Co.	Chicago, IL
2.	Edward J. Leonard, CPA Christopher, Smith, Gentile, Leonard & Shinn, P.A.	Bradenton, FL
3.	Gary Waltrip, CPA Allen & Co.	San Jose, CA
4.	James R. Eggert, CPA Kieliszak, Eggert & Co.	Providence, RI
5.	Delbert M. Goehner, CPA	Pasadena, CA
6.	Bill Chaffee, CEO Advanced Reserves Management, Inc.	Del Mar, CA

Sincerely,

Judith

Judith Sherinsky
Technical Manager
Auditing Standards Division

JS/ls
Attachments

(1

ARTHUR ANDERSEN & CO.

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602
(312) 580-0069

November 5, 1992

Ms. Judith M. Sherinsky
Technical Manager
Auditing Standards Division
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Judith:

The following are my brief comments on the exposure draft of the proposed SOP, "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations:"

- As an editorial suggestion only, the second sentence in paragraph 2 that begins "That information includes -" should read "That information consists of" since the word "includes" infers that there is more required supplemental information than that contained in the two bullets that follow.

- Secondly, while we may have discussed this point during one or more committee meetings, I can't recall whether we specifically addressed the need for the SOP to cover the situations described in c. and d. in paragraph 7.39 of the CIRA audit guide in the context of a compilation or review. Those situations are (a) when the accountant is unable to complete the required (compilation) procedures and (b) when the accountant is unable to remove "substantial doubts about whether the supplementary information conforms to prescribed guidelines." I would suspect that these situations seldom arise in practice so we can probably live without addressing them in the SOP, but perhaps you should confirm this with Dan and one or more of the current Committee members.

If you have any questions Judith, please don't hesitate to call.

Very truly yours,

Jerry

Jerry E. Serlin

MT/1109w

(2)

Christopher,
Smith, Gentile,
Leonard &
Shinn, P.A.

November 18, 1992

Judith M. Sherinsky
Technical Manager
Auditing Standards Division, File 2000
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

I agree with the reasons and issuance of the proposed Statement of Position (SOP) "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations". I would like to take this opportunity to make the following suggestion for rewording paragraph 6.

> The American Institute of Certified Public Accountants has determined that supplementary information about future major repairs and replacements of common property is required to supplement the basic financial statements. The Association has not presented this supplementary information which is not a part of the basic financial statements.

If you have any questions concerning this response, please do not hesitate to contact me.

Sincerely,

CHRISTOPHER, SMITH, GENTILE,
LEONARD & SHINN, P.A.

Edward Leonard

Edward J. Leonard, C.P.A.

EJL:dm

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November 24, 1992

Ms. Judith M. Sherinsky, Technical Manager
Auditing Standards Division, File 2000
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

RE: EXPOSURE DRAFT - PROPOSED SUPPLEMENT TO AICPA AUDIT AND ACCOUNTING GUIDE, *COMMON INTEREST REALTY ASSOCIATIONS*

Ladies and Gentlemen:

My accounting firm, Allen & Cook, Inc., performs audits and reviews of approximately 200 CIRAs of all types -- condominiums and townhouse projects, housing cooperatives, and commercial condominiums. In addition, I am President of the Executive Council of Homeowners, a nonprofit educational organization with 814 homeowner association (CIRA) members. I am therefore particularly qualified to address the Auditing Standards Division on the proposed supplement to the CIRA Guide.

The exposure draft would require that the accountant, at a minimum, compile the required unaudited supplementary information described in the Audit and Accounting Guide for Common Interest Realty Associations. However, the supplementary information required is in the nature of a *budget, forecast or projection*. It is our understanding that such presentations are specifically excluded from the scope and authority of the Accounting and Review Services Committee (ARSC), who were limited to *unaudited financial statements of a nonpublic entity*. Projections and forecasts are not "financial statements" for purposes of SSARS (AU 100.04). Therefore, the ARSC has no authority to be issuing this proposed supplement to the Guide.

The required CIRA supplementary information is derived from sources outside the accounting records. If it is to be addressed by auditing standards, then it should be considered nonaccounting data for which a disclaimer of opinion is appropriate under existing guidelines. If it is to be governed by those professional standards that specifically address projected or forecasted information, the auditor's report should address the required procedures stipulated by the CIRA Guide, as it is more closely akin to the "agreed upon procedures" for forecasted information described in that body of standards.

The requirements of the CIRA Guide, as written, appear adequate and are not misleading. For that and reasons explained above, we hereby formally oppose the proposed Statement of Position.

Very truly yours,

Gary Waltrip

Gary Waltrip, CPA
Allen & Cook, Inc.

KIELISZAK, EGGERT & COMPANY
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December 7, 1992

Ms. Judith M. Sherinsky
Auditing Standards Division, File 2000
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

On behalf of the Accounting, Auditing and Practice Review Committee of the Rhode Island Society of CPA's, we fully concur with the proposed Statement of Position (SOP) "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations" dated October 26, 1992.

Issuance of this SOP will provide the necessary authoritative guidance on accountants' responsibilities for reporting on required supplementary information which accompanies reviewed or compiled financial statements of common interest realty associations.

Very truly yours,

James R. Eggert, Chairperson

cc: Raymond Church
Executive Director, Rhode Island Society of CPA's

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Delbert M.
Goehner
Accountancy Corporation

December 10, 1992

Judith M. Sherinsky, Technical Manager

Auditing Standards Division, File 2000
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1211 Avenue of the Americas
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RE: Proposed Statement of Position
Reporting on Required Supplementary Information
Accompanying Compiled or Reviewed Financial
Statements of Common Interest Realty Associations

I have read the exposure draft of the proposed SOP and have several concerns.

While the title indicates reporting on both compilation and review engagements, the document cops out when it comes to review engagements and makes reference toAT section 100. I have been unable to find enough guidance in that section to determine what work is needed to meet the review requirements as regards the required information. It appears that this is not prospective financial information, but just what is it?

It seems that the list of steps leading to a compilation are more extensive than those for the financials, but what is meant by (d) in paragraph #3?

Paragraph # 4 implies that the inclusion of this supplementary information in the scope paragraph is not allowed---i.e., "... indicate in an additional paragraph of the report, or in a separate report,...". The Compilation and Review Alert-1992, included in the December issue of the CPA LETTER contains an example on page 9 of a compilation report that sticks to the basic two paragraph report and that meets the SSARS #1 criteria for reporting on supplemental information. Paragraph #4 seems to imply that CIRAs must be treated differently!

In my search of Section AT 100, paragraphs 40 to42 and 56 thru 58 seem to be applicable--but I am still at a loss as to what needs to be done to review the supplemental information, and what form the report will take. The labelling of the report paragraph in paragraph # 4 implies that this is only for compilations--but it seems to be necessary only on review engagements when the supplemental information is not reviewed.

Sincerely,

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Advanced Reserves Management, Inc.

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December 9, 1992

Ms. Judith M. Sherinsky
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1211 Avenue of the Americas
New York, New York 10036-8775

Dear Judith,

I am forwarding my comments and suggestions on the Proposed Statement of Position, "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations". Some of the problems with the Proposed Statement of Position are inherent from the CIRA Audit and Accounting Guide itself. Included you will find a combination interpretation and editorial I have prepared of the Guide relating to the "Future Major Repairs and Replacements" (or Reserve) issues. Some the areas which I feel need addressing are as follows:

1) Inconsistencies which can exist from one HOAs financial statement presentation to anothers, due to different methods of calculating for Future Major Repairs and Replacements. The different methods require different presentations and the results of these methods can be materially different by as much as 50%.

2) Identification of the methods in the Guide, would solve point one. The Auditor could then disclose the method being used, which the user of the financial statements would then understand.

3) "Certain limited procedures" of the required supplementary information needs to be addressed. The procedures appear to be audit procedures. If the are audit procedures and the auditor has performed work, he can not disclaim his or hers opinion which the Guide is directing the Auditor to do.

4) Chapter 3 of the Guide has been written as background knowledge for the Auditor on Future Major Repairs and Replacements. But in this chapter is also guidance to follow in performing an audit. It appears difficult to determine what is background knowledge and what is guidance. If information in this chapter is determined to be guidance opposed background knowledge, the Auditor might feel a need to increase the scope of work to satisfy he or she of the financial position of the CIRA which might or might not be necessary.

These are the main areas which need to be addressed. There are other minor items in the Guide interpretation. I have also included an article I have written explaining the different reserve calculation methods which will give some background information.

Problems that appear in the SOP, besides the inherent problems from the Guide, mainly focus around a lack of separation between a compilation and a review. These are both very different engagements, but the direction in the SOP is commingled which will cause confusion. There are other minor issues which are included in my comments.

My main concern for the Guide and SOP is the confusion that still exists relating to Future Major Repairs and Replacements and the other issues addressed, by Auditors. The intent of the Task Force has not been successfully communicated to the Auditors. The Auditors are forming many different interpretations of the Guide which is represented through articles and seminars, which is not spreading the intent of the Task Force. I have had many long educational conversations with Joel Tannenbaum and now feel I have a pretty good idea of what the intent of the Guide is suppose to be, but I am probably one of the few who does. It would be helpful if my suggestion were considered for inclusion in the Guide as well as determining the unresolved areas which I have addressed.

I appreciate your time and consideration in reviewing my comments. I hope to hear from someone that these areas will either be addressed or not, so as to further my own education. If there are any questions about my comments please do not hesitate to call me.

Sincerely yours,

Bill Chaffee

Bill Chaffee
CEO

INTERPRETATION OF THE CIRA GUIDE RELATING TO RESERVE ISSUES

by
Bill Chaffee
November 3, 1992

INTRODUCTION:

After years of research by an AICPA Task Force, the first AICPA Audit and Accounting Guide for the related areas of common interest developments was produced. The AICPA Audit and Accounting Guide for "Common Interest Realty Associations" (the equivalent of California's "common interest development" terminology) was issued as of August 31, 1991. The intent of the Guide is to present recommendations by the Task Force on the application of generally accepted auditing standards to audits of financial statements of Common Interest Realty Associations (CIRAs). The Guide presents descriptions of financial accounting and reporting principles and practices of CIRAs.

The most important element this guide will offer is a means of consistency on how CIRAs are presented financially. Until the issuance of the Guide, there was no direction on how CIRAs should present themselves financially except for generic generally accepted accounting principles (GAAP) guidelines. Due to the uniqueness of CIRAs and numerous interpretations of GAAP (when relating to CIRAs) by individual Certified Public Accounts, very different financial presentations and results are produced, which could be significant even if auditing identical information.

Since the issuance of the guide the Certified Public Accountants (CPAs) have shifted their interpretation of GAAP when relating to CIRAs, to interpretation of the Guide (which in some areas sets GAAP). There appears to be confusion by CPAs as they become familiar with the new requirements and guidelines of where their responsibility starts and ends and how financial statements and additional information presentations should be produced and presented in the basic financial statements. Under optimum situations the CPA would not normally produce the financial statements and the accompanying notes, this should be ultimately the responsibility of the CIRA. While this is such a new area of reporting based upon the Guide, the CPA has been in a position of educating the CIRAs and their board of directors.

When reporting on financial statements, the AICPA guidelines are recognized by all of the United States. This is the first significant step in addressing the issue of Reserves (referred to in the Guide as "Future Major Repairs and Replacements") on a national level. Until the issuance of the Guide very few states have addressed the issue of Reserves relating to common interest developments. In a round about way the AICPA and CPAs are introducing the area of Reserves and related Reserve studies of common interest developments to the states which have yet to deal with Reserves.*

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* It should be noted that no where in the Guide is the word "Reserves" utilized. The Guide states on page 11 in a footnote, "The fund is commonly referred to as a "reserve fund" in the legal documents of CIRAs and in the industry. The term reserves is not used in the guide because different meanings are attached to it, and misinterpretations could result." So, the word "Funds" is used.

The real problem arises with the individual states which are forming their own legislation on requirements of how to calculate and account for Reserves and how they should be presented, hence setting their own criteria and internal controls. The Guide does not give direction or guidelines on how to calculate Reserves or the related assumptions, but does give guidelines on how to present Reserve related information in the basic financial statements and in the related supplementary information. It is unfortunate that the Task Force did not elect the responsibility and go one step further in producing guidelines in regards to how to calculate reserves. This would have saved a tremendous amount of time, confusion and frustration as individual states will now have to deal with this issue. Consistency in the presentation of Reserves from one CIRA to another will not exist and it will be difficult for the users of the financial statements to be aware of this situation. Hopefully this need will become apparent and future guidelines will be made available to all states, if not by the AICPA, maybe through CAI National or the Federal government.

FUTURE MAJOR REPAIRS AND REPLACEMENT:

While the Guide deals with many areas of CIRAs, Future Major Repairs and Replacement will be the main focus of this document. Topics of discussion will relate to the CPAs / Auditors objectives and responsibility in issuing audited financial statements for CIRAs.

In Chapter 4 of the Guide, "Financial Statement Presentation", the Guide outlines the presentation requirements of financial statements, notes to the financial statements and required supplementary information which are to exist in the "full presentation" (being the financial statements, notes to the financial statements and required supplementary information and the Auditors report or opinion). The financial statements will include a balance sheet, statement of revenue and expenses, statement of changes in fund balances and a statement of cash flows. Notes to the financial statements are primarily disclosures on the CIRAs legal form, tax filing status, governing documents, policies, explanation of the financial statements themselves, etc. Required supplementary information which is required in a CIRA audit relates to data for Future Major Repairs and Replacements. After the complete report is produced the auditor is then able to perform his or hers audit procedures. *

Chapter 7 of the Guide, "Audit Considerations", provides guidance on audit procedures that apply specifically to audits of CIRAs. These procedures should be considered in addition to the audit procedures customarily performed in audits of financial statements. The Auditor is responsible for following the Guide in performing an audit.

FINANCIAL STATEMENTS:

The presentation of the historical Reserve activity in the financial statements, being the balance sheets, statements of revenues and expenses, changes in fund balances and the statement of cash flows are basically standard and easy to understand and follow based upon the examples in the appendix: Exhibits 1.1, 1.2, 1.3 and 1.3A.

Paragraph 4.20 under the section, "Accompanying Information" states:

> " CIRA's records usually contain more details than are necessary to present financial statements in conformity with GAAP. Consequently, the financial statements may include accompanying information that is not required but may be meaningful to users."

Paragraph 4.21 proceeds with:

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* The proper procedure is that the financial statements, the accompanying notes and any required additional information is to be prepared by the CIRA and presented in finished form to the Auditor, who will then perform his or her audit. More often than not, this is not the case. The Auditor more often than not will audit the CIRA's records and then compile the complete report . There is sometimes a question of the Auditor's independence. That is if the Auditor prepared the full presentation, is he or she auditing their own work.

"A CIRA's financial statements may be accompanied by a schedule analyzing the CIRA's program for major repairs and replacements. That schedule may present beginning balances, additions, expenditures, and ending balances of funds for future major repairs and replacements by individual categories of common property."

Exhibit 1.6 of appendix A illustrates paragraph 4.21 as follows:

XYZ Condominium Association, Inc.
Schedules of Changes in Replacement Fund Balances
for the Year Ended December 31, 19X2

Common Area Component	Beginning Fund Balance	Addition to Fund	Funding Requirements	Components of Ending Fund Balance
Roofs	$96,000	$202,000	$144,000	$154,000
Streets	17,000	44,000	4,000	57,000
Recreation facilities	50,000	10,000	5,000	55,000
Exterior siding	38,000	104,000	94,000	48,000
Pools, spas, solar equip.	8,000	36,000	5,000	39,000
Tennis courts	4,000	10,000		14,000
Furniture and equipment	12,000			
Lawsuit legal fees		10,000	10,000	12,000
Total	$225,000	$416,000	$262,000	$379,000

The above exhibit presents the "Common Area Components" and the related "Beginning Fund Balance" and "Additions to Fund". The allocation of the beginning fund balance per paragraph 4.30 (the second bullet), will be determined as "amounts of funds accumulated for each [component] to the extent designated by the board". This is a completely arbitrary allocation, not for just the beginning fund balance but also for additions to funds. Charges to funds is an actual number which can be audited and the ending fund balance is simply added across. The only numbers with any validity are actual charges to the fund, while the other numbers can be manipulated for any desired presentation. This is not an auditable schedule (being only a schedule to the financial statements) and it is questionable if it should be presented with the financial statements, or even presented in the supplementary information.

The Auditor might ask him or herself the question, if paragraph 4.21 says, "A CIRA's financial statements may be accompanied by a schedule analyzing the CIRA's program for major repairs and replacements", and a statement as the one presented in Exhibit 1.6 is included with the financial statements, that wouldn't this statement have to be audited? A third party reading the basic financial statements could surely come to the conclusion that the statement was audited. Also in the statement, "analyzing the CIRA's program", indicates how is the CIRA doing something. The statement illustrated in Exhibit 1.6 is to be historical data and should be audited as so. It is unclear what direction the Auditor is receiving from the Guide, or if the Guide understands this type of information. At a minimum, it should be marked "unaudited" with a note explaining that the allocations are arbritrary.

The basis of this statement indicates that funds are being segregated by component and it could be construed that funding requirements are being calculated by component (which also becomes apparent in Exhibit 1.7 of appendix A, which is discussed in this document in the Required Supplementary Information section). If the Guide is requiring that accumulated funds are to be presented per each component, then there is a question if the Guide is inferring to the type of method that should be used for calculating the Reserve contribution. The "Segregated" method, which is the type of presentation being reflected in Exhibit 1.6 and 1.7 for calculating Reserves, was probably the original method conceived. More effective and accurate methods have been derived. These methods are termed as Pooling and Cash Flow, which are becoming increasingly popular due to there ability to project that funds will be available when needed and to avoid the possibility of over funding by owners. It is not clear if the Guide is attempting to direct how the calculations are to be made, and this is probably not the intent. Consideration should be given in the Guide of explaining the different methods and their individual presentations. These funding methods can produce different results by as much as 30% to 50%. The Auditor should be advised to disclose the method which was used in calculating the reserves. This would give the users of the financial statements the ability to draw conclusions based on the methods actually used. Additional discussion on this subject matter will continue in this document in the Required Supplementary Information section.

NOTES TO THE FINANCIAL STATEMENTS:

Common interest developments (CIDs) governing documents in the State of California are know as the "Covenant, Conditions and Restrictions" (CC&Rs). These documents should contain policy pertaining to how the CID should deal with Reserves. What are the policies for accumulating reserve funds, how often should a reserve study be done, etc. In the State of California, Civil Codes exist which can override the existing CC&Rs if specified policy does not exist or if the Civil Code imposes more stringent standards than the existing CC&Rs. More often than not this is the case. Since the first Civil Codes relating to reserves were enacted in 1983, CC&Rs in CIDs formed prior to 1983 usually do not reflect any documentation regarding Reserves, as well as most CIDs formed after 1983. It usually takes a large majority of owner votes to amend CC&Rs, so Reserve policy is not likely to be added to the CC&Rs.

Per paragraph 7.29 of the Guide, it is the Auditors responsibility to review and disclose certain information relating to Reserves in the CC&Rs (termed as "CIRA documents" in the Guide). It is also his or hers responsibility to be knowledgeable with current Civil Codes and state statues, due to the fact these codes can override existing CID documents. An Auditor would have to be knowledgeable of overriding legislation which might exist in a given state where the audit is taking place. As per paragraph 4.26 of the Guide, the Auditors should address the following areas:

"A CIRA should disclose information in its financial statements about its funding for future major repairs and replacements. Disclosures about such funding should include the following:

- Requirements, if any, in statutes or the CIRA's documents to accumulate funds for future major repairs and replacements and the CIRA's compliance or lack of compliance with them

- A description of the CIRA's funding policy, if any, and compliance with that policy

- A statement that funds, if any, are being accumulated based on estimated future (or current) costs, that actual expenditures may vary from these estimates, and that the variations may be material

- Amounts assessed for major repairs and replacements in the current period, if any

- A statement indicating whether a study was conducted to estimate the remaining useful lives and the costs of future major repairs and replacements

CIRAs that fund future major repairs and replacements by special assessments or borrowings when needs occur should disclose that information."

The Guide continues to state in paragraph 4.27 as follows:

"If the disclosure about a CIRA's funding for major repairs and replacements required by paragraph 4.26 of this guide is absent or inadequate, the auditor should consider modifying his or her report as discussed in SAS No. 58, Reports on Audited Financial Statements."

The auditor is required to modify the report based upon insufficient disclosures of paragraph 4.26 of the Guide. This could possibly be not acceptable per the CID's CC&Rs or by the board, which might invoke certain actions or remedy of such a situtation or in the case of future reports.

It is only the Auditors responsibility to review and disclose the items noted in paragraph 4.26 of the Guide. The Auditor is not stating or issuing comments or giving assurance that:

- requirements to accumulate funds for major repairs and replacements are adequate or sufficient, only if the CID is in compliance or not abiding by governing documents, state statutes or the CC&Rs.

- the funding policy is adequate, only that the CID is in compliance with CIDs funding policy.

- amounts assessed for major repairs and replacements in the current period are sufficient or not.

- if there was a Reserve study conducted, is the study accurate based upon the information contained.

The Guide is basically taking the position that it is not the Auditor's responsibility to perform audit procedures and state sufficiency or adequacy of the items in paragraph 4.26 of the Guide. The Auditor's responsibility is only to state what exists and whether the CIRA is in compliance.

The Guide gives recommendations in paragraphs 4.28 and 4.29 on disclosures in regards to what is basically a Reserve study, if one has been performed or not performed. These disclosures are based on the following:

- The CIRA elects to only partially adopt the study's recommendations.

- The board of directors has conducted a study to estimate future expenditures for major repairs and replacements. Unit owners have decided not to fund those needs currently.

- The CIRA has not conducted a study to estimate the remaining useful lives and the costs of future major repairs and replacements of the common property that will be required in the future.

In paragraph 4.28, it refers to Note 4 of exhibit 1.4 in appendix A, which gives notes to the financial statements examples. These examples actually quote funding requirements from the supplementary information. To quote these funding requirements in the basic financial statements indicates these figures have been audited, when they have not. It seems contradictory to refer to supplementary information which has been disclaimed and then make presentations of this information in the notes to the basic financial statements.

The items in paragraph 4.26 of the Guide could be construed as projecting certain events in the future. These situations could be interpreted that Reserve funds will be available when needed. The Auditor walks a fine line that it is his or hers responsibility to disclose findings but not take a position on those findings (findings being situations or policies which would hinder or prohibit the CIRA for accumulating sufficient funds for future major repairs and replacements when they would be need). To do so would lend comfort to the areas in paragraph 4.26 of the Guide, which might indicate that policies related to Reserve funding will assure that sufficient funds will be available when needed in the future. An Auditor reports on financial statements are after the date of those financial statements, which means they issue reports and opinions based upon historical data and not on forecasts and projections. In normally audited financial statements Auditors do not issue an opinion on forecasts or projections which is part of the objective of a Reserve study. Audits or opinions on forecasts and projections are a completely different type of engagement from a historical data audit, with different types of scope, disclosures, opinions and disclaimers.

Finally the objective of the Auditor, in regards to Reserve related notes to the financial statements, is to review and disclose findings on Reserve policy and whether the CIRA is in compliance. The Auditor is not to form any opinions on the adequacy of the policy which could indicate comfort or assurance.

This analysis or interpretation on the "notes to the financial statements" relating to Reserves, which are an integral part to the financial statements, to this point have been on Chapter 4 of the Guide, "Financial Statement Presentation", and paragraphs 7.29, 7.30 and 7.34 through 7.37, of Chapter 7 of the Guide, "Audit Considerations". Paragraphs, 7.29 and 7.30, are the only two paragraphs in

Chapter 7 which give any guidelines or direction for audit consideration on notes to the financial statements relating to future major repairs and replacements or Reserves. Paragraphs 7.22 or 7.23 might be considered which deal with budgets and state that, "Budget information for unexpired periods is considered to be Prospective Financial Information, Financial Forecasts and Projections".

REQUIRED SUPPLEMENTARY INFORMATION:

Required supplementary information is not standard in all industries audited reports. Industries can be very unique and different. Specific industries reporting formats are adapted and additional information is needed to have a better understanding of the financial position and reporting of an entity in that industry. CIRAs are in the category of being unique and different. Paragraph 4.30 of the Guide states what is required supplementary information for the CIRA industry as follows:

"CIRAs should disclose the following as unaudited supplementary information:

- Estimates of current or future costs of future major repairs and replacements of all existing components, such as roofs, including estimated amounts required, methods used to determine the costs, the basis for calculations (including assumptions, if any, about interest and inflation rates), sources used, and the dates of studies, made for this purpose, if any. *

- A presentation of components to be repaired and replaced, estimates of the remaining useful lives of those components, estimates of current or future replacement costs, and amounts of funds accumulated for each to the extent designated by the board."

The unaudited supplementary information described above is the basic data that is found in a Reserve study. The Guide does not dictate that estimated costs must be presented in either current or future cost, but that it is the CIRA's choice to present costs in either basis. In regards to basis of calculation, the related assumptions are to be disclosed, if any, plus if interest or inflation rates have been considered. Once again the Guide is not stating that interest or inflation (time value of money factors) need be considered in the calculation. The Guide is requiring that the supplementary information be presented for each Reserve component and that the information be detailed by each Reserve component as follows:

- Reserve component description

- Estimate of the remaining useful life

- Estimate of current or future replacement cost

- Estimated funding requirements for the following year

* "There is no requirement for CIRAs to obtain studies prepared by professional engineers. Estimates made by the board of directors or estimates obtained from licensed contractors are satisfactory, as discussed in paragraphs 3.06 and 3.07 of the guide."

- Amount of funds accumulated as designated by the board

As per paragraph 4.31 of the Guide, Exhibit 1.7 of appendix A, contains two sample alternative presentations in regards to the required supplementary information requirements above. Alternative A illustrates unaudited supplementary disclosure based on a study conducted by the board of directors about the estimates of current costs of major repairs and replacements. Alternative A is shown below:

XYZ Condominium Association, Inc.
Supplementary Information on Future Major Repairs and Replacements
December 31, 19X2
(Unaudited)

Alternative A

The board of directors conducted a study in November 19X2 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were obtained from licensed contractors who inspected the property.
The following table is based on the study and presents significant information about the components of common property.

Components	Estimated Remaining Useful Lives (Years)	Estimated Current Replacement Costs	19X3 Funding Requirements	Components of Fund Balance at Dec. 31, 19X2
Roofs	5 to 14	$1,620,000	$120,000	$154,000
Streets	5 to 14	96,000	40,000	57,000
Recreation facilities	2 to 11	120,000	12,000	55,000
Exterior siding	7 to 11	760,000	72,000	48,000
Pools, spas, solar equip.	2 to 14	112,000	36,000	39,000
Tennis courts	5 to 10	64,000	10,000	14,000
Furniture and equipment	3 to 7	80,000	12,000	12,000
		$2,852,000	$302,000	$379,000

Alternative B illustrates unaudited supplementary disclosure based on a study conducted by a consulting firm about the estimates of future costs of major repairs and replacements. Alternative B is shown below:

XYZ Condominium Association, Inc.
Supplementary Information on Future Major Repairs and Replacements
December 31, 19X2
(Unaudited)

Alternative B

The ABC Consulting Company conducted a study in November 19X2 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on future estimated replacement costs. Funding requirements consider an annual inflation rate of 5 percent and interest of 8 percent, net of taxes, on amounts funded for future major repairs and replacements.
The following table is based on the study and presents significant information about the components of common property.

Components	Estimated Remaining Useful Lives (Years)	Estimated Future Replacement Costs	19X3 Funding Requirements	Components of Fund Balance at Dec. 31, 19X2
Roofs	5 to 14	$3,023,000	$152,000	$154,000
Streets	5 to 14	179,000	46,000	57,000
Recreation facilities	2 to 11	180,000	15,000	55,000
Exterior siding	7 to 11	1,256,000	93,000	48,000
Pools, spas, solar equip.	2 to 14	174,000	42,000	39,000
Tennis courts	5 to 10	97,000	12,000	14,000
Furniture and equipment	3 to 7	107,000	14,000	12,000
		$5,016,000	$374,000	$379,000

The Guide does not say these are the only acceptable presentation formats, but that the above information must be presented. The above illustrations present highlighted totals of the individual components. It is obvious based upon ranges presented for estimated remaining useful lives, that there must be numerous items having these individual descriptions. This would indicate there is supportive detail which would back up the highlighted totals presented.

As already stated in this document in the section, Financial Statements, Exhibits 1.6 and 1.7 indicate that funds are being segregated by component. Exhibit 1.7 presents that funding is also calculated by each component on a Segregated method. There are proven downfalls to the Segregated method that based on how accumulated funds are allocated to each component, this will affect the outcome of the funding requirement. Based upon different component allocations of accumulated funds, different amounts of component funding requirements will be derived. This is not the case if the Pooling and Cash Flow methods are utilized. In these methods an overall contribution for all the components is calculated and the sufficiency of the contribution is proven through a cash flow projection. If it is not the intent of the Guide to dictate funding methods, then consideration of these other methods should be addressed. These methods are an integral part of the CIRA and should be part of the CIRA's policies. If Pooling or Cash Flow methods are utilized, then their presentations would be much different than what is being presented in Exhibits 1.6 and 1.7. It should be noted that the Pooling and Cash Flow methods can be utilized and once calculated the results can be manipulated to be presented in the formats illustrated in Exhibits 1.6 and 1.7. But, this would truly be a cosmetic presentation and serve no real purpose, only to meet what appears to be required by the Guide or to meet state statues if any have been adopted of this nature. Once again, it would be advised if the different methods were presented in the Guide, then the Auditor could disclose the method being used.

The Guide goes on to say in paragraph 4.31, that an additional explanatory paragraph would have to be added to the auditor's report if the information in Alternative A or B above is not presented. The information is required even if a CIRA's governing documents and state statutes do not require the CIRA to fund systematically for future major repairs and replacements (as stated in paragraph 7.40). In addition paragraph 4.31 states that additional explanatory paragraphs would need to be added to the auditor's report in the event any of the following situations occurred:

- That information materially departs from information required in paragraph 4.30 of the guide.
- The procedures prescribed in paragraph 7.31 (stated below) of the guide were not completed.
- The auditor has unresolved doubts about the adherence of the information to the information required in paragraph 4.30 of the guide.

Paragraph 7.39 expands on paragraph 4.31 above, and is some what redundant as follows:

> "Since supplementary information is not audited and is not a required part of the basic financial statements, the auditor need not add an explanatory paragraph to his or her report on the audited financial statements to refer to the supplementary information or to his or her limited procedures, except in the following circumstances:
>
> a. The required supplementary information is omitted.
>
> b. The auditor has concluded that the measurement or presentation of the supplementary information departs materially from prescribed guidelines.
>
> c. The auditor is unable to complete the procedures prescribed in paragraph 7.31.
>
> d. The auditor is unable to remove substantial doubts about whether the supplementary information conforms to prescribed guidelines."

"Unaudited supplementary information" means that no audit procedures have been performed on the information and that the information will be separated from the audited basic financial statements and marked as so. Also a disclaimer will be included in the Auditor's opinion in regards to this information.

Per paragraph 7.38 of the Guide:

> "SAS No. 29, states that the auditor should disclaim an opinion on information accompanying the basic financial statements in an auditor-submitted document unless he or she has been engaged to examine and express and opinion on it. Thus, unless the auditor has been engaged to examine it, the auditor is required to disclaim an opinion on the supplementary information required by paragraph 4.30 of the guide whenever it is included in an auditor-submitted document. The following is an example of a disclaimer that an auditor might use in conjunction with the presentation of that supplementary information outside the basic financial statements in an auditor-submitted document:
>
> > The [identify the supplementary information] on page XX is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it."

This states there is a clear division of the basic financial statements and the supplementary information. Once again, as already discussed, selected information is being presented in the basic financial statements. The Auditor must perform some procedures to satisfy he or she, whether the CIRA is in compliance with the three situations in paragraph 4.31 and 7.39 or that an additional explanatory paragraph is necessary. Paragraph 7.31 of the Guide, outlines what type of procedures should be performed on the required supplementary information as follows:

> "The auditor should apply certain limited procedures to the required supplementary information discussed in paragraph 4.30 of the guide. Specifically, procedures that the auditor should consider include the following:
>
> - Determine by physical inspection of the property or review of the CIRA's legal documents whether the disclosure includes all major property components.
> - Compare estimates of the costs of major repairs and replacements with current period expenditures and with the annual budget, if any.
> - Inquire of management about whether the CIRA's property maintenance records, which reflect each component's replacement history, if any were considered in determining the information to be disclosed.
> - Inquire of management about whether the age and condition of the components were considered in determining the information and amounts to be disclosed.

- Check the mathematical accuracy of amounts disclosed.

- Inquire of management about whether the study was prepared by the board or a professional engineer and whether the methods and bases for estimating the amounts disclosed are documented. Consider whether those methods and bases are reasonable. If the study was conducted by the board, consider whether the source of the information used to estimate the useful lives and current or future repair and replacement costs, for example, bids from contractors or technical manuals on useful lives of various components are reasonable."

It is apparent that the limited procedures described above in paragraph 7.31 can be interpreted as questionable and repetitive, and as to what is the actual intent. It has and can be argued what constitutes "audit procedures" when compared "certain limited procedures". The procedures being required here are:

- Physical inspections

- Comparisons

- Inquiries of management

- Checking mathematical accuracy

- Test of reasonableness methods and bases

- Vouching of lives and costs based on bids and technical manuals

Paragraph 7.38 says in the sample disclaimer, "We have applied certain limited procedures, which consisted principally of inquires of management...". It is obvious that the procedures consist of more than just "inquiries of management".

Usually, a distinction can be made between "audit procedures" and "certain limited procedures." But once again the Auditor might find this difficult, walking a fine line of not performing sufficient limited procedures, or if performing to many procedures. If performing to many procedures, the Auditor might cross the line as to performing audit procedures. It appears the solution the Auditor is being asked to follow is that once limited procedures have been performed and material exceptions have been found in reference to the Guide, then he or she has satisfied themselves that inclusion of an additional explanatory paragraph will be necessary. If the Auditor continues to pursue to resolve the issue, the Auditor might be stepping over the line by performing procedures which could be construed as audit procedures. The Auditor might form an opinion at this point which might now have to be disclosed. If audit procedures have been performed, it must be disclosed along with those findings. The Auditor can not just disclaim and relieve he or she from future exposure or liability if procedures have been performed. At a minimum, assurances and comfort should be given or disclosure to the procedures performed along with the results of those procedures.

By addition of an explanatory paragraph, the opinion of the basic financial statements are not to be interpreted as being affected or qualified. This may seem confusing or contradictory being that this information is required but may not be presented or disclosed properly per the Guide.

Based upon paragraph 7.31 the Auditor must make certain decisions on how to perform the limited procedures described. The following might be considerations of some of the decisions and issues the Auditor could confront:

- Based upon on the CIRA's documents, the CC&Rs, usually being out dated, it might be considered not advised as to not rely on these documents and do a physical inspection of the property.

- Usually major repairs and replacements are categorized as so, that these activities happen to have a minimum of a couple year life, and more likely between five to fifteen year lives between repairs and replacements. This being so, the Auditor will usually not be able to compare cost estimates with current period expenditures. More than likely, the Auditor might consider the procedures in the last point of paragraph 7.31 which might be more appropriate.

- Consideration to determine whether detailed information will be necessary which supports highlighted totals for satisfaction on the mathematical accuracy of amounts disclosed.

- Consideration of procedures that will be needed to gauge whether management, the board, or an outside professional prepared the reserve study and the methods and bases used for estimating the amounts disclosed.

- How to consider whether the methods and bases used are reasonable.

Based on these decisions and issues above, the most difficult area the Auditor has to deal with is how "to consider whether those methods and bases are reasonable." What does this actually mean and to what extent should the Auditor perform procedures to satisfy him or herself?

Paragraph 3.01 of the Guide says, "A CIRA's primary duties are to maintain and preserve the common property. Because the costs of maintaining and preserving common property are shared by all owners, it is the CIRA's duty to decide how to "fund" the cost of future major repairs and replacements." "Fund" in this context can be construed as a plan, via forecasts and projections, for the future.

Paragraph 3.04 of the Guide says, " To implement a policy to accumulate funds for major repairs and replacements, a CIRA's board of directors often needs to educate owners about the benefits of accumulating such funds in advance through periodic assessments and to understand that the systematic accumulation of funds is -

a. A means of assuring that funds for major repairs and replacements will be available when needed.

b. An equitable method of charging current rather than future owners with the cost of the current use of assets.

c. A means of preserving the market value of individual units or shares."

If the board is responsible for setting policy, then policy must be the basis for the methods and bases for estimating the amounts disclosed and documented. So if policy should have intent as "a means of assuring that funds for major repairs and replacements will be available when needed", then is the Auditor required to satisfy himself of points a., b. and c. in paragraph 3.04?

It should be noted that Chapter 3 of the Guide is difficult for the Auditor to decipher. The information included in Chapter 3 is to give the background information on CIRAs and guidance in performing an audit. What is difficult to determine is what is background information and what is guidance? If the information is construed as guidance by the Auditor, then the previous paragraph might become reality in Auditor's reasoning of his or hers objectives.

As stated before in paragraph 7.40, the Guide says, "The information (per Exhibit 1.7 of appendix A) is required even if a CIRA's governing documents and statutes do not require the CIRA to fund systematically for future major repairs and replacements." If the information (per Exhibit 1.7 of appendix A) is required, which is basically the information derived from a Reserve study, then a Reserve study is being required by the Guide. By also requiring that this information be presented even if the CIRA does not fund systematically for future major repairs and replacements, the Guide is also implying that CIRAs have to adopt a policy and fund systematically.

It can be construed that where the Guide was taking a position of review and disclose, it is actually mandating if an unqualified opinion is to be issued without additional paragraphs relating to supplementary information, the CIRA will have to abide by the criteria in the previous paragraph. It also appears that the Guide may have pushed the Auditor over the fine line by having to consider whether those methods and bases are reasonable. The problem now becomes how does the Auditor satisfy himself of reasonableness? And by doing so would he or she be giving assurance to the methods, which would lend comfort as to whether current and projected contributions are adequate, and that funds for major repairs and replacements will be available when needed for the CIRA.

This opens the discussion if the Auditor, through certain limited procedures, finds that the methods for funding may be inadequate and that funds might not be available when needed, then what is his or hers responsibility? The issue might be interpreted as a going concern per SAS No. 59. But this is probably not applicable due to CIRAs having the ability to special assess their owners when there are shortfalls. The situation would have to be disclosed and with what plan the board would probably propose to remedy the situation. The subject of this paragraph is not addressed by the Guide.

Due to the unique nature of CIRAs, and what is stated in paragraph 3.01 and 3.04 of the Guide, future major repairs and replacements are a very integral substance of the CIRA itself. It appears very difficult to draw a line between the basic financial statements and the required supplementary information. If, per paragraph 4.01:

"As discussed in chapter 1 of the guide, CIRAs conduct and report on two primary kinds of activities: (a) the CIRA's normal maintenance and service operations, such as gardening, management, snow removal, minor repairs, and janitorial services, and (b) the CIRA's long-term major repair and replacement requirements, such as roof replacements, street resurfacing, and painting."

it doesn't seem appropriate that the items in (b) above, be addressed or required in supplementary information and not be an integral part of the basic financial statements.

Being that CIRAs are so unique, Reserve study information which is integral to the long-term condition, quality and existence of CIRAs, need assurances as to their current and future adequacy. It would seem easier to address the area of Reserves by performing procedures per the AICPA Statement on Standards for Accountants' Services on Prospective Financial Information, Financial Forecasts and Projections, than trying to divide the audit into two distinct parts.

In essence, Reserve studies provide budgets and forecasts through cash flow projections. Budget information is addressed in Chapter 7, "Audit Considerations", paragraphs 7.21 to 7.23. In paragraph 7.22 it states:

"Budget information for unexpired periods is considered to be prospective financial information and should be reported on in accordance with the AICPA's Statement on Standards for Accountants' Services on Prospective Financial Information, Financial Forecasts and Projections. Budget information for unexpired periods that accompanies audited financial statements in an auditor-submitted document should be reported on as described in SAS No. 29. Because such information is generally not susceptible to auditing procedures, it is usually necessary for the auditor to disclaim an opinion on such information."

It states above "generally not susceptible to auditing procedures." Consideration should be made whether this information should be made susceptible to auditing procedures for CIRAs. Paragraph 7.22 finishes with:

If such information is included in a client-prepared document that contains audited financial statements, the auditor should refer to SAS No. 8, Other Information in Documents Containing Audited Financial Statements. SAS No. 8 requires that, at a minimum, the auditor read such other information to determine whether the information and the manner in which it is presented are consistent with information in the financial statements."

Once again the Auditor is asked to perform some procedures to satisfy he or she that information presented is consistent with the information in the financial statements.

It should also be noted that paragraph 7.23 states:

"If an accountant assists a CIRA in preparing its budget, he or she may be required to report on the budget."

The above is sometimes the case, that the CPA / Auditor assists in this area. The CPA / Auditor will have to consider additional guidelines. It should be noted that it is not clear whether paragraphs 7.21 to 7.23, in the section called Budgets in Chapter 7, refer to operational and future major repair and replacement budgets or just operational budgets. It would be assumed that these paragraphs relating to budgets, would relate to both areas.

CONCLUSION:

In conclusion of this analysis and discussion, it is obvious that many interpretations can be made from the Guide. What is important is that the Auditor is following the AICPA CIRA's Task Forces intent. The Auditor could be in a liable position based on his or hers interpretation of the Guide. It surely would be better to understand the issues and deal with them from a position of offense, then letting courts set precedence and leaving the Auditor in a position of defense.

If individual states react first and not in conjunction with the AICPA, the Civil Codes and legislature enacted could force the Auditor to perform additional procedures to satisfy him or herself on giving assurances on the projected long-term condition and existence of CIRAs, based upon individual state requirements.

To avoid a position of liability, it would appear that the safest position the Auditor could take is to increase the scope of the engagement to include auditing the reserve study information based upon the similar supplementary information required by the Guide and make the appropriate disclosures. If the Auditor can not satisfy him or herself as to the Reserve study information, then it would be necessary to qualify the opinion which would leave the Auditor in a much less liable position.

COMMENTS ON THE EXPOSURE DRAFT OF
THE PROPOSED STATEMENT OF POSITION

Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations

Dated October 26, 1992

The purpose of this Statement of Position on the CIRA guide relates to when a CIRAs financial statements are compiled or reviewed in accordance with Statements on Standards for Accounting and Review Services (SSARSs). SSARSs does not address the accountant's responsibility when the financial statements are accompanied by Required Supplementary Information. This Statement of Position (SOP) is to augment chapter 8 of the Guide, "Review and Compilation Engagements," by providing accountants with performance and reporting guidance when Required Supplementary Information accompanies the basic financial statements in a compilation or review engagement.

The proposed SOP states paragraph 4.30 of the Guide in paragraph 2, which describes the Required Supplementary Information as follows:

> "When the basic financial statements have been compiled or reviewed, the required supplementary information accompanying the basic financial statements should, at a minimum, be compiled."

If the accountant is compiling the basic financial statements which are to include the Required Supplementary Information, it is obvious the accountant would compile the Required Supplementary Information, if the information does exist.

If the accountant is engaged to perform a review, assuming the CIRA has compiled the basic financial statements with the Required Supplementary Information, it appears the proposed SOP is directing the accountant to, "at a minimum, [the Required Supplementary Information should] be compiled" if the Required Supplementary Information was not compiled by the CIRA and the information is available. If this is the case, then the question becomes is the accountant to review what he or she has compiled or disclose that basic financial statements were reviewed and the Required Supplementary Information was compiled with no review procedures performed? The question of independence arises of compiling and reviewing his or hers compilation. Compilations and reviews are different and distinct engagements and should be treated as so.

Paragraph 3 proceeds with,

"To compile the Required Supplementary Information, the accountant should -

> a. Establish an understanding with the entity regarding the services the accountant will perform with respect to the required supplementary information and how that information will affect the report the accountant expects to render.
> b. Determine what supplementary information is required by the CIRA guide and how that information is to be presented.

c. Obtain an understanding of how the required supplementary information was developed. This understanding ordinarily includes -

- The source of the information (e.g., engineering reports, estimates obtained from contractors, tables in technical manuals on useful lives).

- Whether the required supplementary information is based on current or future replacement costs.

- The interest and inflation rates used to determine funding requirements if the information is based on future replacement costs.

d. Consider whether it will be necessary to perform other accounting services in order to compile the required supplementary information.

e. Read the required supplementary information and consider whether it appears to appropriate in form and free from obvious material error.

f. Obtain additional or revised information if the accountant becomes aware that the required supplementary information is incorrect, incomplete, or otherwise unsatisfactory.

g. If the entity is unable or refuses to provide additional or revised information, consider whether a modification of the standard report is adequate to disclose the deficiency in the measurement or presentation of the required supplementary information. If modification of the standard report is adequate to disclose the deficiency, the accountant should follow the guidance in paragraph 5. If modification of the standard report is not adequate to disclose the deficiency, he or she should withdraw from the engagement.

The quoted section of paragraph 3, with points a. through g., starts with, "To compile the required supplementary information, the accountant should -". Points a. through c. and d. pertain to compiling the required supplementary information if the information exists, while point d. and e. through g. relate to what would seem to be reviewing the Required Supplementary Information prepared by the CIRA. It appears direction is being given to how to compile the Required Supplementary Information, as well as review procedures the accountant should perform on the Required Supplementary Information provided by the CIRA. These statements should be specified as relating to compilations or reviews as to not cause any confusion.

If points a. through d. pertain to compiling the Required Supplementary Information, it seem that point d. should be the first statement, "Consider whether it will be necessary to perform other accounting services in order to compile the required supplementary information". Once this is determined, the accountant could proceed with point a. The statements should be reordered.

Point b. says, "Determine what supplementary information is required...". The purpose of the Guide is to determine for the accountant what is required and how is to be presented. It doesn't appear there is anything the accountant needs to determine, expect which Exhibits in the Guide to follow. Point b. is probably not needed and most of this information is addressed in point c.

Point d. can also relate to review situations as points e. through g. As stated before these points should be separated from the compilation points. Point e. should be considered for expansion of detailing what exactly the accountant is being asked to do. To "consider whether it appears to be appropriate in form and free from obvious material error", implies the accountant is to do some work. The scope of this work should be defined.

Paragraph 4 of the proposed SOP makes it clear if the basic financial statements have been compiled or reviewed and the Required Supplementary Information has been compiled it must be disclosed through an additional paragraph that the Required Supplementary Information has been compiled, without audit or review. The title above the sample additional paragraph, below paragraph 4, should be made clear (or deleted altogether) that this is an additional paragraph to be included in the accountants report, being compilation or review report.

It should be noted, that in the sample audit engagement letter, Appendix B, Exhibit 1 of the Guide, it states the following:

> "We will not determine whether the reserve balances are adequate to meet future repair and replacement costs because such a determination is outside the scope of the engagement."

There is no mention as to "future repair and replacement costs" in the sample compilation or review engagement letters in the Guide, Appendix B, Exhibits 2 and 3.

In the sample letters of representation for reviews and audits, Appendix B, Exhibits 4 and 5, the following statement and representation is being requested,

> "The board of directors is collecting funds for major repairs and replacements in conformity with the Association's policy to fund for those needs based on a study conducted in November 19X2. The board of directors believes that the funds will adequately provide for future major repairs and replacements".

The statement in the sample audit engagement letter, above, should be considered for inclusion in the review engagement letter. If it is represented by the board of directors in a letter of representation that they, "believe that the funds will adequately provide for future major repairs and replacements", there might be a question if the accountant should be giving comfort of this nature in the situation of a review.

Don't Fall for the Reserve Flim Flam, Understand What's going on! Reserve Funding Methods and the Facts on Percentage Funding

Do you know the basics of different reserve funding calculation methods (Straight Line, Segregated, Pooling, Cash Flow and Time Value of Money)? Do you know why percentage funding is not what it is all hyped up to be?

The budgeting process for reserves has been a slow evolution from the original and still existing DRE (Department of Real Estate) filing requirements for developers to the introduction of Civil Codes pertaining to Common Interest Developments (CIDs) to a multitude of other methods used today.

The first method derived for calculating the reserve portion of the maintenance fee was introduced by the DRE. The DRE's required documents for an initial reserve budget accumulated data consisting of individual reserve item's current cost and their estimated useful life, and then directed that the current cost be divided by the useful life producing the reserve contribution amount for that reserve item. Once this process was repeated for each reserve item, the individual contribution amounts were added together which produced a total contribution for the whole HOA. The total contribution was then divided by the number of units generating each owner's contribution. This calculation process is considered the Straight Line-Segregated (SLS) method and is the beginning of the history on reserve funding calculations. Straight Line (SL) meanings that no inflation or interest earned (time value of money factors) are considered in the calculation, and Segregated being that a contribution is calculated for each reserve item.

The SLS method is extremely basic, easy to understand and is still widely used. The first year of the SLS method is particularly simple due to the fact that there are no beginning reserve fund balances. When originally budgeting for the following year, precedence was set on how the ongoing reserve funding process would be done. Since reserve funds were collected and existed, these funds would have to be considered when calculating the new reserve funding requirements for this subsequent year. But, if the contribution was calculated in the initial year for each item, why shouldn't the same contribution be used in the following year? As the reserve items mature, they might not wear as originally estimated. The original estimated life might have to be shortened or even extended, if wearing better than initially planned. The current cost used in the previous year has probably increased due to inflation, so the most current cost would be utilized in this new funding calculation. This information is relatively easy to accumulate and to update the previous year's analysis. What became the issue was what to do with the reserve funds which now existed?

Existing reserve funds are allocated to the individual reserve items, based on how they were originally calculated in the initial analysis. A new calculation is made for each reserve item. The process includes subtracting the reserve funds allocated to the reserve item from the new current cost acquired and then dividing the balance by the new estimated time period until this reserve item is scheduled to be replaced or maintenanced. As before this is repeated for each reserve item and the individual contribution amounts are added together and divided by the number of units, producing the new reserve contribution amount per unit. (See Exhibit A which illustrates the calculation process of the Straight Line - Segregated method.)

Straight Line - Segregated Method
Analysis Date: 01/01/93
Exhibit A

Item	Date In Service	If 100% Funded (A)	Beg. Bal. % Funded	Beginning Balance (B)	Current Cost (C)	Funds Required (D)	Useful Life * (E)	Remain. Life * (F)	Monthly Contribution
		C / E x (E - F)	B / A			C - B			D / F
1	1/1/90	$5,400	29.63%	$1,600	$9,000	$7,400	60	24	$308.33
2	7/1/90	4,167	33.60%	1,400	5,000	3,600	36	6	600.00
3	12/1/90	1,389	57.60%	800	3,000	2,200	54	29	75.86
4	4/1/90	4,125	31.52%	1,300	6,000	4,700	48	15	313.33
5	11/1/91	467	64.29%	300	4,000	3,700	120	106	34.91
		$15,547	34.73%	$5,400	$27,000	$21,600			$1,332.43

* Useful and remaining life are shown in months.

Straight Line - Segregated Method
Analysis Date: 01/01/93
Exhibit B

Item	Date In Service	If 100% Funded (A)	Beg. Bal. % Funded	Beginning Balance (B)	Current Cost (C)	Funds Required (D)	Useful Life * (E)	Remain. Life * (F)	Monthly Contribution
		C / E x (E - F)	B / A			C - B			D / F
1	1/1/90	$5,400	27.78%	$1,500	$9,000	$7,500	60	24	$312.50
2	7/1/90	4,167	43.20%	1,800	5,000	3,200	36	6	533.33
3	12/1/90	1,389	14.40%	200	3,000	2,800	54	29	96.55
4	4/1/90	4,125	43.64%	1,800	6,000	4,200	48	15	280.00
5	11/1/91	467	21.43%	100	4,000	3,900	120	106	36.79
		$15,547	34.73%	$5,400	$27,000	$21,600			$1,259.18

* Useful and remaining life are shown in months.

Each following year this process is repeated for updating the previous year's reserve analysis. It is obvious that there are many recurring activities that affect the analysis. The estimated remaining lives change and fluctuate, the current costs increase due to inflation, reserve items are replaced and maintenanced, interest is being earned on the existing reserve funds. It becomes apparent there is no scientific method or calculation of how to allocate the reserve funds to each reserve item. The concern is, if there are enough funds being set aside for each reserve item, so when that item needs to be replaced or maintenanced sufficient funds exist?

This question gives rise to the idea of Percent Funding that was created and became part of the California Civil Codes. The idea is to disclose what amount of funds should exist for each reserve item if it was 100% funded, compared to what actual amount exists as of the analysis date. A 100% funded being defined as, if an item costs' $100,000, has an original estimated life of ten years and has been in service for three years, then $30,000 in reserve funds should exist for this reserve item. If only $15,000 exists for this reserve item, then it would be 50% funded (see Exhibit A for an example of the percentage funded calculation). The percentage funded of a reserve item is affected by the amount of funds allocated as of the analysis date to that reserve item. Since this allocation is arbitrary and by no means scientific, different results are achieved by how these funds are allocated to the individual reserve items (this scenario is illustrated by comparing Exhibit A to Exhibit B, note the beginning fund balance has been reallocated, producing a different percentage funded for each item, but the portfolio percentage funded is the same for both). The question also arises, what if you aren't 100% funded or what percentage funded is acceptable? These are good questions and individuals who promote percentage funding have tried setting ranges of percentages indicating that the percentage funded amount is either weak, moderate or stable. Whether this criteria or even percentage funding itself gives any indication of adequacy of reserve funds or if funds will be available when needed is completely questionable. Let us investigate a little further.

First, it must be acknowledged that the concept of percentage funded is applicable to the Segregated method where beginning reserve funds are allocated to each reserve item (or in the Pooling method which will be discussed later). It has been concluded that the arbitrary allocation of reserve funds to the individual reserve items will have a direct effect on the percentage funded amount of each reserve item. But, this arbitrary allocation of funds also has a direct effect on an individual reserve item's contribution amount. By changing the allocation of funds to the individual reserve items, in total the contribution amount for the whole HOA will change, and will either increase or decrease based on how the allocation has been made. So different contribution amounts for the whole HOA are achieved when the beginning reserve fund balance is allocated differently between the individual reserve items (this scenario is illustrated by comparing Exhibit A to Exhibit B, note the beginning fund balance has been reallocated, producing a different contribution amount per each item and different total contributions for each Exhibit). In the limited Exhibits presented, there is an almost six percent difference in the total contribution amounts (in accounting standards this is considered material and not acceptable). This is a clear indication that the overall theory of the Segregated method is feeble and the results received could be doubtful and misleading.

Due to theoretical problems of the Segregated method, the Pooling method evolved. In the Pooling method no beginning funds are allocated to individual reserve items. Reserve items are tracked the same and updated as before in the Segregated method, adjusting costs and the time until replacement or maintenance. The theory of the Pooling method calculates the contribution based on the total current cost of all the reserve items less the total existing reserve funds, divided by the weighted average life (WAL) of all the reserve items, as of the analysis date. Similar to the

Segregated method where the process is done by individual reserve items, the Pooling process is based on all the reserve items as a portfolio (see Exhibit C for an example of the Straight Line-Pooling method). The Pooling method eliminates the arbitrary allocation of the beginning reserve fund balance and to every one's surprise significantly reduces the calculated reserve contribution when compared to the Segregated method. Reductions in the contribution amount between the two methods have been found to range between 30 to 50%. This brings about immediate doubt as to the validity of calculating the contribution amount through the Pooling method due to such a drastic decrease.

Straight Line - Pooling Method
Analysis Date: 01/01/93
Exhibit C

Item	Date In Service	If 100% Funded (A)	Beg. Bal. % Funded	Beginning Balance (B)	Current Cost (C)	Funds Required (D)	Useful Life * (E)	Remain. Life * (F)	WAL Factor
		C / E x (E - F)	B / A			C - B			C x F
1	1/1/90	$5,400	27.78%	$1,500	$9,000	$7,500	60	24	216,000
2	7/1/90	4,167	43.20%	1,800	5,000	3,200	36	6	30,000
3	12/1/90	1,389	14.40%	200	3,000	2,800	54	29	87,000
4	4/1/90	4,125	43.64%	1,800	6,000	4,200	48	15	90,000
5	11/1/91	467	21.43%	100	4,000	3,900	120	106	424,000
		$15,547	34.73%	$5,400	$27,000	$21,600			847,000

The Weighted Average Life (WAL) and contribution amount are calculated as follows:
WAL : 847,000 (total WAL factor) / $27,000 (total current cost) = 31.3704 months
Contribution amount : $21,600 (funds required) / 31.3704 months (WAL) = $688.55
* Useful and remaining life are shown in months.

Once again the percentage funded exercise is brought forward to lend credence to the results of the Pooling method. As before, a calculation is made for each reserve item to determine how much in reserve funds should exist, if each reserve item was 100% funded. These 100% funded amounts for each reserve item are added together, which indicates the total amount of reserve funds which should exist if 100% funded for the portfolio (all) of reserve items. This amount is then compared to the total existing reserve funds and the current percentage funded of the portfolio of reserve items is determined. This percentage funded results are the same if the Segregated method is utilized, due to being the same data. There is no difference. The percentage funded amount could not give any indication that the much lower contribution calculated by the Pooling method would be adequate or not. The percentage funded procedure gives no support that the calculated contribution along with the existing reserve funds are adequate for when funds are needed in the future. What does all this mean?

The percentage funded presentation tells us where we are as of a specific point in time, the date the analysis is being done. It can not predict what will happen in the future. In fact it can be very misleading due to all the reserve items in the portfolio having different materiality (cost of the items) and timing (when items will actually be replaced). Due to the inability of percentage funding to give any assurance or comfort that reserve funds will be available when needed, an alternative method is needed to support a contribution amount calculated via any method.

The most obvious method has been available but had been ignored until just the last few years. Even though sparsely used and usually poorly implemented, the Cash Flow method is the means

of assuring that funds for replacement and maintenance of reserve items are available when needed. A cash flow can be extremely accurate in projecting funds available for a desired number of years. But, as with any financial forecast, the assumptions and details utilized to project a financial plan via cash flows, would indicate the accuracy and give assurance to HOAs (see Exhibit D for proof that the contribution amount of $688.55 per month for twenty years, calculated in Exhibit C, is adequate and that funds will be available when needed for the future). Monthly cash flow projections have the ability to integrate many different factors:

- inflation and interest (compounded on either an annual or monthly basis)
- cost of living increases on future contributions
- account for taxes to be paid on interest earned
- applying contingencies
- special assessments if needed
- detail budgeting, etc.

Straight Line - Pooling Method - Cash Flow
Analysis Date: 01/01/93
Exhibit D

Period	Beginning Balance	Annual Contribution	Interest Earned	Scheduled Expenditures	Ending Balance
01/93 - 12/93	$5,400	$8,263		$5,000	$8,663
01/94 - 12/94	8,663	8,263		6,000	10,925
01/95 - 12/95	10,925	8,263		12,000	7,188
01/96 - 12/96	7,188	8,263		5,000	10,450
01/97 - 12/97	10,450	8,263			18,713
01/98 - 12/98	18,713	8,263		6,000	20,975
01/99 - 12/99	20,975	8,263		8,000	21,238
01/00 - 12/00	21,238	8,263		9,000	20,501
01/01 - 12/01	20,501	8,263		4,000	24,763
01/02 - 12/02	24,763	8,263		11,000	22,026
Totals	$5,400	$82,626		$66,000	$22,026

This cash flow projection (ten years shown of twenty calculated) is proof that the monthly contribution amount of $688.55 per month ($688.55 x 12 = $8,262.57 annually) for twenty years, calculated in Exhibit C, is adequate and that funds will be available when needed for the future. (Please note this is a straight line cash flow and that following were not considered in the calculation: inflation, interest earned, contribution cost of living increase, taxes or contingencies. The cash flow also takes into account the continual cycle of replacing or maintenancing the reserve items over the future years.)

Cash flows provide the proof of an insufficient or sufficient funding plan while projecting accurately as to not under fund or over fund the reserves. The percentage funded scenario falls short of trying to compete with this type of analysis. During the evolution of these different methods for calculating reserve funding plans the continual question is, should the time value of money (inflation and interest earned) be considered in these calculations? Some people say yes, while a large contingency take the position it is not necessary to consider inflation or interest earned, because they will off set each other. There might be some credence to this thinking if looking at inflation and interest rates over a ten to twenty year period. It does not give much consideration to the short run. If current inflation is approximately 3.00% for reserve related expenditures and interest earned on reserve funds currently range from 2.5% to 7.5% (investing in variety of instruments from CDs to Ginnie Maes and whether these are taxable or not) it is obvious that consideration should be given to the time value of money.

Time value of money can and has been applied in numerous ways. Derivatives have been applied to the SL method where only inflation or interest earned has been considered. This either gave an optimistic or pessimistic connotation in conjunction with the over funding ability of the SL method. Through the years based upon trial and error the ultimate method for reserve funding has become the Time Value of Money (TVM) method.

Time Value of Money Method
Analysis Date: 01/01/93
Exhibit E

Period	Beginning Balance	Annual Contribution	Interest Earned	Scheduled Expenditures	Ending Balance
01/93 - 12/93	$5,400	$7,058	$267	$5,142	$7,584
01/94 - 12/94	7,584	7,341	278	6,266	8,937
01/95 - 12/95	8,937	7,634	75	12,789	3,857
01/96 - 12/96	3,857	7,940	215	5,573	6,437
01/97 - 12/97	6,437	8,257	428	51	15,072
01/98 - 12/98	15,072	8,587	585	7,092	17,152
01/99 - 12/99	17,152	8,931	759	9,849	16,992
01/00 - 12/00	16,992	9,288	447	11,143	15,585
01/01 - 12/01	15,585	9,660	802	5,302	20,744
01/02 - 12/02	20,744	10,046	697	14,622	16,865
Totals	$5,400	$84,742	$4,553	$77,829	$16,865

This cash flow projection (ten year totals shown of twenty years, from monthly cash flows calculated) is proof that an initial year contribution amount of $588.18 per month for twenty years, using the same data used in Exhibit C, is adequate and that funds will be available when needed for the future. (Please note following assumptions were used in the illustration above: inflation, 3.00%; interest earned, 5.00%; contribution cost of living increase, 4.00%; taxes, quarterly @ 15.00%; contingency, 3.00% funded over 50 months. The cash flow also takes into account the continual cycle of replacing or maintenancing the reserve items over the future years.)

The TVM method applies inflation and interest to the Pooling method and proves the results through a cash flow projection. HOAs have to be recognized as business entities that are for operating, maintaining and protecting the values of our homes. So it only makes sense to utilize the practices which are used and proven. The chances of seeing a business or bank use a percentage funded analysis to plan for the future, is highly unlikely.

As of today, the California Civil Codes require a percentage funded presentation (the American Institute of Certified Public Accountants (AICPA) does not). This is currently being reconsidered by legislative committees in the State of California. The best scenarios for HOAs to follow, would be to have reserve studies utilizing the TVM method and then use those results for formulating a percentage funded presentation (which would be a purely cosmetic presentation to meet the existing Civil Code requirements). The Civil Codes do not indicate that the percentage funded presentation need be presented on a line by line basis for each reserve item or that it should be on the portfolio basis. It would appear to leave this option open, but it is obvious that calculating the percentage funded on the portfolio is much less tedious than for each reserve item.

Reviewing the results of the different methods (see the Exhibits) there are significant differences in the contributions' amounts that have been calculated, ranging from $1,332.43 to $588.18 per month using the same reserve item data.

January 4, 1993 File Ref. No. 2000

To the Accounting and Review Services Committee:

Re: Exposure Draft of proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations

Here are the additional comment letters received to date on the proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations.

	Name/Affiliation	Location
7.	James A. Higbee, CPA Maryland Association of CPAs	Lutherville, MD
8.	James W. Litchfield, CPA Technical Standards Committee of South Carolina Association of CPAs	West Columbia, SC
9.	James B. Thomas, Jr. President's Council on Integrity & Efficiency Standards Subcommittee	
10.	Glenn J. Vice Accounting & Auditing Standards Committee Louisiana Society of CPAs	Kenner, LA

Sincerely,

Judith

Judith Sherinsky
Technical Manager
Auditing Standards Division

JS/ls
Attachments

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7

December 16, 1992

Ms. Judith M. Sherinsky, Technical Manager
Auditing Standards Division, File 2000
American Institute of CPA's
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

Here are the comments of the Auditing Standards Committee of the Maryland Association of CPA's on the Exposure Draft, "Proposed Statement of Position, Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Statements of Common Interest Realty Associations".

1. Paragraph 3 f. discusses the accountant's responsibility when required supplementary information is unsatisfactory. Some members of the committee believe that additional guidance would be helpful as to whether or not this provision applies to interim financial statements.

Sincerely,

James A. Higbee

James A. Higbee, Chairman
MACPA
Auditing Standards Committee

JH/kg
Enclosures

South Carolina Association
of Certified Public Accountants
570 Chris Drive
West Columbia, SC 29169
(803) 791-4181

December 21, 1992

Ms. Judith M. Sherinsky, Technical Manager
Auditing Standards Division, File 2000
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

The Technical Standards Committee of the South Carolina Association of Certified Public Accountants has reviewed the Exposure Draft of the Proposed Statement of Position entitled "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations." We believe the proposed SOP will provide useful guidance and have no objection to its issuance in its present form.

Yours truly,

James W. Litchfield

James W. Litchfield, CPA
Chairman, Technical Standards Committee
South Carolina Associaton of
Certified Public Accountants

JWL:TME

CC: H. McRoy Skipper, CPA
Lollie B. Coward, SCACPA

PRESIDENT'S COUNCIL on INTEGRITY & EFFICIENCY
STANDARDS SUBCOMMITTEE

December 31, 1992

Judith M. Sherinsky, Technical Manager
Auditing Standards Division
File 2000
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Dear Ms. Sherinsky:

The Standards Subcommittee of the President's Council on Integrity and Efficiency (PCIE) appreciates the opportunity to comment on the AICPA Exposure Draft: Proposed Statement of Position - Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations. We offer the following for your consideration.

The AICPA Audit and Accounting Guide "Common Interest Realty Associations" requires common interest realty associations to disclose certain supplementary information outside of the basic financial statements. Paragraph 3. g. of the Proposed Statement of Position states that if the accountant becomes aware that the required supplementary information is incorrect, incomplete, or otherwise unsatisfactory, and if the entity is unable or refuses to provide additional or revised information, the accountant should consider whether a modification of the standard compilation or review report is adequate to disclose the deficiency. If modification of the standard report is not adequate to disclose the deficiency, the accountant should withdraw from the engagement. However, paragraph 6 states that if the entity omits the required supplementary information, the accountant need only add to the compilation or review report a paragraph indicating that the required supplementary information has been omitted.

We believe that it is inconsistent to require an accountant to withdraw from an the engagement when they have trouble reporting the reasons that supplementary information is severely deficient, while on the other hand, requiring the accountant to add a paragraph to his or her report if the entity omits entirely the required supplementary information.

AICPA Professional Standards, Statement on Auditing Standards No. 52 entitled "Required Supplementary Information," does not require the accountant to withdraw from the engagement. Instead, the accountant includes an explanatory paragraph in his or her report describing the material departures from guidelines. Moreover, under AICPA Professional Standards, Accounting and Review Services, section 100.43 states that the accountant need only state in his or her report the degree of responsibility, if any, he or she is taking with respect to supplementary information. These standards do not require the accountant to withdraw from the engagement because of deficiencies in supplementary information. The accountant should withdraw only in the case of material uncorrected deficiencies in the financial statements themselves.

For these reasons, we recommend that the requirement in paragraph 3. g. of the Proposed Statement of Position that the accountant withdraw from the engagement be deleted. The requirement that the accountant describe any deficiencies noted in the required supplementary information should be adequate in every instance. Such treatment would be consistent with the proposed treatment for the complete omission of required supplementary information.

Paragraph 4 provides an example of an additional report paragraph which states in part that "We have compiled (identify the supplementary information) from information that is the representation of management of XYZ Company, without audit or review." We recommend that the sentence be expanded to say "...without audit or review, solely for the purpose of determining whether the information appeared to be appropriate in form and free from obvious material error." This change is necessary to maintain consistency with paragraph 3.e.

Thank you for the opportunity to comment. If you have any questions concerning our comments, please contact Russell Young on (202) 205-9970.

Sincerely,

Gretchen Schwarz for

James B. Thomas, Jr.
Chair

(10)

Accounting & Auditing Standards Committee
Louisiana Society of Certified Public Accountants
2400 Veterans Blvd.
Kenner, LA 70062-4736

December 28, 1992

Judith M. Sherinsky
Technical Manager
Auditing Standards Division
File 2000
AICPA
1211 Avenue of America's
New York, N.Y. 10036-8779

Dear Judith:

Re: Exposure Draft 800039
Proposed Statement of Position
Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations
October 26, 1992

The committee members and technical consultants listed below have reviewed the above exposure draft and have the following comments:

1. Jon Flair, Member

<u>Paragraph #</u>

3-4 Although I agree with the general content of the procedures necessary to compile the required supplementary information for CIRA's, I feel that this SOP effectively creates a new reporting requirement at the SSARS level. Accordingly, since there may be other types of entities that may be required under GAAP to issue supplementary information under compilation or review standards, I believe that the framework and general procedures attendant to this general type of report should be set by SSARS committee in an appropriate statement, not an SOP. Various task forces and committees responsible for the content of specific audit and accounting guides could therefore issue more specific guidance, based upon those particular entities circumstances, that builds upon the guidance continued in the statement.

I believe this procedure to be preferable in maintaining the authoritative hierarchy and integrity on the standards - setting process.

2. Lindsay J. Calub, Member

Paragraph #

1 Informational - no comment.

2 The two paragraphs seem to be repetitive. In the first paragraph it is indicated that estimates of current or future costs of all existing components should be included. The second paragraph indicates that a presentation of components to be repaired and replaced should be included. It is recommended that the two paragraphs are combined to be more specific.

3 Based on the wording in the first sentence it indicates that the financial statements can be reviewed and the supplementary information can be compiled. See comment for paragraph 4.

3a-3g General procedures for the accountant when compiling supplementary information - good guidance.

4 Good guidance for compiled financial statements. For reviewed financial statements it would seem that the required supplementary information could be reviewed and the report could indicate the degree of responsibility.

5 Good guidance.

6 Good guidance.

7 There should not be an option that the accountant may do so in accordance with the Statement on Standards for Attestation Engagements. There should be specific requirements for the standards to be used.

8 No comment.

3. David M. Bassemier, Technical Consultant

We feel that the statement of position is well founded and should be adopted, however, you may wish to consider a recommendation that he statement on Standards for Accounting and Review Services be amended or modified to incorporate this for any compiled or reviewed financial statement which would have required supplementary information.

4. John Benham, Technical Consultant

No comment. We do not have any CIRAs, but if we did the client would probably elect not to include the required supplementary information. The ED provides for an appropriate paragraph to add to the accountant's report in that circumstance.

5. Raymond Prince, Technical Consultant

This requirement would place an additional burden on the CPA to prepare these statements in compliance with professional standards. Most clients of small practitioners would be unable to determine or obtain this information without incurring additional costs. Although the information concerning future major repairs and replacements may be relevant to the users of compiled or reviewed financial statements. It should not be required. This requirement should only apply to audited financial statements.

6. J.M. Fried, Jr., Member

I have no objection to this SOP.

7. Glenn J. Vice, Chairman

I believe this SOP will benefit practitioners. The supplementary information is required by existing standards, this SOP simply gives the practitioner some reporting, disclosure and level of service guidance and is needed. I believe it is well written and should be added to the existing guide.

I hope you find these comments helpful. If you have any questions, please give me a call at 504-876-6143.

Sincerely,

Glenn J. Vice

Glenn J. Vice
Chairman

January 19, 1993

File Ref. No. 2000

To the Accounting and Review Services Committee:

Re: Exposure Draft of proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations

Here are additional comment letters received to date on the proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations.

	Name/Affiliation	Location
11.	Judith H. O'Dell, CPA Technical Issues Committee	Wayne, PA
12.	John Kiss, CPA Auditing Services Committee of Illinois CPA Society	Chicago, IL
13.	Richard Clark, CPA Accounting Principles and Auditing Standards State Committee of California Society of CPAs	Glendale, CA
14.	Walter M. Primoff, CPA New York State Society of CPAs	New York, NY

Sincerely,

Judith

Judith Sherinsky
Technical Manager
Auditing Standards Division

JS/ls
Enclosures

(12)

Division for CPA Firms

American Institute of Certified Public Accountants

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January 6, 1993

Ms. Judith M. Sherinsky
Technical Manager
Auditing Standards Division, File 2000
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft on Proposed Statement of Position "Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations" - File 2000

Dear Ms. Sherinsky:

One of the objectives that Council of the American Institute of CPAs established for the Private Companies Practice Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee ("TIC"). This communication is in accordance with that objective.

TIC has reviewed the guidance contained in the above referenced proposed statement of position related to reporting on required supplementary information accompanying compiled or reviewed financial statements of common interest realty associations. We believe the guidance outlined in the proposed statement will be helpful; however, we offer the following suggestions for your consideration.

The proposed statement does not indicate whether the performance and reporting guidance outlined therein should be applied when the accountant is engaged to review or compile financial statements that are prepared on an other comprehensive basis of accounting ("OCBOA"). We believe an appropriate reference to OCBOA financial statements is desirable. If the guidance is relevant to OCBOA financial statements, the final statement should provide guidance to address the unique characteristics of those engagements.

Footnote 1 states, in part, that estimates obtained from "**licensed contractors**" are satisfactory to corroborate the required supplementary information. However, paragraph 3(c) contains a reference to estimates obtained from "**contractors**." For the purpose of consistency, and because contractor licensing requirements tend to vary, we believe the reference to "licensed contractors" should be replaced with "contractors."

The guidance in footnote 1 appears more descriptive than the information provided in paragraph 3(c) with respect to the accountant's understanding of how the required supplementary information was developed. For example, the footnote states the board of directors can also provide estimates for the supplementary information and studies prepared by professional engineers are not necessary. TIC believes the language in this footnote should be incorporated within the text of paragraph 3(c) to facilitate the accountant's understanding of the guidance.

Paragraph 4 states that the accountant could indicate in a separate report the degree of responsibility he or she is taking for the supplementary information. The Statements on Standards for Accounting and Review Services do not provide reporting guidance on such separate reports. Accordingly, TIC believes the final statement will need to furnish examples of separate reports accountants would issue under these circumstances.

* * *

We appreciate this opportunity to present these comments on behalf of the Private Companies Practice Section. We would be pleased to discuss our comments with you or representatives of the Accounting and Review Service Committee at your convenience.

Sincerely,

Judith H. O'Dell, Chair
PCPS Technical Issues Committee

JHO:al
File 2221

cc: John C. Compton, Chairman, AICPA Accounting and Review Services Committee
Alan J. Winters, Director - Auditing Research, AICPA Auditing Standards Division
PCP Executive and PCPS Technical Issues Committees

ILLINOIS CPA SOCIETY & FOUNDATION

(12)

January 7, 1993

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Exposure Draft--Proposed Statement of Position
"Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations"

Dear Ms. Sherinsky:

The Auditing Services Committee of the Illinois CPA Society is pleased to submit its response to the request for comments on the above Exposure Draft. In general, we believe that the Exposure Draft provides useful guidance to auditors.

The above represents the views of the Illinois CPA Society rather than that of any of the individual members of the committee or any of the firms or organizations with which they are associated.

Very truly yours,

John Kiss

John Kiss, Chairperson
Auditing Services Committee

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(13)

January 11, 1993

Judith M. Sherinsky, Technical Manager
Auditing Standards Division
File 2000
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

California Society Certified Public Accountants

Dear Ms. Sherinsky:

The California Society of Certified Public Accountants' Accounting Principles and Auditing Standards (AP&AS) State Committee takes this opportunity to communicate our comments relating to the exposure draft, Proposed Statement of Position, Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations.

The AP&AS Committee is a senior technical committee of the California Society of Certified Public Accountants. The 1992/93 committee comprises 44 members, of which 16 percent are from national CPA firms, 46 percent are from local or regional firms, 30 percent are sole practitioners in public practice, 4 percent are in industry, and 4 percent are in academia. In addition, five current or former members of the Accounting Standards Executive Committee serve on the AP&AS Committee. The following comments represent the results of the AP&AS Committee's discussion of the Exposure Draft.

The audit guide allows a disclaimer of opinion on the required supplementary information when financial statements are audited. The Committee questioned whether the exposure draft equates a compilation report on this supplementary information, included with a review report, to a disclaimer of opinion. Additionally, the Committee questions whether a separate compilation report would be necessary on compiled financial statements as SAARS indicates that the wording "and Supplementary Information" should be included in the first paragraph of a compilation report when such information is present. Based on our discussions, we suggest that the proposed SOP paragraph 4 be amended to indicate that only a review report would be required to have the additional paragraph regarding compilation of the supplementary information. Along the same train of thought, we would also recommend that the proposed guidance shown in paragraph 5 be restated to indicate that this disclosure would only be added to the compilation report included with a review report. The same situation in a compiled set of financial statements would therefore result in a modification to the compilation report.

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We find the meaning of paragraph 3d to be ambiguous and question whether its inclusion in the proposed SOP is necessary. If it is considered necessary, it would be helpful if the paragraph were expanded to include examples so as to make the meaning more clear.

Lastly, the Committee questions the guidance proposed in paragraph 7. It is the firm belief of the Committee that the required supplementary information is prospective financial information. As such, the current professional standards only allow for either compilation or examination of that information. There is no such thing as a review of prospective financial information. If the AICPA disagrees that the required supplementary information is prospective financial information, then the Committee is of the opinion that the more appropriate service should be agreed upon procedures. Any cite to professional standards should be to standards dealing with agreed upon procedures engagements. If the AICPA still disagrees with this position, we would suggest, that as compilation and review standards are procedure driven, as opposed to opinion driven, more specific guidance as to what procedures should be performed, would need to be developed and included in the proposed SOP before the required supplementary information could be reviewed.

We appreciate the opportunity to express our comments relative to this matter and will be available to discuss the issues, if needed.

Sincerely,

Richard Clark, Chairman
Accounting Principles and
Auditing Standards State Committee

RC:ls

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14

January 13, 1993

nysscpa

Judith M. Sherinsky
Technical Manager
Auditing Standards Division
File 2000
AICPA
1211 Avenue of the Americas
New York, NY 10036-0075

RE: "Proposed Statement of Position - Reporting on Required Supplementary Information Accompanying Compiled or Reviewed Financial Statements of Common Interest Realty Associations."

Dear Ms. Sherinsky:

We are enclosing the comments of the New York State Society of Certified Public Accountants in response to the above subject Exposure Draft. These comments were prepared by the Society's Accounting and Auditing Services Committee.

If you have any questions regarding these comments, please call me and I will arrange for someone from the Committee to contact you.

Thank you for your consideration of our response.

Very truly yours,

Walter M. Primoff/dr

Walter M. Primoff, CPA
Director of Professional Programs

WMP:dr
Enclosures

cc: Accounting & Auditing Committee Chairmen

AICPA AUDITING STANDARDS DIVISION, FILE 2000

COMMENTS OF THE ACCOUNTING AND REVIEW SERVICES COMMITTEE ON THE EXPOSURE DRAFT, DATED OCTOBER 26, 1992, OF A PROPOSED STATEMENT OF POSITION TITLED "REPORTING ON REQUIRED SUPPLEMENTARY INFORMATION ACCOMPANYING COMPILED OR REVIEWED FINANCIAL STATEMENTS OF COMMON INTEREST REALTY ASSOCIATIONS"

The Accounting and Review Services Committee has considered the subject draft and its comments are presented below.

In general, the Committee concurs in the need for the proposed supplement to the AICPA Audit and Accounting Guide on "Common Interest Realty Associations" (CIRA). In particular, the proposed SOP provides clear guidance , in paragraph 4, on the appropriate language for an additional report paragraph dealing with accompanying <u>required</u> supplementary information that has been <u>compiled</u>.

It is the Committee's view, however, that additional reporting guidance is needed <u>in the form of sample reports</u>, to cover:

(1) situations when <u>both</u> required <u>and voluntarily</u> presented supplementary information accompany the basic financial statements and

(2) circumstances when the required supplementary information has been <u>reviewed</u> rather than compiled.

The guidance suggested in (1) would clarify the reporting on both types of information for the benefit of practitioners who may not be that often exposed to this particular situation. It should also include coverage of the requirements when a <u>separate</u> report is presented, as well as when it will be included as an additional paragraph of the report on financial statements.

The guidance suggested in (2) is premised on the Committee's opinion that the cross reference in paragraph 7 back to the Statement on Standards for Attestation Engagements is inadequate, largely because some practitioners who perform a review of the basic financial statements under the Statements on Standards for Accounting and Review Services may not be all that familiar with the application of attestation standards. Further, it is time consuming to the practitioner to peruse those larger bodies of guidance for the fine points related to this situation. At the expense of redundancy, more specific guidance in the proposed SOP on reporting on a <u>review</u> of required supplementary information under attestation standards is strongly suggested.

For reasons similar to those expressed in the preceding paragraph, the Committee urges that the same degree of detailed guidance should be provided to cover <u>review</u> procedures as appears in paragraph 3 for compilations.

The Committee recognizes that the above-mentioned information can be gleaned from the cross referenced material, but concludes in order for the proposed SOP to be useful to practitioners guidance should stand on its own. It should avoid the need for the practitioner, out in the field and under pressure to report on CIRA statements, to research the cross referenced material for the relevant details in reaching his or her conclusions when reporting on the required supplementary information.

January 10, 1993 File Ref. No. 2000

To the Accounting and Review Services Committee:

Re: Exposure Draft of proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations

Here are additional comment letters received to date on the proposed SOP, Reporting on Required Supplementary Information Accompanying Compiled or Review Financial Statements of Common Interest Realty Associations.

Name/Affiliation	**Location**
15. Donald W. Haney, CPA Haney Accountants, Inc.	Sacramento, CA

~~16.~~

Sincerely,

Judith Sherinsky
Technical Manager
Auditing Standards Division

JS/ls
Enclosures

Members
American Institute and
California Society of
CERTIFIED
PUBLIC
ACCOUNTANTS

15

January 13, 1993

Ms. Judith M. Sherinsky, Technical Manager
Auditing Standards Division, File 2000
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

SUBJECT: EXPOSURE DRAFT-PROPOSED SUPPLEMENT TO AICPA AUDIT AND ACCOUNTING GUIDE, COMMON INTEREST REALTY ASSOCIATION

I have recently become aware of the proposed SOP on CIRA supplementary information. I am sure you have received many different perspectives on this proposal. `While there are many issues in the proposal that I would like to address, I will limit my comments to one area-suggested changes to paragraph 6.

The required supplemental information is so important to CIRA financial statement users that a decision by the Association not to disclose it could have serious consequences to the users. Therefore, I suggest the following rewrite of the paragraph 6 disclaimer:

> The Association has not presented the required supplementary information about future major repairs and replacements of common property, which the American Institute of Certified Public Accountants has determined is required to supplement, although not required to be a part of, the basic financial statements. This supplementary information would disclose estimates of current or future cost of future major repairs and replacements of all existing common areas components, including estimated amounts required, methods used to determine the costs, any assumptions used in the calculations, sources used, the dates of studies made for this purpose, and the Association's plan for funding these obligations. The omitted disclosures could influence the users conclusions about the Association's ability and commitment to maintain the common area.

I have also included for your review an example of the supplemental disclosures that I include in my reports. Please call me, toll free, at (800) 350-8334, if you have any questions about the meaning, motive or intent of this letter.

Donald W. Haney, CPA, MBA, MS(Tax)
President

Haney
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NATURE & SCOPE OF STUDY

The Association's board of directors conducted a study in 1992 to estimate the remaining useful lives and the replacement costs of the major components of common property. Replacement costs were based on the estimated costs to repair or replace the major common property components at the date of the study. Various sources such as contractors, vendors, other professionals and trade literature provided the estimated lives, remaining lives and cost figures. These estimates have not been revised since that date.

FUNDING POLICY

As also described in Financial Statement Note 4, the Association accumulates funds for future major repairs and replacements by charging current owners for their share of the wearing out of these components. The estimated funds required were calculated based on future estimated replacement costs, member contributions and related net after tax interest income. The Association's policy is to accumulate funds sufficient to meet these obligations without the need for special assessments. However, actual expenditures and net investment income may vary from the estimated amounts, and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Association may increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

FUNDING ANALYSIS

Based upon the estimates and the assumptions used in the study and the resulting calculations in EXHIBIT C, PROJECTED AVAILABLE CASH, it appears that the Association will be able to meet its obligations for future major repairs and replacements without the need for SPECIAL ASSESSMENTS. However, the Association can not assure the members that a special assessment will not be required.

INCLUDED MAJOR COMPONENTS

The Association included in the study as major repair and replacement components the exterior and interior surfaces that it is obligated to maintain, that have useful lives of more than one year and that have expected current costs to replace of more than $1,000. These items are listed in EXHIBIT A-MAJOR COMPONENT INVENTORY

EXCLUDED MAJOR COMPONENTS

The Association excluded from the study personal property assets and major structural components such as the club house, the streets, underground sewer and water systems, large landscaping features and any other component not specifically listed in EXHIBIT A. The Association assumes any personal property asset replacements will be funded by the annual depreciation charge to the income statement. It further assumes that the major structural items have indefinite lives and the appropriate funding method for their replacement will be decided by the owners when these items need replacing.

EXHIBIT A-MAJOR COMPONENT INVENTORY

Lists the components, their related estimated typical life, remaining life, current replacement cost, the accumulated wear calculated as remaining life divided by typical life multiplied by replacement cost, and annual provision calculated by dividing current replacement cost by typical life.

EXHIBIT B-FORECASTED EXPENDITURES

Displays the amount of money needed each year over the next twenty years to perform the expected major repairs and replacements using the current replacement cost.

EXHIBIT C-FORECASTED AVAILABLE CASH

Calculates the expected available cash each year over the next twenty years calculated using the beginning available cash, expected cash expenditures, expected cash receipts and related assumptions regarding inflation and after tax investment income.

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EXHIBIT A-MAJOR COMPONENT INVENTORY

REPLACEMENT ITEMS		NOTES Page S5	Life Estimated	Life Remaining	Cost Per Unit	Unit Measure	Number Units	Total Cost	Estimated Liability	Annual Provision
Roofs	-Replace	A	20	18	2.77	Sq Ft	944	2,615	261	131
Paint	-Exterior	B	7	5	0.42	Sq Ft	1,200	504	144	72
	Interior		7	5	0.42	Sq Ft	2,560	1,075	307	154
Pools	-Equipment	C	5	3		Set		3,000	1,200	600
	Furniture		5	3		Set		2,000	800	400
	Resurface-Pool		15	13	11.89	Sq Ft	1,262	15,000	2,000	1,000
	Resurface-Spa		15	13	55.55	Sq Ft	90	5,000		
Asphalt	-Resurface	D	20	18	1.06	Sq Ft	46,950	49,870	4,987	2,494
	Reseal		5	3	0.10	Sq Ft	46,950	4,695	1,878	939
Other	-Vinyl Floors	E	10	8	1.50	Sq Ft	800	1,200	240	120
	Fence		10	8	8.00	Ln Ft	135	1,080	216	108
	Walls					Ln Ft	665			
	Water Heater					Ea	1			
	Furniture									
							Totals	86,039	12,034	6,017

EXHIBIT B-FORECASTED EXPENDITURES

Year Count	Year Actual	EXPECTED EXPENDITURE	Roof	Painting	Pool	Asphalt	Other
0	1992	0					
1	1993	0					
2	1994	0					
3	1995	9,695			5,000	4,695	
4	1996	0					
5	1997	1,579		1,579			
6	1998	0					
7	1999	0					
8	2000	11,975			5,000	4,695	2,280
9	2001	0					
10	2002	0					
11	2003	0					
12	2004	1,579		1,579			
13	2005	29,695			25,000	4,695	
14	2006	0					
15	2007	0					
16	2008	0					
17	2009	0					
18	2010	59,765	2,615		5,000	49,870	2,280
19	2011	1,579		1,579			
		115,867	2,615	4,738	40,000	63,955	4,560

See accountant's report, significant assumptions and notes

(1)RATE ASSUMPTIONS -->				3.00%	(2)	(3) 3.00%	(4)	(5) 3.00%	(6) FORECASTED
	[----- YEAR	-----]	[---- EXPECTED EXPENDITURES		----]	[------ EXPECTED RECEIPTS		------]	AVAILABLE
	Count	Actual	Current $	Inflation	Future $	Members	Special	Interest	CASH
Investment Funds Designated for Major Replacements									7,518
	0	1992	0	1.0000	0	6,017	0	316	13,851
	1	1993	0	1.0300	0	6,197		508	20,557
	2	1994	0	1.0609	0	6,383		712	27,652
	3	1995	9,695	1.0927	10,594	6,575		769	24,402
	4	1996	0	1.1255	0	6,772		834	32,008
	5	1997	1,579	1.1593	1,831	6,975		1,037	38,190
	6	1998	0	1.1941	0	7,184		1,253	46,628
	7	1999	0	1.2299	0	7,400		1,510	55,538
	8	2000	11,975	1.2668	15,170	7,622		1,553	49,543
	9	2001	0	1.3048	0	7,851		1,604	58,998
	10	2002	0	1.3439	0	8,086		1,891	68,975
	11	2003	0	1.3842	0	8,329		2,194	79,498
	12	2004	1,579	1.4258	2,252	8,579		2,480	88,305
	13	2005	29,695	1.4685	43,608	8,836		2,128	55,661
	14	2006	0	1.5126	0	9,101		1,806	66,568
	15	2007	0	1.5580	0	9,374		2,138	78,080
	16	2008	0	1.6047	0	9,655		2,487	90,223
	17	2009	0	1.6528	0	9,945		2,856	103,023
	18	2010	59,765	1.7024	101,746	10,243		1,718	13,239
	19	2011	1,579	1.7535	2,769	10,551		514	21,534
			115,867		177,969	161,675	0	30,309	

(1) Assumed Rates of inflation, increase in members contributions and net after tax investment income.
(2) Expected expenditure after multiplying current cost by inflation rate.
(3) Current members' assessment designated for future major repairs and replacements.
(4) Any special member assessments that may be required to provide needed cash.
(5) Net after tax investment earnings on average investment balance.
(6) Prior year cash balance less any expenditures (2) plus receipts (3),(4) & (5).

MODEL LIMITATIONS

The forecasted available cash(EXHIBIT C) calculated by this model is the mathematical result from the interplay of many variables some of which have high precision, others have medium precision and still others that are considered reasonable assumptions. Therefore, while the Association believes the model produces a reasonable understanding of the magnitude of the cash receipts and expenditures during the forecast period, it is HIGHLY UNLIKLEY that the actual results will precisely match the forecasted results.

SUMMARY OF SIGNIFICANT ASSUMPTIONS

The information in the major component inventory (EXHIBIT A) related to estimated life, remaining life, cost per unit and number of units are considered reasonable estimates. The rates for inflation, increase in assessment levels and the net after tax return on investment used to forecast the available cash (EXHIBIT C) are considered significant assumptions. Even if the component inventory estimates prove relatively accurate, minor variations among the three assumed rates could have a major effect on the model's outcome.

COMPONENT DESCRIPTIONS

A. ROOFS-The clubhouse roof is medium shake. The replacment plan assumes that the building codes at replacement time will allow a similar replacement roof.

B. PAINT-The Association maintains the Clubhouse exterior and interior. Exact replacement paint specifications have not been settled. The replacement plan assumes the exterior and interior paint as well as the exterior trim will wear out at the same rate. Actual experience will probably be different and the replacement model adjusted by actual experience and Association decisions with regard to paint specifications and application methods.

COMPONENT DESCRIPTIONS (CONT'D)

C. POOLS-The Association maintains a regular pool and and a hot tub (Spa). The square foot measurements in the replacement plan are the surface only. The equipment includes the standard set of heaters and filters. The furniture consists of several outdoor round tables, chairs and lounges.

D. ASPHALT-The Association has the responsibility to maintain the streets inside the entry area. The resealing costs assumes a standard slurry seal. The resurfacing costs assums a standard one to one & a half inch overlay. The Association will determine more precise specifications and costs prior to the first scheduled reseal.

E. OTHER-The Association also must maintain and replace the clubhouse vinyl floors, drapes and water heater. There is no furniture in the clubhouse. There is a six foot high redwood fence enclosing the pool equipment and part of the pool area. There is a boundry concrete block five foot high fence along which requires little or no maintenance and has an indefinite life.

10:58 AM