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THE CHANGING INSURANCE CLIMATE: What Associations Need to Know

By Debbie Pasquariello, CIC,
BHB Insurance, Toms River, NJ

As a service to our readers, we periodically provide information from guest contributors on important and timely topics. Debbie Pasquariello has over 15 years of specialized experience advising Associations on insurance matters. For many years, she has been actively involved in the leadership of CAI-NJ and is a frequent lecturer/participant in CAI industry forums and workshops, as well as a contributing author to numerous industry publications. She may be contacted via email at dpasquariello@bhbins.com

Even prior to the World Trade Center attacks on 9/11, the climate in the insurance industry was experiencing fundamental changes.

Although these business conditions may not, on the surface, appear to have any relevance to Associations, the aggregate effects of today's insurance climate could have a very meaningful impact on Board/Association Management strategy for providing appropriate insurance protection. This article will provide some background on the reasons underlying certain changes in insurance coverage premiums and limitations, the impact these changes will likely have on Associations, and some practical suggestions for Associations to mitigate these effects.

Background

Prior to 9/11, there were three interrelated factors with which insurers were wrestling:

1. The insurance industry had been in a "soft", or highly competitive, market for almost 14 years; this increased competition for business led to stable, if not lower, premiums for many policyholders.
2. Claims paid over the past decade from losses due to asbestosis, pollution, earthquakes,



hurricanes and other natural disasters have been dramatically above historical norms.

3. The industry relies heavily on its investment income to offset claim payments. Over the past several years, the industry's portfolio returns have failed to keep pace with these liabilities.

As a whole, the industry's losses have far outpaced any offsetting gains from investments. The result of these circumstances is the return of the "hard", or less price competitive, market. Although the industry has seen other "hard markets", there is an important difference between the current hard market and the previous one, in the mid 1980's. The latter was principally limited to a liability crisis, while the current market is one in which virtually all coverage lines are affected. The broader impact of these circumstances was already evident prior to September 11th, but the events of that day have worsened the situation.

The physical loss of the World Trade Center's Twin Towers is only one aspect of the new reality of the insurance business. This was the greatest loss in the history of insurance for a host of business lines.

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Those most severely affected include: Aviation (\$10-\$20 billion), property (\$20-\$30 billion), casualty (\$10-\$15 billion), business interruption (\$10-\$20 billion), automobile, Workers' Compensation (\$5-\$10 billion), as well as, health and life (\$5-\$10 billion). Add to these losses the cost of debris removal at Ground Zero, the extra expense to relocate office space equivalent to the size of Downtown Dallas, and the cost to reproduce the valuable papers and records that were seen covering the streets of New York. No one could have ever anticipated that, for one individual company, the Death Benefits to be paid on a single Workers' Compensation policy could exceed \$500 million. The total losses are not yet fully known, but some have estimated that these losses will likely exceed \$80-\$100 billion.

Anticipated Impact on Associations

What does all this mean for Association policyholders? We anticipate that the ripple effect of these circumstances will be very serious and far-reaching:

- ◆ **Anticipate continued meaningful premium increases** – in the first half of 2001, premiums increased 10-15% and escalated to 15-20% after July 1st. Unfortunately, this trend is accelerating; even those accounts with very good loss experience may experience 30-50% increases in premiums. Accounts that have experienced losses will see much larger increases.
- ◆ **Know that larger accounts, defined as those over \$50,000,000 in property values, will see the largest increases in premiums** – some insurance companies will no longer even be able to write coverage for these accounts, correspondingly reducing coverage and pricing options.
- ◆ **Expect new forms of coverage limitations** – We anticipate several new policy exclusions for 2002, including:
 - Terrorism** – this insurance may be available only to select customers at extremely high prices. The U.S. House of Representatives has passed the *Terrorism Risk Protection Act*, which addresses the terrorism coverage issue with a government loan program. The Senate is still working on their version of this legislation.
 - Mold** – there have been a number of large, highly publicized cases recently, but there have also been many smaller claims, on both personal (homeowners) and commercial policies, all around the country. This situation is a concern for insurance companies because, in addition to the property damage that mold causes – wallboard & carpeting ruined and needing replacement, for example – there is also the fact that some of the mold is toxic and can cause allergic reactions. This can lead to bodily injury claims which can be much greater than the property damage claims.
- ◆ **Understand that the insolvency of some insurance companies will be inevitable** – the cost of reinsurance has increased substantially, while capacity to provide this protection has diminished. This will further limit insurers' ability to provide coverage in the manner, and at more competitive premiums, to which Associations had been previously accustomed.

The reason for this anticipated dramatic spike in premiums, along with related changes in underwriting capacity and

guidelines, is because the events of September 11th changed more than the landscape of Lower Manhattan and the area around the Pentagon; it fundamentally changed the landscape of the insurance industry. The current business climate for insurers has led to tougher underwriting standards, which have made coverage renewals for Associations with poor loss experience or significant capacity requirements, particularly challenging. The industry is turning to the surplus lines markets more often than ever before.

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Another issue for insurers in the aftermath of September 11th, is Workers' Compensation. An increased focus for insurers is concentration of employees at a single site or accumulation of customers in a given geographic area. Although this is not an exclusion, it will be an underwriting condition for these concentrations to remain within insurer-defined parameters. This heightened awareness parallels the way underwriters have been forced by hurricanes of the 1990s to track aggregations of property values in high-risk zones.

Insurers are projecting Workers' Compensation losses in New York to be astronomically high; perhaps as much as \$500,000 to \$900,000 per employee. Based on this type of experience, we anticipate contraction in the number of companies willing and able to provide this coverage. In the wake of this shrinkage of suppliers who will need greater premium compensation to justify their risk of providing coverage, premiums will increase significantly. For example, the Workers' Compensation premiums for *good* risks are expected to increase 40%. Accounts with significant loss experience will see higher increases. We will also see fewer companies in the marketplace.

Practical Guidance for Associations

While this situation may appear very bleak, Boards and Associations do have choices, and there are steps that can be taken to secure appropriate insurance coverage. Here are some steps that may be taken by Associations to help cushion the impact of likely premium increases:

- ◆ **Review the amount budgeted for insurance with your insurance agent, property manager** – and other trusted financial advisors to make sure it is adequate. Expect to have to increase your budget by a significant (as much as 30-50%) amount.
- ◆ **Discuss risk management techniques with your insurance agent and current insurance carriers to help minimize losses** – there are several things Associations

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HOW LONG SHOULD YOU RETAIN FINANCIAL RECORDS?

by Gary B. Rosen, CPA



Just like any other well-run enterprise, Associations need administrative policies and procedures that ensure the retention and protection of important financial records. Why is record retention important to a Community Association? Aside from the obvious “sound business practice” to ease administration and reduce wasted staff time searching for important documents that support regular operations, situations such as annual audits, as well as, Builder/Board or professional transitions are more efficiently accomplished when a comprehensive collection of Association financial records is readily available.

Two of the most common records-retention questions we receive are:

1. Which records do we need to retain?
2. How long should we keep our records?

There will be times when it may be appropriate to seek situation-specific professional advice for records management issues when there is the possibility of litigation or arbitration, but absent such special circumstances, there are some specific guidelines you can use to store and dispose of your records.

We offer the following chart for your reference in forming and following a consistent and easily-administered records management policy:

3-7 Years	7 Years	Permanently
<ul style="list-style-type: none"> ◆ Accident reports/claims (settled cases) ◆ Backup of computer records ◆ Bank statements/reconciliations ◆ Correspondence (general/routine) with unit owners and/or vendors ◆ Duplicate deposit slips ◆ Employment applications ◆ Insurance policies (expired) ◆ Petty cash vouchers ◆ Requisitions 	<ul style="list-style-type: none"> ◆ Accounts payable/receivable ledgers and schedules ◆ Canceled checks (other than those indicated for permanent retention) ◆ Contracts, mortgages, notes, and leases (expired) ◆ Expense analyses/distribution schedules ◆ Garnishments ◆ General/private ledgers, year-end trial balances ◆ Payroll records and summaries ◆ Personnel files (of terminated employees) ◆ Purchase orders (purchasing dept. copy) ◆ Receivable ledgers and schedules ◆ Subsidiary ledgers ◆ Time books/cards ◆ Vouchers for payments to vendors, employees, etc. (includes allowances and reimbursement of employees, officers, etc. for travel and entertainment expenses) ◆ Withholding tax statements 	<ul style="list-style-type: none"> ◆ Audit reports ◆ Charts of accounts ◆ Canceled checks for important payments, i.e. taxes, purchases of property, special contracts, etc. (Checks should be filed with the papers pertaining to the underlying transaction) ◆ Correspondence (legal and important matters only) ◆ Deeds, mortgages, and bills of sale ◆ Financial statements (year-end, others optional) ◆ Minute books of directors, stockholders, bylaws, and charter ◆ Property appraisals by outside appraisers ◆ Property records-including costs, year-end trial balances, depreciation schedules, blueprints, and plans ◆ Retirement and pension records ◆ Tax returns and worksheets-revenue agents reports, and other documents relating to determination of income tax liability ◆ Training manuals ◆ Union agreements (if applicable)



The Changing Insurance Climate

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can implement to help prevent or reduce property and liability losses. This includes even seemingly minor maintenance programs for washing machine hose replacement, water heater replacement, gutter and downspout cleaning, sidewalk inspection, and prompt repairs of cracks, breaks or holes. All of these proactive measures may help to improve the Association's loss experience, and correspondingly, over time, reduce premium costs.

- ◆ **Consider increased deductibles for a reduction in premium** – this will also eliminate small losses from the Association's loss history.

Summary

The "soft", competitive market in which many Associations found insurance premiums to be stable or decreasing during the last ten years ended about a year ago. The increases that began appearing in late 2000/early 2001, have accelerated in the aftermath of September 11th.

Associations that have had loss control programs in place through the years will likely gain some benefit from them as a buffer against anticipated significant premium increases. Associations without a loss-control program in place, would be prudent to consider proactively implementing one, in anticipation of potentially substantial premium increases.

UPCOMING ISSUES:

- **Interfund Balances**
- **How Are Your Investments Insured?**



NEWS AT THE FIRM

ANNIVERSARIES (January–March)

Congratulations to the following W&G staffers who celebrated the following years of service anniversaries:

- 16 years **Sefi Silverstein**
- 15 years **Michael LoVerde**
Pamela Tomminelli
- 14 years **Kristine Flores**
Aurelia Hughes
- 5 years **William McDevitt**
Brian Geissler

WELCOME

Please join us in welcoming new W&G staffer, **Anissa Telle**.

NEW ARRIVAL:

Congratulations to **Joanne Scott** and her husband **Michael** on the 1/3/02 arrival of **Gabriella Emily**.

HAPPIER HOLIDAYS:

The staff of W&G collected money which was matched by the Firm for the NJ Disaster Relief For Children of New Jersey to benefit New Jersey children that were directly affected by 9/11. A huge "Thank You" to everyone who contributed.

This publication is prepared quarterly by Wilkin & Guttenplan, P.C. For further information or for complimentary copies or subscriptions, you may contact Jules C. Frankel at:

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