

Financial Pitfalls All Boards Should Avoid



By Joseph A. Chorba
Wilkin & Guttenplan, P.C.

"Setting maintenance fees unreasonably low isn't the only potential pitfall associations face."

We have all heard the saying "The only things certain in life are death and taxes." Well, if you live in a condominium or homeowners association you can add maintenance fees to the list. It's one of those things that are simply part of living in an association. Maintenance fees are similar to taxes, you pay a pre-determined sum of money, calculated based on a budget by someone you voted for, who then decides how that money will be spent for services provided to you. Much like the taxes you pay to the government, you expect a certain level of services and are unhappy with any increases. The fact of the matter is, costs continue to escalate on an annual basis. Landscaping costs go up. Utility prices go up. Everything goes up. The question is, what should an association do when costs rise? Board members

feel pressured not to increase maintenance fees because they assume the unit owners will be unhappy. They don't want to reduce service levels because they don't want to risk the negative effect on property values and the aesthetics of the community. So what is a board to do? This is a common question that board members and unit owners ask themselves every year. If the answer to this question is not carefully thought out, it could lead to financial problems not only in the current year but for years to come.

Setting maintenance fees unreasonably low isn't the only potential pitfall associations face. There are at least ten potential financial pitfalls that associations face each and every year:

Artificially Low Maintenance Fees

Many times, board members are pressured into keeping maintenance fees consistent year after year. The problem is, as mentioned above, costs continue to rise. If maintenance

fees are not sufficient to support the expenses, the association will fall into a deficit position. Deficits can lead to a number of other problems such as insufficient cash flow and underfunding of replacement cash accounts.

Failing To Address Deficits

We all know that deficits happen. There may be a year when expenses are unusually high due to unexpected events beyond the board's control which causes the association to go over budget. The important thing is what the association does about the deficit. The association must develop a plan to recover that deficit either through a special assessment or adjustment to future budgets. Ignoring the deficit will eventually have a serious impact.

Not Maintaining a Working Capital Surplus

Working capital contributions are collected for a purpose. Problems can arise

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when board members use the working capital contributions for something other than the intended purpose and then do not have a plan to replenish them. Working capital contributions are intended for several pur-

poses. They provide funds at times when unexpected expenses occur and they also provide cash to help with the peaks and valleys in cash flow during the year. If working capital contributions are used, the board

should have a plan to replenish the funds. As a general rule, we recommend maintaining 2-3 months current maintenance fees in either working capital or surplus.



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Inadequate Replacement Funding

What is sufficient in terms of the replacement fund? If I asked 10 different attorneys, accountants, and/or board members, I might get 10 different answers. But when deciding whether or not the replacement fund is healthy you should ask the following questions:

1. Is there a current independent engineer's replacement study (performed within the last 3 years)?
2. Is the association funding in accordance with the engineer's recommendations?
3. Is the proper amount of cash set aside in an account earmarked for replacement fund expenditures?

If the answer to all three is "Yes" then you are properly executing your fiduciary responsibilities with regards to replacement funding.

Not Using Your Association Professionals

The board is driving the bus, but who is helping them decide which direction to turn? It is important that the board members do their homework when deciding on a management company, attorney, auditor or engineer. These are the four of the most important hires the board is going to make because each of them are going to help the board make decisions that affect every aspect of living in the association. Hiring experienced professionals is a must!

Not Performing Preventative Maintenance

Deferring preventative maintenance can be another tempting way to keep maintenance fee increases at a minimum for the upcoming budget year. However, like other short-term fixes, this will come back to haunt the association in the long run.

Improper Communication With the Residents

Communication is key. One of the biggest mistakes a board can make is not properly communicating with the unit owners. Many associations prepare quarterly newsletters and have frequent meetings that are open to all members. Associations should do what makes sense for them but try to make sure



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unit owners are aware of the important decisions facing board members.

Maintaining Incomplete Board Minutes

Boards have a fiduciary responsibility to do what is in the best interest of the association. Board minutes provide an official record of all of the discussions and decisions made on an ongoing basis. One of the pitfalls boards face is either not maintaining minutes of meetings or maintaining insufficient meeting minutes. The goal should be to leave no doubt. Board minutes must provide a clear record of the board's decisions and actions.

Inadequate Financial Reporting

Another potential pitfall boards face is not being financially informed. Management companies should provide a monthly financial package to the board that contains a budget v. actual report, delinquency report, balance sheet, bank statements, check disbursement listing, vendor accounts payable listing, etc. Someone on the board should be responsible to review these reports to understand what transactions have taken place, as well as the impact they have on the financial health of the association. This is another form of communication that is important to board members in order to fulfill their fiduciary responsibility.

Lack of Documented Internal Controls

Internal controls are basically the process that is in place to ensure accurate financial reporting and control over association assets. Having procedures in place for processing maintenance fee income from unit owners, and selecting and paying vendors is all part of an association's internal controls. Your management company may assist with this process, but board members must understand the internal controls at the management company and be actively involved in creating and maintaining proper internal controls tailored to their situation. The board is ultimately responsible for the financial operation of the association.

As you can see, being a member of the board is not as easy as some people may assume. The board has to make some very difficult and sometimes unpopular decisions in order to avoid these common pitfalls and protect the interests of their neighbors and themselves. However, being aware of and avoiding these common financial pitfalls will help a board make informed and responsible decisions for their association. ■

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