SOUTH COAST HOMEOWNERS ASSOCIATION

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Michael J. Gartzke, CPA, Editor

IN THIS ISSUE

UPCOMING SOUTH COAST MEETING

Annual Law and Legislative Update

DATE – Wednesday, January 30, 2008

TIME – 7 – 9 PM

PLACE – Encina Royale Clubhouse, 250 Moreton Bay Lane, Goleta

Directions: 101 exit Fairview Avenue North approximately 2 blocks to Encina Road (at Fairview Theatres). Turn right on Encina Road and go one block to four-way stop at Moreton Bay Lane. Turn left into Encina Royale. Clubhouse is on the right across from the flagpole. Parking is available on the street and in the adjacent parking lot.

SPEAKERS – James H. Smith of Grokenberger & Smith and David A. Loewenthal of Loewenthal, Hillshafer & Rosen will present our annual law and legislative update including the new agenda law as well as assessment collection procedures in a declining real estate market. Other topics are to be determined.

2008 MEMBERSHIP INVOICES MAILED

Your 2008 membership invoice was mailed in October. Dues remain at $60 per year. Don't forget your $20 early renewal discount (net = $40) if paid by November 30, 2007.

BOARD BASICS – BUDGET DEVELOPMENT MECHANICS
By: Michael J. Gartzke, CPA

Editor's Note: I apologize for this issue being so late. Many calendar year associations probably have completed their budgets by now. These budget articles were ably edited by Chris Andrews, Reserve Specialist of Stone Mountain Corporation who supplemented the discussion of reserve disclosures in these articles.

Developing a sound realistic budget involves **people, planning and research**. Don't wait until 15 days before the budget needs to be mailed to start work on it. Have a plan in place and **implement** it. Here are some guidelines to assist you in developing a budget for your association.

People – Who should be involved in developing your budget? The principal players are your board and manager. Some associations will have a finance committee consisting of the treasurer, other board members and some owners who are not on the board. Don't overlook your CPA or financial professionals in this process.

Planning - When do you get started? Budgeting can be a 12-month a year process. Generally, I start working on budget drafts in the eighth or ninth month of the fiscal year. Some associations, especially larger ones may start sooner. Enough time must be allowed to develop the budget draft and have the board approve it prior to mailing to the members. Additional drafts may be needed to complete the process. Budget comparisons should be made monthly with actual income and expense to determine financial performance all during the year – see article following. The budget is due to the members 30 days before the start of the association's next fiscal year. For calendar year associations, that means December 1.

Research – What information do we need? Where can we get it? The answers may or may not be out there but you need to ask the questions. How good can we make the crystal ball?

Have **historical expense** information available. Use complete general ledgers for this year and the prior year to review detailed expense information. Are expenses like water seasonal? Looking at January-July's water expense will not accurately predict common area water use in August – December.

Review **utility** bills for changes in rates. Are they the same as last year? If not, how have they changed? Are you aware of any pending changes? Many utility providers now change rates mid-year. This year, the Goleta Water District made a significant change in fixed meter rates in July. For some associations, that change increased costs by as much as 50%.

What have your **insurance** premiums done the past two years? What does your agent/broker think about premiums for the next renewal? While it is still early, I have received reports from a number of board members and managers that renewal premiums for 2007-08 are the same or less than last year. Some have decreased significantly. This was before the California wildfires in late October.

Talk to your **service providers –** If landscaping is a major part of your operating budget, should you find out what the marketplace is? Are landscape companies workers comp premiums doubling? What are contractor rates doing? Is your manager now required to provide more services? What are these costs?

This year, associations should consider establishing a **bad debt allowance** for uncollectible assessments. Contrary to some local news reports, we are seeing foreclosures in our county, especially in North County and in condominiums. After all, if you were a speculative purchaser of real estate, wouldn't it appeal to you to have the homeowners association take care and maintain the property for you while you wait and see if you can "flip" the property and make $50,000 or more? Further, many of the irresponsible loans were made to those who could not afford to make payments once the rates adjusted. For example, an increase in the interest from 4.5% in 2004 to 6.75% today would result in a minimum of a 50% increase in the monthly payment. If you have a lot of new owners, you could be at risk for lost assessments. In my database of 60 area HOAs (4,399 units), I have seen delinquent assessments more than double in the past year. It's not getting any better. If there is no equity in the property or if the owner is "upside-down" (owes more than the current value), you will not collect anything in a foreclosure. You may be able to obtain a small claims judgment and then attempt to collect on it. This is a time-consuming task and the judge may not be interested in allowing your collection costs as part of the judgment. The end result? Responsible owners in your association will have to pay for irresponsible ones who defaulted.

What is the current rate of **inflation**? Published Consumer Price Index (CPI) statistics in recent months range from 2.2% to 4.3%. Caution should be used when applying CPI rates as many goods and services purchased by associations are not tied to the CPI such as insurance or utilities.

Are any **special projects** or new services pending? Are you planning to revise your CC&Rs? Are you planning to change from self-management to professional management? Are you contemplating major maintenance that is not part of your reserve study?

Speaking of the reserve study, what is the **recommended reserve contribution** for the following year? Are **special assessments** needed to meet major maintenance expenses?

Implementation – Once you have pulled together most if not all of the above-referenced information, it's time to start putting together the first draft of the budget. I believe that prior to the finance committee or the board considering the budget, the Treasurer, manager or CPA should put together the initial draft, considering all the information in hand at that point. For me, it's easier to consider changes and discuss it with others if there is a draft available for review. Developing a initial draft with many people at the meeting could be very cumbersome. How do you put together a draft?

I start with a spreadsheet with all the income and expense categories that are to be budgeted listed down the first column. The next column is the actual income and expense for the current year for the number of months completed (e.g. 8 months through August). Column 3 would be a prorata amount of the current annual budget. (e.g. 8/12 of the annual budget through August). Column 4 would be the difference (variance) between the actual income/expense (column 2) and the prorata budget (column 3). The variance would tell us how we are doing so far this year – over or under budget. Column 5 would be the total budget for the current year which would be our reference to column 6 – the proposed budget for next year. You could add additional columns for net change in dollars in this year's vs. the proposed budget and for remarks – why a category is changing.

Having a draft available facilitates discussion. Comments can range from the factual – "The county raised our trash rates 20% last year" to the philosophical – "What would happen if we didn't heat the pool year round? With the proper documentation in place, the board can act and approve the budget.

Other Disclosures – In addition to the budgeted income and expenses for the association for the coming year, the association's operating budget mailing must also contain other disclosures:

- Summary reserve information and percent funded from the reserve study
- *"Assessment and Reserve Disclosure Summary* Form - filled out
- Insurance coverages, deductibles and limits
- Assessment collection procedures
- Policies to impose fines for CC&R violations
- Availability of corporate minutes
- Procedures for resolving disputes – Alternate Dispute Resolution
- Notification of assessment change

BEYOND THE BASICS – IS YOUR BUDGET REALISTIC
By: Michael J. Gartzke, CPA

The association's annual operating budget, when prepared thoroughly, provides significant information to members and third-party users such as lenders, real estate agents and the association's own financial professionals about the association's current and future financial position. While we know that California law requires the distribution of the budget 30 days before the beginning of the association's fiscal year, how useful can this document be? How can the budget be made more "user friendly"? This article will examine a variety of issues with the goal of making your annual budget a most effective financial planning tool for your association.

Review your association's income and expenses against the current budget at every board meeting and explain variances.

All financial software programs from Quicken up through specialized HOA programs have the capability of loading your current budget into the program and running actual vs. budget reports for the current month as well as year-to-date. A variance is simply the difference between the actual amount and the budgeted amount. For instance, if you budgeted $5,000 for insurance and the actual was $ 6,000, you would be over budget by $1,000 or have a variance of $1,000 from the budget. Variances may be seasonal such as irrigation water or as a result of expenses such as insurance that may not be paid monthly. Changes in contract costs or unexpected expenses may also explain variances. Reviewing this information on a continual basis keeps the board better informed when making financial or maintenance decisions. Communicating this information to members through the association minutes or newsletter allows members to be aware of the association's current financial status.

1) How do we incorporate the reserve study into the operating budget?

Your reserve study contains disclosures that are required to be included in the budget document. California Civil Code Section 1365 requires a summary of the reserve study be distributed to the members with the budget. These disclosures include:

- Estimated replacement cost, estimated useful life and estimated replacement cost of each major component.
- The current estimate of the amount of cash reserves necessary to repair/replace the major components
- The current amount of accumulated cash reserves
- The "Percent Funded" – actual cash divided by "necessary cash"
- A statement as to whether the board anticipates a special assessment to make major repairs or establish reserves
- A statement regarding the procedures used to establish the component and funding information contained in the reserve study.

In addition, starting in July 2005 and amended as of January 2007, California Civil Code Section 1365.2.5 requires the distribution of the *"Assessment and Reserve Disclosure Summary*" form.

Most professional reserve studies will have an "Executive Summary" with this information. You can simply copy these few pages from the complete report and include it with your budget document. This summary should also include the recommended annual funding amount for reserves that you can use as the reserve contribution line item in the operating budget.

2) **Is our reserve study adequate? Is it updated?**

Many associations will spend money on "reserve" components that are not included in their reserve study. Examples might include tree trimming, roof repairs or water damage repairs. These could be considered major components but no funding is being considered in the reserve study. The association should consider paying for these items via the operating budget if they occur annually or expanding their reserve study to incorporate these kinds of items if they occur less frequently and provide funding for them. Some associations establish a dollar threshold above which the cost items are included in the reserve budget and below which they are paid via the operating budget.
While California law requires a new reserve study every three years, it also requires the

board to review the study annually, and implement adjustments as needed. If there are numerous or substantial adjustments, the board should consider an update to the study. Adjustments could include shortening or lengthening the life of a major component after getting new information from a contractor, changing cost information or adjusting the study when a component is repaired or replaced.

3) Can we use the reserve fund as a contingency fund?

Some boards look to the reserve funds as a funding source for any unanticipated expense whether a reserve expense or not. The California Civil Code restricts the use of reserve funds to ***"the repair, replacement, restoration, or maintenance of, or litigation involving the repair, restoration, replacement or maintenance of, major components which the association is obligated to repair, restore, replace or maintain and for which the reserve fund was established."***(CC 1365.5(c)(1)). The code allows for some exceptions provided the board meets some very strict disclosure requirements to its members regarding the temporary use of reserve funds and the pay back of these funds over the next 12 months. "The board shall exercise prudent fiscal management in maintaining the integrity of the reserve account…"

5) Can't we simply not fund all of the budgeted reserves if we run short of operating money?

From your author's perspective, this appears to be becoming more common and is a recipe for danger.

First, recall that at the beginning of your fiscal year, your association distributed a budget where reserve funding was clearly stated. You are actually collecting two assessments, an operating assessment and a reserve assessment, which are combined into a single assessment for administrative convenience. One check can be written by an owner and deposited into one bank account. From there, the assessment should be split and deposited monthly into the reserve account. Members have an expectation that their reserve assessment is funding reserves and not paying for something else, like increased insurance premiums or utilities – every month of the year.

By not funding reserves because of cost overruns in the operating budget, you have essentially used reserve money for operating purposes. California Civil Code Section 1365.5(c)(2) requires that "(t)he board shall exercise prudent fiscal management in maintaining the **integrity** (emphasis added) of the reserve account." Maintaining the integrity of the reserve account means funding the reserve assessment as budgeted into the reserve account periodically.

Second, California Civil Code Section 1365.5(b) requires *"(t)he signatures of at least two persons, who shall be members of the association's board of directors… shall be required for the withdrawal of moneys from the association reserve accounts."* The manager, bookkeeper, accountant or others cannot sign on the association's reserve accounts. I have noticed associations not funding reserve assessments but keeping the money in the operating account to pay reserve expenses when they occur. By keeping these reserve funds in the operating account, the intent of the Civil Code is circumvented since nondirectors nor officers of the association need to sign on the operating account under a manager's or bookkeeper's control.

Third, not having to fund all of the reserves would allow the association to budget less than necessary to meet its operating obligations. It can be politically expedient not to have to tell the members that assessments need to be increased. Reserves are not a contingency or a slush fund for operating expenses. They are for meeting the major repair and replacement obligations of the association.

6) What are the consequences of not funding reserves?

There are a number of negative consequences when reserves are not funded. Among them are:

a) **Delays in making necessary repairs –** It is much easier to commit resources to make timely repairs when funds are available to the association than when the association has no funds to do the work. If work is delayed, it is inevitably more expensive because additional work may be needed to correct deteriorating conditions.

b) **The need for special assessments –** Special assessments tend to be unpopular, depending upon the reasons for it. See item 7 following.

c) **Marketability of units –** Buyers, lenders and others are looking to budgets and reserve information to determine how financially sound the association is. Association units with stronger reserve positions are more marketable. Poor reserves can make sales and refinances more difficult, especially in a down real estate market.

d) **State law –** While state statutory law does not mandate reserve funding, it does mandate all the disclosures noted earlier. Some California case law (Raven's Cove Townhomes – 1981) involved a board that did not provide for adequate reserves in the association's formation. The court held the directors personally liable for not funding those reserves. This makes the point of funding adequate reserves in light of all the required disclosures mandated by state law.

e) **Unhappy members –** Members who believed that a certain portion of their assessment was going towards reserve funding when it did not can cause the board and the association a great deal of unnecessary grief.

7) Special Assessments – How can they help you or hurt you?

There are times when a special assessment is necessary. As much as you try, there are many variables that boards and their managers cannot control. The association has several forms of special assessments at its disposal. Not all require a membership vote.

a) 5% of the budgeted gross expenses – This assessment is useful for smaller needs and is not subject to a membership vote if used only once during the fiscal year. For example, an association with a $100,000 budget and 50 members could levy a special assessment of up to $100 per member under this provision. ($100,000 x 5% = $5,000 divided by 50 members = $100 per member). This could be useful to meet unanticipated changes in operating expenses such as insurance and utility billings. In some cases, it is impossible to project what certain expenses will be 9-12 months after the budget process. It could also be used to reimburse unexpected legal costs that will not be recovered. It is important to communicate the need to the membership as to why this type of assessment is being imposed and why you could not anticipate its need during the budget process.

b) Extraordinary expense required by a court order – Members don't get to vote on these assessments but these would be rare and generally outside the scope of the association's normal operating or reserve budgets.

c) Extraordinary expense required when a threat to personal safety is discovered – Some years ago, a local association was required to resurface their deteriorated parking area. Their insurance agent felt the existing conditions were hazardous and the association's insurance might be cancelled if the condition wasn't corrected. The board could impose a special assessment to correct this condition without a vote of the membership

d) Extraordinary expense that could have been not reasonably foreseen at the time the budget was drafted – Use caution if considering a special assessment under this section. There could be situations where members would question why you didn't know about the expense at the time the budget was drafted. On the other hand, there can be very valid reasons to use this section for a special assessment. Perhaps there is dryrot or other structural damage that could only be quantified after substantial investigation and testing. It might be best to put this type of assessment to a vote initially to determine the amount of support for the assessment.

e) Assessments not falling under the exceptions listed above – Then a vote of the membership is required either by mail or at a membership meeting with ballots, proxies, etc. where at least 50% of the members participate. In all but the smallest special assessments, the association should consider having a "town hall" type meeting to present the information used to justify the need for the special assessment and allow for member comment and input. Depending upon the amount of the assessment, you may wish to offer the members an opportunity to make installment payments on the assessment to generate more support. Some members will not be able to come up with large sums of money, even with 30-60 days notice so then you can run into collection problems. If the amount of the assessment is large and funds are needed relatively quickly, you may wish to consider a bank loan to fund the work now and pay off the loan with the special assessment proceeds, when received.

Special assessments can have the potential of being politically volatile. Prompt, consistent communication with members through minutes and newsletters can help to diffuse some problems. Special assessments can be a quick way to meet an unexpected need or can cause member unrest if members perceive that the board did not handle the situation correctly.

8) Aren't members supposed to approve the budget at the annual meeting?

In most cases, no. The Civil Code provides that the board of directors approves the budget if the regular assessment increases by 20% or less and it has met its disclosure requirements regarding the preparation and distribution of its operating budget and reserve study disclosures. If the assessment increase is greater than 20% or the association has not made the required disclosures, then the members must approve the change in assessment.

Some CC&Rs, especially ones drafted before 1985, have different requirements for approving the budgets and any resulting change in assessments. The Civil Code **overrides** the governing documents in these situations and is controlling. All associations are governed by these assessment provisions, even if the governing documents are more restrictive.

9) Other Associations pay less than we do. Their assessments are not going up as

much as ours. Inflation was only 3% last year. Why are our assessments higher and going up more?

There is peer pressure out there to not change assessments and somehow make it work. There is knowledge that another association of similar size has lower assessments.

When comparing assessments, it is imperative that you compare your association to *similar* associations as there are many factors which go into developing an appropriate assessment such as:

- Age of the association – newer associations may have lower day-to-day maintenance costs. They may also have fewer maintenance responsibilities than older associations.

- Level of services – some associations will opt for more landscaping services, for example, than its neighbor. Maybe another association carries earthquake insurance and another doesn't. Still others may have more shared utilities than other associations. Within the confines of the governing documents, associations may be able to make some choices regarding how much the association will provide to its members.

- How healthy is the reserve account? Many associations find themselves having to play "catch-up" with their reserve funding because of a lack of appropriate funding in past years. The net result is usually significantly higher assessments in later years

- Economic Conditions – High demand services are not tied to inflationary adjustments but may be increasing more due to demand, government regulations, etc.

- Value of services – perhaps the other association is receiving better value for its assessment dollar than you are. Are you satisfied with the services that you are receiving? These are subjective measures and many times reasonable people will disagree.

- No two associations are exactly alike. Decisions made early on may have an economic impact many years later.

10) If we spend less operating funds than budgeted this year, can we apply the surplus to next year?

Absolutely. The trick here is to determine if you are going to have excess operating funds at the end of the year when you are preparing the budget 3-4 months before the end of the fiscal year. Conversely, you may need to budget additional funds in the subsequent year to meet shortages in the current year. The association should maintain an operating fund of 1 month's expenses to facilitate cash flow and help meet unexpected costs. (you might need more depending upon the size of your association or the timing of expenditures). Only apply the surplus if you are certain that you will have one to apply to next year.

11) Promote the total economic value of the association and that the assessment is going to maintain and enhance that value (Sell your assessment!) – An association of 100, $500,000 homes has an economic value of $50 million. Sometimes, putting a $10/month increase in the assessment in the context of $50 million seems trivial and indeed, members may be more understanding when the assessment change is seen in that context. The board and its management take the responsibility for maintaining and operating the association seriously.

12) Emphasize the areas where expenses are changing and why the assessment must change to meet these obligations – While the association budget may have 20 or more expense categories, the major changes may usually be distilled into 3-4 areas that cover most if not all of the assessment change. For example, insurance costs have increased dramatically over the past several years. Common area electric costs increased 40-50% after deregulation. Some water districts have passed through higher costs to cover state water and other capital projects. After a new reserve study is completed, some associations are boosting their reserve contributions to meet the recommendations of their reserve specialist. By emphasizing these major areas at the beginning of the budget narrative, members will be less likely to object to the need to change the association assessment because you have proven to them that these factors "are out of our control."

13) Use charts/graphs to help explain the "numbers", cost history and changes –

Many members can relate better to graphs, charts and other visual aids rather than just a schedule of numbers. Consider Including these in your budget document or at an annual meeting presentation.

- Pie chart showing allocation of assessment – Most associations can classify their expenses into 5 major categories – utilities, common area maintenance, insurance, administrative and reserve funding. A pie chart will show the relative amounts being applied to each of these major categories

- Use of per member per month computations. Members can relate best to the actual amount of the monthly assessment check that they write. For example, a $300 per month assessment might be broken down into $60 utilities, $55 insurance, $85 common area maintenance, $15 general and administrative and $85 reserve funding. You could add a column in the operating budget alongside the budgeted expense amounts to show that information

- Bar graphs can be used to compare relative amounts of the budgeted expenses compared to previous years to show the changes over time and can be enlightening to boards and members about why assessments have to change

14) Involve your professionals – If your CPA, manager or other financial professionals have experience with other associations besides yours, then they have a great deal of information to offer you as you develop your budget and sell it to the membership. We work in this field daily, get calls from concerned board members and owners and have access to many resources to assist in recommending a realistic assessment and help you stay out of trouble.

It can pay dividends to have your financial professionals attend your annual meeting to present the association's current financial condition and budget and help explain the thorny issues. We can bring years of experience to your membership and offer insights and comparisons not otherwise available to your board. There is considerable value in having an objective third party present this information rather than a Board member who may or may not be perceived to have personal biases. I have found members who attend meetings receptive to information provided by the association's professional team and seem pleased that we would take the time to prepare association-specific information and present it during the membership meeting. We're here to help you (and we're not from the government!)

In summary, it should be apparent from the foregoing that budgets should be prepared "from the bottom up" – that is: all of the constituent costs are compiled into line items in the budget and the sum total of all budget line items will produce the correct total budget amount. This should be an objective and unemotional process, always carried out with a strong sense of fiduciary duty, not self-interest.

The "bottom up" budgeting method differs from the "top down" approach in which board members *arbitrarily* decide what they want next year's monthly assessments to be and then try to make the expense line items "fit" into that number as best as they can. Sometimes it doesn't really fit, but they make it fit anyway!

A good or bad budget can make or break an association, so due diligence in your budget process will pay off in the long run.

RECORD RETENTION

By: Walter G. Grady, CPA
Alameda, California

Editor's Note: Walt has provided accounting services to homeowners associations in the Bay Area for over 25 years. He has been active in the Executive Council of Homeowners (ECHO), a northern California HOA organization and has served as chair of their Accountants Resource Panel. He is a frequent contributor to the CPA Education Foundation's *Common Interest Realty Associations Accounting Conference,* a seminar held in San Francisco and Los Angeles for CPAs every two years. The issue of record retention comes up frequently and we thank Walt for allowing us to reprint his article.

Record retention is a difficult issue for most Associations. It is often compounded by the lack of professional guidance as to what records need to be retained. The Association may have a closet full of records, but if they are disorganized and no one can find anything when needed, then it is time to review and organize the records.

Record retention is especially important because of frequent turnover of the Board of Directors. It is also futile if former Board members are retaining Association records, but no one knows about it. Each Board needs to establish and follow a record retention policy.

WHAT RECORDS?

All documents need to be considered. This includes legal, financial, insurance and maintenance records as well as general correspondence. Written documents, computer disks and tapes, equipment specification and instruction books and even pictures all need to be addressed.

WHY KEEP RECORDS?

There are legal requirements for keeping certain records such as board minutes and tax returns. Board minutes are permanent records and need to be retained indefinitely. Tax returns can be audited up to three years from when they are filed. Since they are not filed until after the year is over, supporting documentation needs to be retained for four years.

Other records need to be retained for their informational value. For example, on the last roof replacement - what were the specifications, date of replacement, cost and warranty information? Maintenance history and repair records can help to determine when components should be replaced.

Still other records need to be retained due to possible future Board or legal action, such as a history of repeated rules violation which may lead to future Board action, or history of water intrusion problems which may lead to a construction defects legal action.

Architectural Control records are particularly important. The Board needs to be able to identify each architectural change that has ever been approved and, conversely, each change that has been denied, as well as maintaining a history of violation notices.

TOO MANY RECORDS

Often too many records are retained. Each Board member does not have to keep a copy of minutes of meetings as long as the original is properly filed and is available. Detailed monthly financial statements do not have to be retained once annual financial statements have been issued by the CPA. One copy of anything is enough!

ORGANIZATION

There is no right or wrong method of organization. I recommend separating the records by category:

- Legal Records
- Financial Records
- Maintenance/Facilities Records
- Correspondence
- Other

Within each category, records should be grouped into:

- Permanent Records
- Retain for 4 years
- Retain till superseded
- Often Superseded records in turn should be retained for 4 years
- Retain one year

PERMANENT RECORDS

- Legal:
    - Board Minutes and Notices of Meetings
    - Executive Session Meeting Minutes
    - Membership Meeting Minutes and Notices of Meetings
    - Committee Meeting Minutes
    - Original Enabling Documents:
        - CC&R's
        - Bylaws
        - Articles of Incorporation
    - Amended Enabling Documents
    - Legal Settlement Agreements
    - "Client/Attorney Privileged Information" file
    - Developer Disclosure Statements
    - Deeds
    - Title Insurance Policies

- Financial:
    - Annual Corporate Tax Returns
    - Letters granting tax exempt status
    - Issuance of tax ID number
    - Annual CPA Prepared Financial Statements
    - Annual general ledgers

- Maintenance:
    - Blue Prints
    - Building Drawings and details of Additions or Modifications
    - Major Component Listings, Specifications and Measurements

- Other:
    - Documents requesting Architectural Changes
    - Approvals and denials of Architectural Change Requests
    - Notice of violations of Architectural Controls

RETAIN FOR 4 YEARS

- Legal:
    - Membership Meeting Ballots, Proxies and Check in Sheets

- Financial:
    - Bank Statements & Canceled Checks
    - Paid Bills

Payroll Tax Returns
Time Cards
Monthly General Ledgers
Accounts Receivable Listings
Deposit slips
Dues billing and collection documents

- Correspondence:
  "Serious" Correspondence
  Newsletters

- Other:
  Insurance Claims History

RETAIN TILL SUPERSEDED:
("*" denotes transferring superseded document to the 'four more years' category)

- Legal Records:

* Contracts:
Management
Vendor Services
* Loan Documents
* Listing of Rules
* Interpretations of Rules under specific circumstances
Non-Architectural Enforcement Matters
(ex: Parking Violations. Discard when owner sells unit)

- **Maintenance/Facilities Records:**

* Warranties and Guarantees
* Reserve Studies
* Funding Studies
Equipment Specifications
Complete details of last replacement of all major components

- **Other Records:**

* Original Insurance Policies
* Employment Contracts
* Personnel Files

RETAIN ONE YEAR

Meeting Agendas
Monthly Financial Statements
"Light" Correspondence, especially if situation has now been resolved or action completed

WHERE SHOULD RECORDS BE KEPT

Records should be stored together in a safe, dry area, preferably in a storage closet on site or with the management company. Permanent records such as Board Minutes should be kept in a fire proof cabinet. It is not uncommon for the management company to retain most of the permanent records and the current records.

HOW SHOULD RECORDS BE KEPT

Records should be stored in uniform size record storage boxes. If records are to be destroyed after a certain date, write on the box the destruction date. Number the boxes so that they can be kept in order. Keep a separate listing of the contents of each box. It is much easier to look through a ten page listing and find a reference to a box number than it is to physically look through ten boxes.

ANNUAL CHORES

At the end of the fiscal year, gather up the current year records. Always take the time to index the boxes prior to adding them to the storage site. At the same time, review the stored record listing sheets for records that have expired and destroy them. Make notations on the listing that the records were destroyed and the date destroyed.

A FINAL WORD

Use common sense in determining what records to keep or destroy. If in doubt contact your professionals - Attorney, CPA, Professional Manager, Insurance Agent, Banker, or Reserve Specialist.

ANNUAL FINANCIAL REPORT REQUIREMENT FOR SMALLER ASSOCIATIONS

The California Corporations Code (Sections 8320-25) require corporations (including your homeowners association) to keep adequate and correct books and records of account. The corporation must advise each member annually of his right to receive a financial report if the gross revenues of the corporation (including member assessments) exceed $10,000 per year. This annual report will contain a balance sheet at the end of the corporation's fiscal year and an income statement (profit and loss) for the fiscal year then ended.

This provision may also be found in the association's governing documents as well (CC&Rs and bylaws). The annual report requirement is separate and distinct from the requirement that an association governed under the Davis-Stirling Act have their financial statements reviewed by a CPA when annual revenues exceed $75,000 per year. (Civil Code Section 1365(b).

Thus, financial information must be made available for any association whose revenues exceed $10,000 per year. For example, a 5-unit association with assessments of $200 per month will have revenues of $12,000. This annual report does not have to be done by a CPA unless your governing documents require it. You must disclose who prepared the annual report (Accountant, bookkeeper, treasurer, manager, etc.). Most associations, however, will engage a CPA or tax professional at year-end because Federal income tax returns are required for all associations and most boards and management companies do not want to prepare tax returns.

Further, the Davis-Stirling Act requires association boards of directors to review an income and expense statement for the association's operating and reserve accounts on at least a quarterly basis. (Civil Code Section 1365.5(a)(5). A small association should be able to use the same financial statements reviewed by the board to satisfy the Corporation Code requirements for the annual financial report. These financial statements can also be used to satisfy requests from escrow for association financial information.

Since the annual financial report requirement must be disclosed annually, make it part of your budget disclosures that the annual financial report is available to members or simply automatically provide the report after year-end.

TIPS FROM THE POOL GUY

By: Brandon Fennell, Avalon Pool Service
Contact Information at the back of the newsletter

Pool Leaks

If you suspect a leak in your pool, there is an easy and inexpensive way to detect it.

1 Fill the pool to its normal running level.

2. Then, with the pool water, fill a five gallon bucket to a couple of inches from the top.

3. Sit the bucket on the second step of the pool, making sure that the bucket is at least five inches deep into the pool water.

4. Mark the water level inside the bucket.

5. Then shut the system off to the pool, and mark the water level on the outside of the bucket.

6. Turn the system back on, using its normal running hours.

7. After 24 hours, compare the water loss in the pool to the water loss in the bucket.

8. If the water loss in the pool is greater than in the bucket, then there could be a leak in the pool.

9. The two levels should be relatively the same, but you should expect some water loss due to normal evaporation.

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