

Welcome!

Washington State Chapter COMMUNITY ASSOCIATIONS INSTITUTE

The leading professional organization providing
education, resources, and advocacy
for community association living.



A Championship Budget



Who we are

- **Kevin Ducotey, PCAM, Condominium Management, AAMC.** Kevin is the Director of Condominium Management, an Accredited Association Management Company serving Community Associations in the Puget Sound area. Kevin maintains a Bachelor's in BA – Finance and a PCAM designation. The PCAM designation is the highest professional recognition available nationwide to managers who specialize in community association management.

Who we are

- Catherine Kuhn, CPA is the Firm Director (Northwest Division) for Newman & Associates, CPA, PC (formerly Caglianuf & Company, CPA)
- *The firm is devoted exclusively to serving the financial needs of almost 900 Community Associations in the Northwest and 1500 CAs in the Southwest.*

Who we are

- Jim Talaga, Reserve Specialist, - President Association Reserves WA. 2 years preparing and overseeing 10,000 studies. 11 years on the CAI legislative action committee where he regularly monitored and participated in the drafting of Community Association law. Former board member of two associations. In the 10 years prior to Association Reserves Jim was a real estate appraiser, and builder of custom homes with his father.

Who you are?

- Old Act Condominiums (created <1990)
- New Act Condominiums (created >1990)
- Mixed Use Condominiums
- Homeowner's Associations
- WUCIOA Community (after 7/1/18)



The Schedule Today:

1. Requirements/Definitions/Roles
 - Questions and answers
2. Budget Development
 - Questions and answers
3. Financial/Audit Controls
 - Questions and answers
4. Reserve Study
 - Questions and answers



Category	Item	Amount	Total
1. Requirements/Definitions/Roles
2. Budget Development
3. Financial/Audit Controls
4. Reserve Study



Section 1 – Requirements/Definitions/Roles



Budget Approval RCW 64.34.308 – Condominiums

Within thirty days after adoption of any proposed budget for the condominium, the board of directors shall provide a summary of the budget to all the unit owners and shall set a date for a meeting of the unit owners to consider ratification of the budget not less than fourteen nor more than sixty days after mailing of the summary. Unless at that meeting the owners of units to which a majority of the votes in the association are allocated or any larger percentage specified in the declaration reject the budget, the budget is ratified, whether or not a quorum is present. In the event the proposed budget is rejected or the required notice is not given, the periodic budget last ratified by the unit owners shall be continued until such time as the unit owners ratify a subsequent budget proposed by the board of directors.

Budget Approval RCW 64.38.025 – HOA's

- Within thirty days after adoption by the board of directors of any proposed regular or special budget of the association, the board shall set a date for a meeting of the owners to consider ratification of the budget not less than fourteen nor more than sixty days after mailing of the summary. Unless at that meeting the owners of a majority of the votes in the association are allocated or any larger percentage specified in the governing documents reject the budget, in person or by proxy, the budget is ratified, whether or not a quorum is present. In the event the proposed budget is rejected or the required notice is not given, the periodic budget last ratified by the owners shall be continued until such time as the owners ratify a subsequent budget proposed by the board of directors.

Budget Approval Horizontal Regime Act

- No requirement in the Act.
- Refer to the Declaration for requirements.

WUCIOA

WUCIOA Section 326 – Budget and Assessments

- Section 326 (rcw 64.90.525) overrides any conflicting provisions in RCW 64.38, i.e. the "Homeowners Association Act" (HOAA). • The Legislature declared that Section 326 supersedes the governing documents of any HOA in order to "protect the public interest." – Presumably, this language was drafted to prevent a successful "impairment of contracts" argument being made. – Section 326 was drafted to directly overturn the Casey decision.

Budget and Assessments Process

- Similar to existing process under RCW 64.38.025: – Board adopts budget and presents to membership for ratification. – Unless a majority of votes in the association reject the budget at that meeting, it is ratified. • If rejected, the prior budget continues. – Note: If quorum not established at this meeting, the budget is automatically ratified. • Major Change: The budget and assessments are ratified in the same vote.

WUCIOA

Budget Requirements

- The budget must include:
- The projected income to the association by category
- The projected common expenses and those specially allocated expenses that are subject to being budgeted, both by category
- The amount of the assessments per unit and the date the assessments are due
- The current amount of regular assessments budgeted for contribution to the reserve account
- A statement of whether the association has a reserve study that meets the requirements of section 331 (rcw 64.90.550) of WUCIOA and, if so, the extent to which the budget meets or deviates from the recommendations of the reserve study
- The current deficiency or surplus in reserve funding expressed on a per unit basis.

What is a Budget

- CAI's Definition
 - A budget is a financial plan for an organization-in this case, a community association. A budget provides an estimate of a community's income and expenses for a specific period of time.

Accounting Basics

Just what do "Cash", "Accrual", and "Fund" mean, anyway?



Cash Accounting:

- Transaction is recorded when cash is affected, either on the revenue or expense side.
- Revenues (assessments) are recorded when they are received, expenses are recorded when they are paid.
- Balance Sheet reports cash balances.





Accrual Accounting:

- Transaction is recorded when event occurs, regardless of cash activity.
- Revenues (assessments) are recorded when they are charged, whether they are received or not
- Expenses are recorded when they are incurred, whether they are paid or not
- Balance Sheet reports cash balances, as well as receivables (unpaid assessments) and payables (unpaid obligations).



Modified Accrual Accounting

- Revenues (assessments) are recorded when they are charged, whether they are received or not.
- Expenses are recorded when they are paid.
- Balance Sheet reports cash balances, receivables (unpaid assessments) and may indicate larger payables (such as major contracts).



Fund Accounting

- Records financial activity by fund (operating fund, construction fund, reserve fund, insurance fund, special assessment fund)
- Specific dollars earmarked for specific projects



Chart of Accounts

- An organized list of name and numbers of all accounts in an organization's general ledger. The number helps you locate the account. The name describes the purpose of the account.
- Determine the chart of accounts for the budget.
- The chart of accounts will match the Income Statement.
- How detailed should it get?



Typical Chart of Accounts

- Four digit numbers give you flexibility.
- 1000's – Assets
 - 2000's – Liabilities
 - 3000's – Income
 - 4000's – Operating – administrative exp.
 - 5000's – Operating – utilities exp.
 - 6,000 – Operating – Maintenance exp.
 - 7000's – Reserve Expenses

Why Do We Care About Accruals & Assets?

- The annual budget should be compared to the MONTHLY financial statements.
- The MONTHLY financial statements must reflect the budget accurately to be meaningful.
- An accurate budget is a great internal control
- An accurate budget is a primary audit tool by the CPA.



Who's Responsible for the Budget?

- **The Board of Directors** is responsible for the development and approval of the budget.
- The Board has the ability to delegate its responsibility to develop the budget to a committee, a site manager, or the management company.
- Get people involved – the more eyes the better.
- Develop a broad base of experience.



What is the Manager's Responsibility?

Managers:

- Provide a draft for discussion purposes.
- Provide historical data in support of board's efforts.
- Provide future projections in support of their efforts.
- Provide industry perspective of relative costs.
- Support the board in the development of their budget.



Board Members:

- Are the primary drivers of the budget process
- Must stay in compliance with the governing documents (timelines, ratification, approvals, etc.)
- Review the draft budget, and consider the information contained within the draft budget
- Honestly look at the future, and evaluate projects, expenses, and reasonable timelines



Budget Process



When should we start?

- Start early
- Be mindful of your declaration requirements
- Fiscal year-ends may vary
- New act condominiums call for the ratification of the budget, with specific timelines
- Count backwards from the date the budget needs to be approved according to declaration requirements (60 days prior to end of the year)
- Provide owners with sufficient time to adjust their payments.



Sources of Budget Requirements

- Federal laws and regulations.
- State statutes, regulations & court decisions.
- Local laws and regulations.
- The community's governing documents.



Lender's Requirements

(FHA, VA, Fannie Mae)

Provides for the funding of replacement reserves for capital expenditures and deferred maintenance amounting to at least 10% of the budget.



Requirements/Definitions/Roles:

Questions?



(Section 2) Budget Development



What is Budgeting?

- **Budgeting:**
- Provides an estimate of revenue and expenses.
- It's a system of financial controls.
- It's a philosophy of financial management.
- It's simple in concept, complicated in execution.
- It's worthy of work and attention.
- It's a financial plan.
- It represents what is important to the owners, discretionary expenses - landscaping



What are the primary drivers of budget development?

- The Reserve Study.
- Current cash position.
- Last year's budget performance.
- Next year's increases.
- Trends from prior year's budget performance.



Budget Tools

- General Ledger – year to date.
- Accounts Payable Report.
- Vendor History.
- Invoices.
- Balance Sheet.
- Income Statement.



Pitfall One

1. Using Other Income to Balance the Budget
 - a. Interest Income from Reserves
 - b. Late Fees
 - c. Fines
 - d. Other income that is not certain



Budget Preparation Step 1 – project actual income & expenses

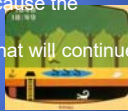
- Income – accrual or cash?
- Other Income – include other income – late fees, interest, etc.
- Include a year's worth of billing cycles – monthly, semi monthly, quarterly?
- Explain significant positive and negative variances
- Invoices coded the correct GL.
- Reserve expenses must be equal to the reserve transfers.
- List all reserve expenses.
- What is an operating expense and reserve expense – reconcile
- What is the budget surplus or deficit for the year?

Budget Preparation Step 2 – prepare new budget

- Income – accrual or cash?
- Don't use other income that is not predictable and guaranteed to balance the budget
- Reserve Contribution – use what is recommended in the reserve study as the starting point.
- Calculate Operating Expenses – zero base, historical trend, hybrid, contract increases, inflationary increases – utilities.
- Discretionary expenses vs. fixed expenses. Most expenses are fixed for the most part.
- Reduce expenses if possible– i.e earthquake insurance, save on electric by changing light bulbs.
- Solicit bid estimates for planned projects.
- Consult with insurance broker for changes in the insurance premium.
- Are there any new expenses to consider?

Pitfalls Two and Three

2. Not addressing a budget surplus or deficit for the current year in the new budget. RCW 64.34.356 for Surpluses.
3. Not understanding or identifying budget variances – good or bad.
 - a. Did specific items or expenses cause the variance?
 - b. Was it just recurring expenses that will continue in the new fiscal year?



Zero-Base Line Items

- Assumes \$0.00 as a starting point.
- The numbers are justified or backed up by a contract amount or assumption.

Historical Trend Items

- Uses the prior expenses history of the Association to predict the expenses for the future.
- Older Associations have more history, resulting in increasingly accurate budgets.

Would you use zero base, historical, or hybrid to calculate?

- | | |
|---------------|------------------------|
| • Mgmt Fee | • Irrigation |
| • Audit | • Building Maintenance |
| • Insurance | • Landscaping |
| • Legal | • Landscape other |
| • Electric | • Fire and Safety |
| • Water/sewer | • Exterior Cleaning. |
| • Garbage | |

Budget Preparation Step 2 Cont – prepare new budget

- Include budget surplus or deficit in new budget. Surplus reduces assessments and deficit inflates the assessments.
- Include "Bad Debt" – how much?
- Review recommended reserve expenses not completed in current year, will they be scheduled in the new year, and possible reserve expenses needed but not planned. (This is separate from operating budget).

Pitfall Four

4. Not having Enough "Fat" in the Budget to Account for Unexpected Items.
 - a. The more mechanical systems the building has the more likely you will have unexpected repairs.
 - b. Use Contingency line items in the budget for flexibility. (see handout pkg)



Budget Preparation Step 2 Cont – prepare new budget?

- The most effective approach is to use all three methods to calculate the new numbers.
- Budget Notes – how detailed to get? Be able to justify all numbers regardless of method, more details may require a separate sheet, be concise, break down fixed amounts vs. variable.
- Assume the reader of the budget knows nothing about the association.

Budget Preparation Step 3 – prepare new budget?

- Breakdown the annual numbers into monthly amounts.
- Cuts down on variances (artificial variances).
- Takes into account seasonal changes.
- Matches budget with reality.

Budget Preparation – final step?

- Calculate assessments increase to balance the budget.
- Is there a cap on the increase amount?
- My experience is that increases over time will average approx. 3% a year.
- Adopt a policy to increase assessments based on a CPI – minimum increase?
- It is not a “badge of honor” to keep the assessments flat. The “good” board today will become the “bad” board later – 5 years.

Pitfalls Five, Six, & Seven

5. Not Adopting a Realistic Budget – not having enough “Fat” in the budget to account for unexpected items
6. Not Including Bad Debt – not accounting for “Bad Debt”. Is that a issue in 2018?
7. Not Keeping Operating Expenses Level Year to Year – treat some items as a reserve expense. This reduce the budget surplus and deficits. Barking or have contracts that are paid out evenly each year – Elevator and Fire and Safety – 5 year test for example



Budget Development:

Group Discussion – project actual expenses



Budget Development:

Questions?



Timeout!!



Footnote on Cashflow and Retained Earnings

- Evaluating Retained Earnings.
- Evaluating Cash Flow.

Retained Earnings/Equity/Fund Balance:

- Evaluation Retained Earnings is very important and not done often enough.
- Current Year Earnings – Accrued Income less operating expense less reserve contribution.
- Retained Earnings – same formula above except for all prior years.
- General Rule – the larger the negative number – the more likely the Association has a problem with cash flow. The larger the positive the number – the more likely the Association has a healthy cash flow.
- CAI benchmark: 1-3 months of avg operating exp in Retained Earnings/Equity

Cashflow/Cash Position

- Why is it important?
- Can be harder to determine because of Accrual Accounting – accounts receivable?
- Negative retained earnings is usually an indicator of the health of your cashflow.
- What affects cash flow? – not addressing shortfalls, expenses higher than income, delinquencies, bad debt, prepaid dues.



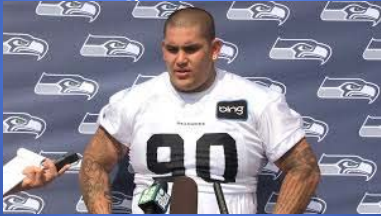
Pitfalls Eight and Nine

8. Not Evaluating Cash Flow/Cash Position at year end.
9. Not Evaluating Retained Earnings at year end



Cashflow and Retained Earnings:

Questions?



Section 3 – Financial Controls and Audits



Financial Controls

- Don't change the budget in mid year. Special assessment requires a supplemental budget.
- The budget is only an estimate and a tool.
- Variances will exist for every item. Important to look at the "Big Picture".
- Read financial statements.
- Reconcile bank accounts.
- Two board members authorize **reserve** expenses.

Financial Controls

- Use multiple banking institutions if cash & investments are over \$250K.
- Liquidity and Safety more important than return on money.
- Borrowing from reserves – not recommend for operating expenses.
- Minutes should show approval for all reserve expenses and reserve transfers.

Audits: What They Do Accomplish

- Provides compliance with 64.34.372 for condominiums, 64.38.045 for HOAs and 64.90.530 for WUCIOA communities
- Provides an opinion on the financial statements as a whole
- Provides *reasonable* assurance that the statements are free of *material* misstatements
- Provides an overview and understanding of the association's financial controls
- Provides audit adjustments (if necessary).



Audits: What They Don't Accomplish

- Provide bookkeeping for the Association
- Provide a reconciliation of bank statements
- Provide for discovery of immaterial misstatements
- May not detect theft, fraud, or intentional acts unless specifically engaged for that purpose.



**Audits:
Do We Have To Have One?**

HOA Act 64.38.045 (Homeowner's Associations):
"...The financial statements of associations with annual assessments of fifty thousand dollars or more shall be audited at least annually by an independent certified public accountant, but the audit may be waived if sixty-seven percent of the votes cast by owners....vote each year to waive the audit.



**Audits:
Do We Have To Have One?**

(WCA) rcw 64.34.372 (New Act Condominiums):
"...At least annually, the association shall prepare...a financial statement of the association in accordance with (GAAP). The financial statements of condominiums consisting of fifty or more units shall be audited at least annually... In the case of a condominium consisting of fewer than fifty units, an annual audit is also required but may be waived annually by unit owners to which sixty percent of the votes are allocated...





**Audits:
Do We Have To Have One?**

HPR rcw 64.32.170 (Old Act Condominiums):

- "...All books and records shall be kept in accordance with good accounting procedures and be audited at least once a year by an auditor outside of the organization.
- Defaults to New Act requirements, UNLESS the Governing Documents for the Old Act Condo require an audit.



Audits: Do We Have To Have One?

WUCIOA: rcw 64.90.530 (7/1/18)

(2) ... annual assessments of \$50,000 or more must be audited at least annually by a CPA. ...annual assessments of less than \$50,000, an annual audit is also required but may be waived annually by unit owners other than the declarant of units to which a majority of the votes in the association are allocated, excluding the votes allocated to units owned by the declarant.

Financial handouts

- CAI "TIPS" Industry Standards
- Budgeting tips: Contingency & Bad Debts - FAQs



Financial controls & Budget follow-up:

Questions?



Section 4: Reserve Budget



WA Condo History



RS Basics – Cash Flow Planning, Managing Financial Risk

Three Key Results



Special Assessment Risk



What is % Funded?

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How much should our budgeted reserve contribution rate be?

- Depends upon where your at, what you're risk tolerance is & where you want to go. **Start Here** ↓

Fiscal Year Start: 04/01/17 Interest: 1.0% Inflation: 3.0%

Reserve Fund Strength Calculations (All values as of Fiscal Year Start Date)					Projected Reserve Balance Changes			
Year	Starting Reserve Balance	Fully Funded Balance	Percent Funded	Special Assmt Risk	Reserve Contribs	Loans or Special Assmts	Interest Income	Reserve Expenses
2017	\$14,400	\$402,671	3.6%	High	\$27,480	\$335,000	\$561	\$279,600
2018	\$97,641	\$218,380	44.8%	Med	\$37,739	\$0	\$1,151	\$4,223
2019	\$132,508	\$249,775	53.1%	Med	\$38,871	\$0	\$740	\$156,483
2020	\$15,637	\$126,160	12.4%	High	\$40,038	\$0	\$322	\$7,212
2021	\$48,785	\$153,468	31.8%	Med	\$41,239	\$0	\$912	\$16,903
2022	\$73,753	\$172,604	42.7%	Med	\$42,476	\$0	\$943	\$2,261
2023	\$114,912	\$208,311	55.2%	Med	\$43,750	\$0	\$1,350	\$4,896
2024	\$155,116	\$243,381	63.7%	Med	\$45,063	\$0	\$1,785	\$0
2025	\$201,963	\$289,520	70.7%	Low	\$46,414	\$0	\$1,941	\$63,972
2026	\$186,346	\$264,099	70.6%	Low	\$47,807	\$0	\$2,041	\$14,092

And here....

Go Hawks!

2021-3
WSV

# Component	Deflat Life (yrs)	Current Cost Estimate	Disinflation Rate%	Contribution Significance
Site/Structure				
101 Site/Inlet - Repair/Replace	40	\$8,200	\$100	0.22%
102 Fence Chain Link - Replace	40	\$4,100	\$100	0.11%
170 Landscaping - Refurbish	0	\$16,000	\$0	0.50%
190 Walkways - Replace	40	\$4,000	\$100	0.21%
Building Exterior				
002 Roof Asphalt Shingles - Replace	20	\$73,000	\$1,500	4.91%
010 Sutters/Downspouts - Repair/Replace	25	\$11,300	\$400	0.71%
015 Chimney Covers & Flue Caps - Repair	30	\$50,000	\$1,977	1.61%
020 Siding w/Concrete - Replace	30	\$230,000	\$4,700	7.81%
025 Siding w/Stone - Replace	30	\$230,000	\$4,700	7.81%
030 Exterior Surfaces - Paint/Coat	10	\$60,000	\$6,000	6.31%
035 Windows, Doors - Repair/Replace	30	\$200,000	\$4,400	7.31%
040 Decks - Clean/Repair/Coat	1	\$30,000	\$0	10.11%
042 Walkway North - Clean/Repair/Coat	1	\$30,000	\$0	10.11%

Even better – simply follow the recommendations in the study!

3- Minute Executive Summary	
<i>Results as-of 1/1/2013:</i>	
Projected Starting Reserve Balance:	\$100,000
Fully Funded Reserve Balance:	\$444,547
Average Reserve Deficit (Surplus) Per Unit:.....	\$6,891
Percent Funded:	22.5%
100% Full Funding 2013 Monthly Reserve Contribution	\$6,030
70% Threshold Monthly Reserve Contribution.....	\$5,280
Baseline Contribution (min to maintain reserves above \$0).....	\$3,800
Recommended 2013 Special Assessment for Reserves:.....	\$0
Most Recent Reserve Contribution Rate:.....	\$4,000

Key factors to reserve plan success

- Understand per Gov Doc's responsibilities for Maintenance, Repair & Replacement
- Accuracy of component list & pricing (inflation is likely more than you think).
- Frequency of updating – required every year
- Assess for hidden damage: know your buildings inside & out
- Financial means of owners: can you be both compassionate and fiscally disciplined?
- Be Hawkish!



Typical results of poor, or no reserve plan

Associations:

- Special assessments, delinquencies
- Breakdown of community spirit
- Diminished marketability
- Lower property values

Seahawks: poor ticket sales, lower TV revenue & ability to attract top talent, consumers spending their discretionary dollars elsewhere

Law requirements

- RCW 64.34 & .38 All residential associations with significant assets. Opt out with 2/3 vote if less than 10 units. Disclosure with budget compares cash flow of budgeted rate with RS recommendation.
- New RCW 64.90.525 (d) (e) (f)
- 64.90.535
- 64.90.545 all residential except nominal costs or study exceeds 10% of annual budget
- RCW's also outline what must be included (1% rule), borrowing from reserves, provision for attorney fees, disclosure statement with budget (meets or deviates), Public Offering Statement, Resale Cert. (do / do not have compliant study)
- RCW 64.90.620 POS for Conversion stipulates in (f) the current deficiency or surplus in reserve funding expressed on a per unit basis

Pitfall Ten

10. Not Following the Reserve Study and the Recommended Reserve Contribution.
- a. The most important thing the Board can do is fund the reserves via the budgeting process. Is it a priority and explained to the membership?



RESERVE BUDGET QUESTIONS?????



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Ten Pitfalls to Avoid:

1. Using "Other Income" to Balance the Budget.
2. Not Addressing Budget Surplus or Deficit for the Year.
3. Not Understanding Budget Variances – why did we over spend?
4. Not having Enough "Fat" in the Budget to Account for Unexpected Items.
5. Not Accounting for "Bad Debt" and Not Rolling Over Unused Bad Debt Every Year.
6. Not keeping Operating Expenses Consistent and Level from Year to Year.
7. Not Following the Reserve Study and the Recommended Reserve Contribution.
8. Not Evaluating the "Cash flow" of the Association at Year End.
9. Not Looking at "Retained Earnings" at Year End.
10. Not Using the Three Standard Methods to Calculate the Budget Numbers.

FINAL QUESTIONS?????? Thank You!



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