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Financial Pitfalls All Boards Should Avoid

by Joseph Chorba

We have all heard the saying, “The only things guaranteed in life are death and taxes.” Well, if you live in a condo or HOA you can add maintenance fees to the list. It’s one of those things that is simply part of living in an association. If you think about it, maintenance fees in a way are really a form of tax. You pay a sum of money, determined by someone you voted for, who decides how that money will be spent for services provided to you. And much like the taxes you pay, you expect a certain level of service in return yet hate when they increase. The fact of the matter is, costs go up. Landscaping costs go up. Fuel goes up. Pool maintenance goes up. Everything goes up. The question is, what should an Association do when costs rise? They don’t want to increase maintenance fees because current economic times are really hitting people hard. Yet all of the bills that keep rolling in are increasing. And they don’t want to decrease the level of services because they don’t want to risk a negative affect on property values. So what do they do? This is a common question that Board members and unit owners ask themselves every year. And, 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.

Improperly assessing maintenance fees isn’t the only potential pitfall associations face. We put together a list of 10 potential pitfalls that Associations are faced with every year:

- 1. Maintenance Fees** – Many times Board members are pressured into keeping maintenance fees consistent year after year. The problem is, as mentioned above, costs rise. And 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.
- 2. Developing a Long-term Financial Plan** – We all know that deficits happen. There may be a year when repairs and maintenance expenses are unusually high due to unexpected repairs that cause the association to go over budget. The important thing is what the association does about the deficit. Many times, the deficit is ignored and life goes on. The association should develop a long-term plan to recover that deficit and bring the association back to break even.
- 3. Working Capital Contributions** – Working capital contributions are there

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Financial Pitfalls *(cont. from page 1)*

for a reason. Problems can arise when board members use the working capital contributions for something other than the intended purpose and then do not have a plan to replenish the funds. Working capital contributions do a few things. They provide funds for times when unexpected expenses occur. 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 of current maintenance fees in either working capital or surplus.

- 4. 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 3 questions: Is the engineer's reserve study current (performed within the last 3 years)? Is the association funding in accordance with the engineer's recommendations? Is the proper amount of cash set aside in an account earmarked for replacement fund expenses? If the answer to all three is "Yes," then you are doing OK.
- 5. Association Professionals** – The board is driving the bus, but who is helping them decide on the direction? It is important that the board do their homework when deciding on a management company, attorney, auditor, and engineer. These are the four most important hires the board is going to make because they help the Board make decisions that affect every aspect of living in the association.

- 6. Preventative Maintenance** – Deferring preventative maintenance can be another tempting way to keep maintenance fees low for the upcoming budget year. However, much like other short-term fixes, this could come back to haunt the association in the long run.
- 7. Communication** – Communication is key. One of the biggest mistakes boards make is not properly communicating with the unit owners. Many associations prepare quarterly newsletters and have frequent meetings open to all. Associations should do what makes sense for them but try to make sure that all unit owners are aware of what is going on.
- 8. 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 meeting minutes or maintaining them insufficiently. The goal should be to leave no doubt. Leave a trail for all who come after you of the thought process and decisions you have made.
- 9. Monthly Financial Reporting** – Another potential pitfall boards face is not being informed themselves. Management companies should provide a monthly financial package that contains a budget vs. actual report, balance sheet, income statement, check disbursement listing, etc. The board should review these reports to understand what transactions have taken place as well as the impact they have on the financial statements. This is another form of communication that is important to a board

member fulfilling their fiduciary responsibility.

- 10. Internal Controls** – Internal controls are basically the process that is in place to ensure accurate financial reporting. Processing maintenance fee income from unit owners and selecting vendors are all part of your internal controls. And a board member may say, "Our management company takes care of things like that." Well there is your pitfall. Boards should understand the internal controls at the management company and in many areas should be actively involved in creating and maintaining proper internal controls. The board is ultimately responsible for the financial statements so they should understand the process that goes into arriving at those financial results.

As you can see, being a member of the board is not always as easy as some people may think. The board has to make some very difficult, sometimes unpopular decisions that affect neighbors, friends and themselves.

Joe Chorba is a supervisor at Wilkin & Guttenplan, P.C. He can be reached at jchorba@wgcpas.com.

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A Primer on Sales Tax Form ST-8

by Carol Koransky, CPA, MBA

What is Form ST-8?

The Form ST-8 (certificate of exempt capital improvements) is to be used when the association is undertaking a capital improvement that is exempt from NJ sales tax.

Why fill out Form ST-8?

A properly completed form will exempt the contractor from charging the association for sales tax on the labor/service costs associated with exempt capital improvements. Labor costs related to repairs and maintenance is always subject to NJ sales tax.

What is meant by capital improvement vs. repair and maintenance?

In general, if the result of the contracted work just maintains the existing value of the property then the work is considered a repair and/or maintenance item and therefore not a capital improvement. If the work results in an increase in the value of the real property, it is considered to be a capital improvement. Many, but not all, capital improvements are considered exempt capital improvements (see chart below). The determination of what constitutes a capital improvement is not always clear. For more information, please see "Overview of NJ Sales and Use Tax for Associations" in the Summer 2010 issue of the *Community Property Advisor*.

Who fills out Form ST-8 and what information is required?

Form ST-8 must be completed by the owner of the property that is undergoing the capital improvement. Information required includes:

1. Name of contractor
2. Address of contractor
3. Contractor's NJ certificate of authority number
4. A description of the nature of the exempt capital improvement
5. The address/location of where the work is being performed
6. The amount of the contract price.

Both the contractor and the owner of the property must sign the form. The contractor maintains the form with their records. The association should maintain a copy, but they are not required to remit the form to the state.

What happens if a Form ST-8 is not completed?

If Form ST-8 is not filed, then the contractor must collect the sales tax on labor/services performed in connection with the exempt capital improvement.

Whose responsibility is it to prepare the Form ST-8?

It is the association's responsibility to prepare this form and remit to the contractor.

| Examples of Exempt Capital Improvements and Taxable Capital Improvements | |
|--|--|
| Exempt Capital Improvements | Taxable Capital Improvements |
| New roof | Installing carpeting or other flooring |
| Paving of driveways | Installing a hard-wired security, burglar or fire alarm system |
| New heating system installation | Seeding of new lawn |
| Installation of new siding | Clearing and filling land associated with seeding of new lawns |
| New construction | Planting trees, shrubs, etc. |

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News from the Firm

Employee Anniversaries

26 Years

Annette Murray

25 Years

Janine Zirrieth

24 Years

Margot Julis
Sue Klimcsak

21 Years

Carol Roseninge

12 Years

Daniel Manning
Vinay Navani

11 Years

Jill Carvalheira

10 Years

Cristina McLaren

8 Years

Joe Chorba

7 Years

Karen Becza Woolley
Maureen Jasper
Tom Pedersen

5 Years

Laura Crowley
Sharon Degenaars

Upcoming Webinars

W&G will be hosting several webinars in upcoming months. Contact Avery Quayle at aquayle@wgcpas.com for details about the following:

December, 9, 2010 -
Community Association Clubs: Modern Challenges and Perspectives

January 11, 2011 - *Co-op Concerns*



IRS Ending Tax Deposit Coupons by Lauren Landolfi

The Internal Revenue Service has been using a variety of incentives and requirements to encourage corporate taxpayers to pay federal taxes electronically using the Electronic Federal Tax Payment System (EFTPS). Until now, taxpayers with annual tax deposits under \$200,000 were permitted to use paper based federal tax deposit (FTD) coupons (Form 8109-B) to remit tax payments. Under that system, taxpayers would take the FTD coupons to their bank which would transfer the funds directly from the taxpayer's bank account to the IRS.

The FTD paper coupon deposit system will no longer be maintained by the Treasury Department after December 31, 2010. Some banks have already stopped accepting FTDs. While the rules have not yet been finalized, beginning in 2011, most business tax deposits will be required to be made electronically. There will be likely be some exceptions for small tax payments, but the thresholds for those tax payments have not yet been determined.

Many CIRAs have relatively small payments due with their corporate tax return, but when added to their payroll taxes (which may be administered by a third party payroll service) may find themselves over this threshold. While using EFTPS is convenient, registration is not instant and must be done several weeks in advance.

Signing up for EFTPS can be done at www.eftps.com. In order to register, an Employer Identification Number, bank account number, and address as it appears on IRS tax documents will be required. We encourage CIRAs to enroll in EFTPS as soon as possible in order to be able to make a payment by EFTPS, if required, and avoid a penalty for failure to do so.

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Upcoming Issues

- Allocating Federal Taxes to the Replacement Fund
- Taxes – The W&G Way
- The Difference Between Internally Generated Financial Statements and Audited Financial Statements

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