IT'S BUDGET TIME – ARE YOU BUDGETING FOR ALL OF YOUR FUNDS?

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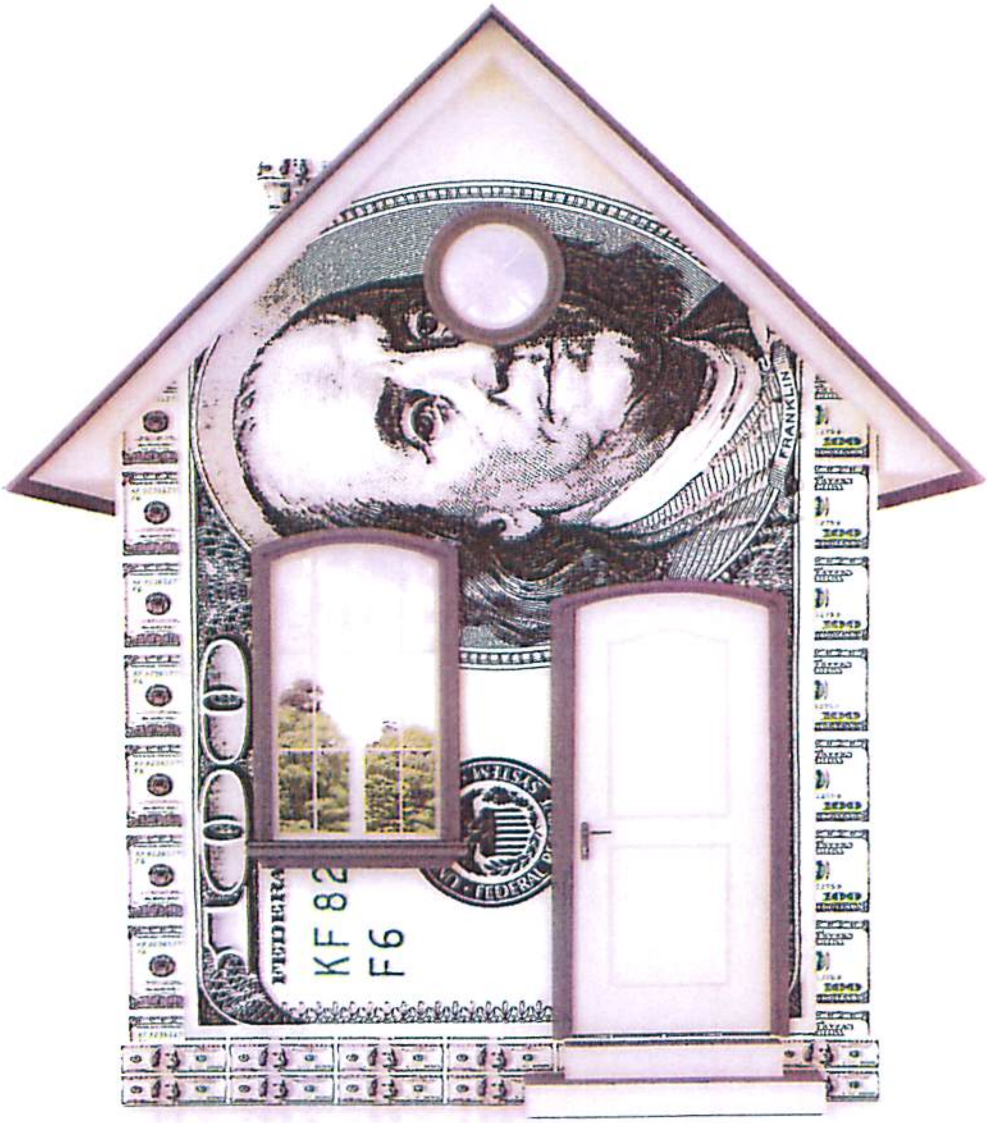
It's October and your association is completing its budget, but let's take one more look before it's finished.



One of the most common mistakes Boards make is either not budgeting or not budgeting properly for other funds besides the Operating Fund. You might be thinking that you have budgeted for all of your funds, which typically include Operating and Reserve Funds. First of all, you may have budgeted for your Reserve Fund, but did you really determine the proper budgeted reserve assessment? Second, there are actually four possible funds. The four funds are the Operating Fund, the Operating Contingency Fund, the Reserve Fund, and the Capital Improvements Fund.

Let's first discuss the Operating Contingency Fund. Many associations budget and make payments for painting, caulking, sealing and power washing out of their Reserve Fund. The Internal Revenue Service has determined that these expenditures are periodic maintenance expenses and should be paid out of the Operating Contingency Fund. For this reason, we always suggest that associations set up an Operating Contingency Fund. Each year, your association should budget for these periodic maintenance items so that there will be funds available to pay for them when they need to be done. Each year your association should transfer these budgeted expenses to the Operating Contingency Fund and then pay for them out of this fund.

The Operating Contingency Fund can also be used to pay for various operating contingency expenses that have either not been budgeted or exceed the budgeted expense. These contingency expenses can include excess snow plowing costs due to heavier than expected snow falls, or higher than expected utility costs due to colder than normal winters or hotter than normal summers. If these budgeted contingency expenses are not used during the year, then we usually recommend that the association transfer these unused contingency expenses to the Operating Contingency Fund. However, an association should first review its declaration before transferring these funds to determine if the declaration indicates what the association should do if it has excess operating funds at the end of the year. The declaration may indicate that excess operating funds be refunded to unit owners.

Usually the largest contingency item that gets overlooked is the contingency for bad debts. We all know that the amount of operating fund assessment income that is budgeted each year is determined by the operating fund expenses. We also know that the operating assessment income is based upon the amount of assessments that are billed each year. However, associations do not always collect all of the assessments that are billed. To determine what you may not collect, start by reviewing your monthly aged accounts receivable. Every association needs to have a good and consistent collection policy that it diligently follows, along with a good, experienced collection attorney. The key is to minimize slow-paying unit owners and units that go into foreclosure. Once the Board has reviewed its aged receivables, there should be a budget line item for contingency for bad debts. If you do not have collection issues, and if your declaration is silent on whether you can transfer excess operating funds, transfer this unused contingency for bad debts to the Operating Contingency Fund.

Many associations do not need to budget for a Capital Improvements Fund. This fund is designated for the acquisition or construction of new common area components. Examples are a new clubhouse, parking garage, swimming pool, or purchasing more land. These expenditures are funded by a separate assessment, a special assessment, a loan from a financial institution, or a combination of any of the three. Reserve funds should not be used for any of these expenditures.

This leads us into our discussion regarding your Reserve Fund (funds accumulated for major repairs and replacement of common area components) and properly budgeting for reserves. How did your association determine the amount of the budgeted reserve assessment? The only

answer should be that it is based upon your reserve study. What we find is that many associations either do not have a reserve study or, if they have one, it has not been updated or reviewed in many years. Every association should have a reserve study prepared every three to five years, preferably by a professional engineering firm. The association's annual budget should designate an itemization and allocation of reserve funds.

Every year at budget time, your Board needs to review the reserve study and funding schedule. The Board then needs to update the funding schedule based upon what actually happened during the past year compared to what the reserve study showed. Once the reserve study has been updated, your association can now properly budget for reserves.

Often we find that associations have co-mingled the Reserve and Operating Funds by paying reserve expenses out of the Operating Fund and either not reimbursing the Operating Fund or not reimbursing it for the exact dollar amount. Also, many times budgeted reserve assessments are deposited in the Operating Fund, but not transferred to the Reserve Fund. It is your fiduciary duty as a Board member to make sure that these reserve expenses and reserve assessments are paid by and deposited into the Reserve Fund.

When you are budgeting for reserves, please keep in mind that you can actually budget for multiple reserve funds. If you have a Reserve Fund project that will start in the coming year, your association may want to open up a separate reserve fund bank account. If your association budgets to special assess unit owners and/ or obtains bank financing, you will now be able to compare actual results to budgeted figures to determine if you collected the amounts you budgeted and if you disbursed the funds that you budgeted to be paid.

Understanding how to budget properly for all of your association's funds can provide a more meaningful budget for the Board to make decisions throughout the year.

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