

Finance Committee Meeting Feb 18, 2022

Present: Ed Organ, Jeffery Janus, Bill Klett, Tom Ortez, Nancy Foote, Linda Brown

Absent: Bill Defazio, Mike Silvester,

Agenda and Minutes

Meeting began at 1:00

- 1) **Operating Reserve Policy Revision** - Jeffery took the lead on this item and provided the committee with a complete revision of the Policy including a new name for the Policy. The new policy is named the, "SURPLUS/DEFICIT POLICY", (S/D). There are ten points to the new policy and Jeffrey walked the committee through each point asking questions and explaining the new policy. The S/D policy provides two things, it provides a requirement to follow IRS Ruling 70-604 regarding year end budget surpluses and it provides a "Separate Cash Operating" account that is available only when there is a "Cash Operating" account short fall. Ruling 70-604 is an IRS tax avoidance ruling. The S/D account shall be funded by the budget and end of year budget surpluses. The IRS Ruling 70-604 has to be voted on and approved by the Members. This was done in past years, however, the vote wasn't approved for 2021 because of the Failed election in July 2021.

The new Policy will take end of year budget surpluses, the amount of such surplus shall be transferred to the S/D account up to the maximum balance of \$200,000. The remainder of the budget surplus, (the "Applicable Excess"), shall be incorporated into the following year's budget process in accordance with IRS Revenue Ruling 70-604. The process gets a little sticky because you have to estimate your yearly Budget surpluses in September of every year to make the budget surplus "Roll Over" deadline and be put into the next year's budget. The GM pointed out this would be hard to accomplish and there could be tax implications if the estimate was incorrect. It was also noted that if this policy passes we will need to do the estimates and implement said policy. The new policy was tabled waiting on the following questions that needed to be answered by Gary Porter, our tax preparer/auditor:

- a. If the yearend estimated budget surplus is incorrect what happens regarding both the IRS 70-604 Ruling and our actual tax liabilities. Scott said he would discuss this with our tax preparer.
- b. Even though the Membership has voted to approve the use of the IRS Ruling in the past, it appears that the budget surplus was not "Rolled" over into the following year's budget thus not complying with the requirements of the IRS 70-604 Ruling. Is this true, or did Gary Porter take into account those Budget Surpluses in our 2018, 2019, and 202 tax returns? Scott said he would discuss this with Mr. Porter.

- c. One of the requirements of the budget process is a “Zero” based budget. This means we only budget for needed monies and collect monies/assessments from the Members to cover these expenses. This Policy will create an S/D fund that is not required for the budget process. The question is, is it legal to budget for these types of excess funds? Scott said he would discuss this with our auditor.

2) **Reserve Policy Amendment** - Ed led the discussion on the Reserve Policy. He pointed out that the policy does not in some areas comply with our CC&Rs, By Laws, Finance Manual, or Civil Codes. During the discussion the committee recommended to remove the word “**renovation**” from the first two paragraphs under **General** in the Policy. This brings the Policy into compliance with the above internal and external documents. The committee agreed that the fourth paragraph in the **General** section should be removed as noted in the proposed change. The committee also agreed to add a third-party consultant as designated in paragraph six in the **General** section. Scott then explained the Reserve Funding “Threshold” plan to the committee. He explained the difference between “Threshold” funding and “Percentage” funding for Reserves.

The following question was asked during the discussion

- a. Scott was asked about Member By Laws Section 9.02 (b) Board Actions Requiring Member Approval (ii) Incur aggregate expenditures for capital improvements to the “Common Areas in any fiscal year in excess of five percent (%) of the budgeted gross expenses of the Assn for that year. Scott said that this doesn’t apply to Reserve fund usage.

3) **Financial Report – Questions to be answered by Scott include:**

- a. What is our state and Fed tax rate. Scott said Fed tax rate is 21% and State is 8.8%. Scott said the ASSN paid taxes on \$87,495 in 2020.

Questions to be answered by Gary Porter:

- a. Do we pay taxes on yearly budget surpluses. Scott said he didn’t think we did, however, he would check with Gary Porter our tax preparer.
- b. If we implement one of the three options that Davis Stirling recommend for surplus monies, will we still pay taxes on our budget surpluses. Scott said he thought we were already taken care of by the IRS Revenue 70-604 rule.
- c. A question from the audience asked, since our budget surpluses have not either been “Rolled” into the following years budget or

given back to the Members, how could we use the 70-604 rule?
Scott said he would check with Gary Porter.

- d. What options does our tax preparer recommend to lower our taxes. Scott said he hadn't checked with them yet.

4) **Provide an update of financial reports and errors on those reports. Specifically our 2021 income taxes** - Ed tried to discuss and explain the issues he perceived in the 2021 Federal and State taxes with Scott, however, the overhead pages that were produced for the meeting were not legible on the projector so Ed said he would discuss this issue with Scott in his office during the week.

5) **Net Worth Values in the Financial Report.**

The question was asked; why do the Net Worth numbers in the Balance Sheet not match the same numbers found elsewhere on the balance sheet for Operating Fund Transfers, Fixed Assets, Reserves, and Operations. Scott said that he would have to discuss this with our Auditor. It was pointed out that these numbers were inputs in our Admin Software and appeared to be inputted by our staff. The Accounts also seem not to be attached to any other accounts in the Accounting software. Those "Net Worth" account are:

- a. Acct 2810 - Operating Fund Transfers \$369,183.
- b. Acct 3010 - Fixed Assets \$2,541,146 vs BS 2,623,509.
- c. Acct 3025 – Reserves \$2,386,776 vs \$3,824,902
- d. Acct 3020 Operations – (\$222,867) vs Net Operations on the P&L pages in the financial report. \$283, 866.

6) **Nancy and Linda provide update on LACC Finance Manual update/revision** - All committee members agreed that Nancy and Linda did a great job updating/revising the Manual. There were a couple of comments made to the Manual. Ed stated he would send the revised Manual with all comments to the committee members for review and we would approve the Manual at the next committee meeting.

7) **Software Issues** - Jeffrey reported that he has a company that will look at our software and discuss issue with the Admin staff. This company will do a free telephone assessment/question answer with the Admin Staff to see if they believe they can fix our problems. The cost of fixing the issue should run from \$5,000 to \$10,000 if the company can troubleshoot/repair the software.

8) **Funding, discuss ways to fund "NEW" approved projects for LACC. Will these methods avoid taxes, will these methods need Member approval, Is there a limit on what can be set aside for new projects? There was much discussion on this item** - Scott said that we couldn't use Reserve funds for these projects. He did say that Reserve funds could be used to repair, restore, replacement, or maintain existing common areas. He said the Assn would have to designate priorities for NEW capital projects and then raise dues to address needed

funding for these projects. He did say that Member By Law Section 9.02 would come into effect when estimated cost was above the five percent of the budgeted gross expenses for the Assn. Therefore any New Capital costing over \$200,000 would have to be voted on by the Member for approval. The committee pointed out that the Assn needs to start prioritizing needed projects if we intend to fund them in the coming years.

- 9) **Capitalization of Fixed Assets Policy Amendment and what it accomplishes.** The committee had a long discussion on changing this process to raise our Reserve Fund limits on items from \$1,000 to \$5,000. Scott said that this would make it easier for the Staff to track the Reserve Fund items. He also said that with inflation many more items were being added to the list that didn't exist several years ago.
It was pointed out that changing the system may cause the Admin staff problems for the first year or so. Scott agreed with this analysis.
It was pointed out that about 40% of the current Reserve fund Items were below the \$5,000 threshold and thus would be eliminated from the Reserve Fund. It was also pointed out that this would increase the percent (%) funding of the Reserve Fund.
A question was asked, what will happen to those extra funds in the Reserve Fund. Scott said that they would stay in the Fund. That the Fund could and possibly should be increased in value and this would help accomplish that goal. It also means items that previously were spent out of Reserve will now need to be budgeted for during the budget process. This policy will increase out annual budgeted expenses.
The committee took a vote as to approve this Policy and they voted to approve this Policy 5 for and 1 against.
- 10) There were many questions still not answered throughout this meeting. Scott agreed to set up a conference call with Gray Porter, Scott Devereaux, Bill DeFazio, Jeffrey Janus, and Ed Organ for clarification and understanding.
- 11) Meeting was adjourned at 3:30