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YOU'RE FINISHING THE BUDGET... Did You Overlook Any Items?

It is hard to believe it is that time of year again. It is the beginning of fall and of course, the time to finalize the budget. All Boards should be reviewing their monthly financial statements each month, comparing actual results to budgeted amounts and gaining an understanding as to why there are any material differences even though the actual budget process begins in August and usually is completed in October.

As an accountant and CPA involved in the condominium and homeowners association industry for over 35 years, there are certain budget items that are overlooked many times. Before you finalize your budget, take one last review to see if you overlooked any budget items.

Contingency for Bad Debts

We all know that the amount of operating fund assessment income that is budgeted each year is determined by the operating fund expenses. We also know that the operating assessment income is based upon the amount of assessments that are billed each year; however, Associations do not always col-

lect all of these assessments. When preparing your budget, an often overlooked item is contingency for bad debts, which is determined by reviewing the operating assessment income that cannot be collected.

To determine what you may not collect, start with reviewing your monthly aged accounts receivable. Every Association needs to have a good and consistent collection policy that they diligently follow along with a good experienced collection attorney. The key is to minimize slow paying unit owners or units that go into foreclosure. Once the Board has reviewed its aged receivables, there should be a budget line item for contingencies for bad debts.

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Contingency Expenses Related to Severe Weather

Besides, budgeting for contingency bad debts, Associations can budget for other contingency expenses. These contingency expenses can include possible excess snow plowing costs due to heavier than expected snow falls or higher than expected utility costs due to colder than normal winters or hotter than expected summers. If these budgeted contingency expenses are not used during the year, the Association may be able to transfer these unused contingency expenses to an operating contingency fund. Associations should review their declaration first before transferring these excess funds to see if your declaration indicates what to do with any excess operating funds. It may reflect that excess operating funds should be refunded to unit owners.

IRS Determination on Painting Expense

An operating contingency expense that is not always budgeted properly is painting, since many Associations budget this expense with reserves. The Internal Revenue Service has determined that painting is not a reserve expense but an operating maintenance expense even though major painting projects may only be done every few years. Each year Associations should budget for painting in the operating fund budget and then transfer this budgeted expense that is not used to a separate operating contingency fund account. Your Association will then have accumulated the necessary funds to pay for the painting project when it is scheduled.

Accounting Fees & Income Tax

Additionally, I always notice there are two budgeted operating expenses that are overlooked a great number of times; accounting fees and income taxes. Budget preparation time is when Associations should ask for proposals for year-end accounting and income tax preparation. Although year-end audits are always recommended over compilation and reviews, every Association should look at its by-laws and declaration to see if it states whether audits are required. If these documents are silent, and you have a loan, look at your loan document to see if an audit, review or compilation is required. With

respect to income taxes, the Association should then determine if income taxes should be budgeted. We have many Associations that ask us to review their financials through June or July and estimate if any taxes should be budgeted. Even if your Association had no taxes due in prior years, it is possible that you could owe in the current year. For example, signing a licensing agreement with a cellular company most likely would be taxable. If we determine that income taxes could be owed,

we can now perform tax planning to minimize or even possibly reduce income taxes to zero.

Capital Reserve Account Funding

The last area that is overlooked is properly budgeting for reserves. Many Associations always ask me, "How much should we have in reserves and how much should we budget each year?" Each time I am asked, I say the same thing, "It is dependent upon your



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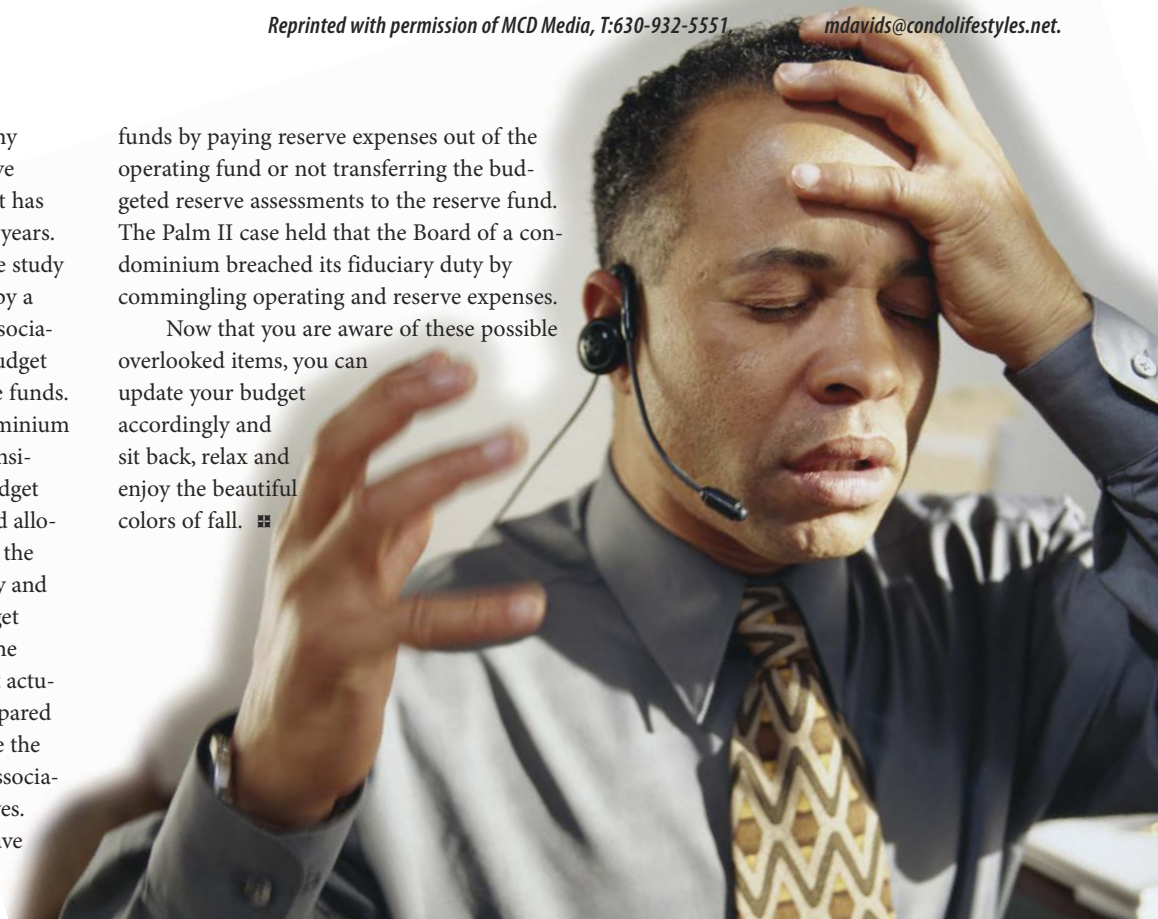
reserve study.” What we find is that many Associations either do not have a reserve study prepared or if they do have one, it has not been updated or reviewed in many years. Every Association should have a reserve study prepared every 3 to 5 years, preferably by a professional engineering firm. Your Association should designate in your annual budget an itemization and allocation of reserve funds.

The Palm II case found the condominium association breached its fiduciary responsibility by failing to provide an annual budget for the reserve account that itemizes and allocates reserve funds. The real key is that the Boards need to review this reserve study and the funding schedule every year at budget time. The Board then needs to update the funding schedule depending upon what actually happened during the past year compared to what the reserve study showed. Once the reserve study has been updated, your Association can now properly budget for reserves.

Often we find that Associations have commingled the reserve and operating

funds by paying reserve expenses out of the operating fund or not transferring the budgeted reserve assessments to the reserve fund. The Palm II case held that the Board of a condominium breached its fiduciary duty by commingling operating and reserve expenses.

Now that you are aware of these possible overlooked items, you can update your budget accordingly and sit back, relax and enjoy the beautiful colors of fall. ■



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