
SECTION 2

FINANCIAL & INSURANCE & TAXES

GENERAL INFORMATION

TYPICAL OPERATING ACCOUNTS

A GOOD DESCRIPTION OF EACH ACCOUNT ASSISTS
IN BUDGET PREPARATION

HOMEOWNERS ASSOCIATION

OPERATION ACCOUNTS: EXPENSES

November 1991

DESCRIPTION:

1. GENERAL MAINTENANCE & REPAIR

SUPPLIES: Light bulbs for cul-de-sac street light and any other support costs.

2. LANDSCAPE

CONTRACT: The monthly maintenance contract fee is to be charged to this account.

IRRIGATION REPAIR: All costs for the repair of irrigation line, valves, sprinkler heads and the REPAIR and testing of backflow valves.

TREE MAINTENANCE: All costs for protection from deer, removing, relocating and raising of trees, special fertilizing and other work not included in the contract.

PLANT REPLACEMENT & UPGRADING: All costs for replacement of dead trees and plants. Costs for the addition of trees and plants for area improvement. This is an annual account, not the long term replacement which is included in the Reserves.

LAWN MAINTENANCE: All costs for extra fertilizing, lawn topping, pest control and other work not included in the contract.

PLANT MAINTENANCE: All costs for protection from deer, removing, relocating and other work not included in the contract.

GENERAL MAINTENANCE: All costs for spot addition of bark, erosion control and items not included above.

3. UTILITIES:

ELECTRIC: PG&E costs for two meters on the irrigation system plus quarterly payments to three (3) homeowners for the cul-de-sac street lights that are on those house meters.

WATER:

DOMESTIC: Household water costs.

IRRIGATION: Irrigation water costs from meter at 6340 Rocky Road - Account No. 895461322 and 339 Boulder Circle - Account No. 895485061

_____ HOMEOWNERS ASSOCIATION

4. ADMINISTRATION:

AUDIT & TAX PREPARATION: Outside accounting and tax preparation services.

LOMAA: Annual dues and other costs.

ACCOUNTING FEES: The monthly contract management fee is to be charged to this account.

MISCELLANEOUS: Legal and other costs not included in other accounts.

POSTAGE & SUPPLIES: All postal costs, reproduction and office supply costs.

5. TAXES: All income taxes.

RESERVE STUDY

REQUIRED EVERY THREE (3) YEARS

1. NARRATIVE
2. PREPARATION GUIDE
3. FUNDING SPREAD SHEET
4. 30 YEAR CASH FLOW

L O M A A WORKSHOP 1993

RESERVE STUDY

Assembly Bill Number 871, effective January 1, 1992 requires:

"At least once every three years the board of directors shall cause a study of the reserve account requirements of the common interest development to be conducted..."

Requirements by Law for a Reserve Study are:

1. LIST THE MAJOR COMPONENTS - must include items whose estimated life is less than 30 years
2. DESCRIBE THE COMPONENTS
3. USEFUL LIFE OF THE COMPONENTS
4. REMAINING LIFE OF THE COMPONENTS
5. CURRENT COST OF REPLACEMENT

Currently associations have included in their annual budget presentation a " Replacement Reserve Funding Requirements " tabulation. This was developed in the misty past by the Developer and continued by the accounts manager (unless a board has taken steps in recent times to make a through review and updating of the Reserves).

I. LIST THE MAJOR COMPONENTS

In general Oakmont Associations have:

1. Building Exterior Painting
2. Streets
3. Concrete
4. Irrigation
5. Retaining Walls
6. Fences
7. Landscaping
8. Light Fixtures
9. Drainage

II. DESCRIBE THE MAJOR COMPONENTS

Define and determine the quantity and extent of the components.

5.

EXAMPLE:

1. Building Exterior Painting: 25 units (may or may not include privacy fences).
2. Streets: 18,500 square feet of asphalt streets including 2 cul-de-sacs.
3. Concrete: Driveways - 14,000 sf, walks - 2,650 sf sidewalks 6 ft wide - 1,450 lf, curbs & gutters - 3,100 lf
4. Irrigation: 3 controller stations, 2 backflow valves, 25 solenoid valves
5. Retaining Walls 1 @ 4ft x 25 ft, 1 @ 8 ft x 45 ft
6. Fences: none
7. Light Fixtures: 6 street lights, 15 walkway low voltage lights
8. Drainage: 3 drop inlets with 200 ft RCP draining to creek
9. Landscape: Description included in analysis.

III. USEFUL, REMAINING LIFE & CURRENT COST OF REPLACEMENT OF MAJOR COMPONENTS

Determine the estimated useful life, remaining life and current replacement cost.

EXAMPLE:

1. Building Exterior Painting: 25 units, 6 year cycle, painted 1991, next painting 1997, current cost to paint units per contractor 03/25/93 \$785.00.
Current cost: \$19,625.00
Stain fences \$85.00 per unit every 3 years. Next stain 1994. Current cost: \$2,125.00
2. Streets: 18,500 sf
Slurry seal: 7 year cycle, sealed 1989, next 1996, per LOMAA \$0.16/sf. Current cost: \$2,960.00
Paving: 25 year cycle, new 1982, repave 2007, per LOMAA \$0.94/sf. Current cost: \$17,390.00
3. Concrete: Driveways - 14,000 sf, walks - 2,650 sf sidewalks 6 ft wide - 1,450 lf, curbs & gutters - 3,100 lf. Survey of 1989 indicated 1,800 sf of driveways with cracks and exposed to tree root damage . Expect repairs in 18 years @ current rate of \$4.50/sf. Walk and side walk exposure is about 200 sf in 18 years @ current rate of \$12.00/sf. Curb & gutter repairs - current 200 lf has cracks. Assume 18 years @ \$35.00/lf.

Current cost: Driveways -	\$ 8,100.00
Walks -	\$ 2,400.00
C & G -	\$ 7,000.00
TOTAL	<u>\$17,500.00</u>

4. Irrigation: 3 controller stations, 3 backflow valves, 25 solenoid valves. Repairs to backflow valves are provided for in operations budget. 1 valve has been replaced to new standards and should last 30 years. 1 valve repaired 1992- must replace if repairs are required again - assume 3 years or 1995 @ \$900. 1 valve no repairs - assume repair 1993 and replace 1996 @ \$900. Solenoid valves 20 years remaining life (1993) @ \$275/valve. Controller 15 years @ @1,200/ unit.

a. Backflow 1 @ 900 in 2 years
 1 @ 900 in 3 years use \$1,800 in 5 years for budget purposes and carry as a line item.

b. Solenoid 25 @ \$ 275 =	\$ 6,875.00
c. Controllers 3 @ \$ 1,200 =	\$ 3,600.00
	<u>TOTAL \$10,475.00</u>

Total 30 year life or 2012, remaining 19 years.

5. Retaining Walls 1 Timber @ 4ft x 25 ft, 1 @.8 ft x 45 ft. Rebuild in 10 years @ \$5,000.00

6. Fences: none

7. Light Fixtures: 6 street lights, 15 walkway low voltage lights. Street lights @ \$2,000.00 total and walkway lights at \$15 each replaced twice in 30 years or total \$450.00. All installed in 1982. Remaining life (1993) 19 years.

8. Drainage: 3 drop inlets with 200 ft RCP draining to creek. New 1982 - 30 year plus life - may require cleaning of leaves, branches, etc. Possible outfall repairs every 10 - 15 years. Inspection shows wear and a little erosion. Estimated cost at \$2,000.00 in 4 years including a flushing of all lines.

9. Landscape:

a. Trees: Oak require major pruning every 10 years (last prune in 1991)@ \$2,500.00 in 8 years.

b. Allow major replacement of landscape on a 15 year basis of \$1,000/year. Total \$15,000.00

HOMEOWNER ASSOCIATION

Reserve Study _____

Useful, Remaining Life & Current Cost Of Replacement

1. Building Exterior Painting: _____ Units, __ year cycle
painted in _____, next painting _____

Current cost to paint units \$ _____

Current cost determination: _____

a) Fences: ___ year cycle, stained in _____, next _____

Current cost \$ _____ cost determination: _____

2. Streets: Slurry Seal _____sf, _____ year cycle
sealed in _____, next sealing _____, \$ _____/sf

Cost determination _____

Paving: _____ year cycle, paved in _____, next _____

Cost \$ _____/sf Cost determination _____

3. Concrete: Driveways _____sf, walks _____sf
sidewalks ___ ft. wide _____ lf, curbs &

gutters: _____lf. Driveway Concrete remove &

replace @ \$ _____ sf; Walks remove & replace @

\$ _____sf; Curb & Gutter repairs @ \$ _____ /

lf. Estimated repair work _____

HOMEOWNER ASSOCIATION

4. Irrigation:

Controller Stations: _____ each @ \$ _____

Est life: _____ years; Remaining life _____ years

Solenoid valves: _____ each @ \$ _____

Est life: _____ years; Remaining life _____ years

Replace Backflow valves: _____ each @ \$ _____

Remaining life existing valves: _____

5. Retaining Walls: Description: _____

Estimated life & Rebuild cost: _____

6. Fences: Description: _____

Estimated life & Rebuild cost: _____

7. Light fixtures: _____

Estimated life & Replacement costs: _____

HOMEOWNER ASSOCIATION

8. Drainage: _____

9. Landscape: _____

REPLACEMENT RESERVE STUDY FUNDING REQUIREMENTS (JUNE 1993)
 L.O.N.A.A. HOMEOWNER ASSOCIATION, SANTA ROSA, CA

COMPONENT DESCRIPTION	CURRENT REPLACEMENT COST	ESTIMATED USEFUL LIFE	ESTIMATED REMAINING USE LIFE	REQ'D BAL		REQ'D BAL	
				AT 12/31/93	1994 ADD.	1994 EXPEND	AT 12/31/94
1. PAINTING							
UNITS	19,525	6	3	6,230	3,582		9,813
FENCES	2,125	3	0	1,349	776	2,125	0
2. DRAINAGE							
SCH MAINT	2,000	4	3		500		500

TOTAL NON-CAPITAL	23,750			7,579	4,858	2,125	10,313

1. STREETS							
SEAL	2,960	7	3	1,208	483		1,691
PAVE	17,390	25	14	6,956	696		7,652
2. CONCRETE	17,500	18	17		972		972
3. IRRIGATION							
BACKFLOW SOLENOIDS CONTROL	1,800	5	3	343	377		720
4. TIMB WALLS	10,475	30	19	3,325	515		3,841
5. FENCES	5,000	10	9		500		500
6. LIGHTS	2,450	30	19	778	121		899
7. LANDSCAPE							
TREES	2,500	10	8	238	262		500
GENERAL	15,000	15	14		1,000		1,000

TOTAL CAPITAL	75,075			12,348	4,926		17,774

TOTAL RESERVES	98,825			20,427	9,785	2,125	28,087
=====							

- REVIEW NOTES:
1. REQ'D BAL 12/31/94 = CURRENT REPLACE COST/USEFUL LIFE X (USEFUL LIFE - REMAIN)
 2. 1994 ADD = REQ'D BAL 12/31/94 - REQ'D BAL 12/31/93
 3. % FUNDED: ASSUME CASH IN RESERVE ACCOUNT AT END OF 1993 = \$16,270
 THEN % = ACTUAL BALANCE 12/31/93/ REQ'D BALANCE 12/31/93 =
 \$16,270/\$20,427 x 100 = 79.6%

REVISED 1994

SAFEGUARDING ASSETS
OF
HOMEOWNERS' ASSOCIATIONS

Presented by
JAMES H. ERNST, CPA, MS-TAX

L. O. M. A. A.
HANDBOOK

Section 2
FINANCIAL

December 1996

JAMES ERNST ACCOUNTING
101 GOLF COURSE DRIVE • SUITE 207 • ROHNERT PARK • CA 94928
1447 MORNING GLORY DRIVE • PETALUMA • CA 94954
707-588-8025 Fax 707-588-8026

SAFEGUARDING ASSETS OF HOMEOWNERS' ASSOCIATIONS

TABLE OF CONTENTS

	PAGE
SAFEGUARDING ASSETS OF HOMEOWNERS' ASSOCIATIONS	1
FINANCIAL STATEMENTS	2
DUTIES OF THE BOARD OF DIRECTORS	2
INTERNAL ACCOUNTING CONTROLS	3
Cash Receipts	3
Members Assessments	3
Other Cash Receipts	3
Deposit Slips	4
Lock-Box Deposits	4
Reconciliations	4
Cash Disbursements	4
Operating and Reserve Expenditures	4
Signatures	4
Canceled Checks and Bank Transfers	4
Reconciliations	4
Signature Cards	4
Investments	5
Collections of Delinquent Assessments	5
Insurance	5
Licensed Contractors	6
Professional Advice	6
Income Taxes	6
Minutes of Board Meetings	7
Checklist	7
CONCLUSION	7
SCHEDULE A (HOA Internal Controls Checklist)	8

SAFEGUARDING ASSETS OF HOMEOWNERS' ASSOCIATIONS

HOW COULD THEY HAVE DONE THAT? This is the question most often asked right after we find out a *trusted* individual (e.g., manager, treasurer or staff member) has run off to Bimini with another Association's bank account.

Then we ask ourselves, **WHAT CAN WE DO TO SAFEGUARD OUR ASSOCIATION'S ASSETS?** However, before we can answer this question, we must first define the **ASSETS** of the association that we want to safeguard.

Cash obviously comes to mind after this type of incident. Then, although often a distant second, we might think of tangible personal property (fixed assets); we might ask, how do we keep the neighborhood delinquents from throwing our furniture into the pool?

What we often forget is that **THE VALUE OF THE ASSOCIATION'S PROPERTY** is the most important asset. In addition to holding on to our cash and watching over our furniture, the board of directors has a fiduciary duty to protect and enhance the fair market value of the residences in which we live. We must remember that the Association's property value is materially impacted by the degree to which the Association has been meeting its obligation to repair, restore, replace or maintain the common property, along with safeguarding the cash and furniture.

To safeguard the value of the Association's property, we must do more than simply have good internal accounting controls. We must always follow the "prudent man" rule, for the board members; or the "prudent expert" rule, for managers, accountants and other professionals involved with the Association. What would a prudent person or prudent expert do in this situation?

After we have started the asset list by identifying the Association's property value as its most important asset, followed by cash and furniture, we should add intangible items to our list. These may include, the timely collection of membership assessments and fees, the safeguarding of assets from unexpected loss through adequate insurance or the use of licensed contractors, seeking competent professional advice and following it, following Internal Revenue Service (IRS) codes and regulations to prevent unnecessary income tax assessments, hiring and training competent personnel, among others.

As a Certified Public Accountant (CPA), my initial concern is with the Association's system of internal accounting controls (including those of the management company), as well as with the accounting guidelines legislated by DAVIS-STIRLING¹; for example, financial

¹ California Civil Code (CC) § 1350. Short title "Davis-Stirling Common Interest Development Act."

statement reporting requirements² and the duties of the board of directors³.

Before we talk about specific internal accounting control procedures, let's first look at these legislative accounting guidelines.

FINANCIAL STATEMENTS⁴

It is often said that the best place to start is at the beginning. For Homeowners' Associations the best place to start is before the beginning, this is known as the BUDGET. Proper preparation and monitoring of the budget is a key starting point for safeguarding assets.

Davis-Stirling requires that "...the association shall prepare and distribute to all its members a proforma operating budget." It goes on to say that "[a] copy of the operating budget shall be annually distributed not less than 45 days nor more than 60 days prior to the beginning of the association's fiscal year." The law requires that we estimate the revenues and expenses of the Association for the next fiscal year, and include an amount necessary to defray the cost of reserve components in our estimate (or notify members whether a special assessment will be required).

At a recent Wine Country Resource Panel (WCRP) meeting a presentation was made by a panel of experts on the budgeting process. In their presentation they pointed out that the budgeting process requires knowledge of the past revenues and expenses of the Association (history often repeats itself), full cooperation from vendors (we don't want any surprises), participation by the members (a budget committee is essential), and an eye into the future (a crystal ball can't hurt).

By following their recommendations, a well thought out budget can be prepared.

DUTIES OF THE BOARD OF DIRECTORS⁵

After this well thought out budget has been prepared and distributed to the members, the next step, as partially required by Davis-Stirling, is to review the periodic financial activity of the Association. This is accomplished on a quarterly basis (unless required more often by the governing documents) by reviewing the financial statements of the Association (Davis-Stirling only covers the income and expense statement⁶), reconciling all cash balances to the bank statements, and comparing actual operating and reserve revenues and expenses with budgeted amounts (Davis-Stirling only covers the reserve activity⁷).

² CC § 1365. Financial statements.

³ CC § 1365.5. Fiscal duties of board of directors; Signatures required for withdrawal of money; Reserve accounts.

⁴ CC § 1365.

⁵ CC § 1365.5.

⁶ CC § 1365.5(a)(5).

⁷ CC § 1365.5(a)(3).

When actual activity is significantly (or unexpectedly) different than the budgeted amounts the board of directors should know why. Are the members paying their dues? Is the cash in the bank account different than the amount on the financial statements? Is money being spent on unbudgeted items? Look outside, are the maintenance and repair items that were paid for being done?

These legislated and suggested duties provide for a historical (after-the-fact) review of the financial activities of the Association. However, the best defense is often a good offense, and a good offense is embodied in a good system of internal accounting controls.

INTERNAL ACCOUNTING CONTROLS

In addition to the budgeting process and the periodic review, a good system of internal accounting controls should be put in place to make it harder for someone to run away with the store.

In an article recently published in THE ECHO⁸, *Internal Controls - A Mandatory Policy for A CID Association*, by Joelyn K. Carr-Fingerle, CPA, the emphasis of internal controls was placed primarily in the cash area – for Associations in the WCRP area, cash (or investments) is often the largest financial statement asset. Joelyn cited the need for two signature checks (required by Davis-Stirling for withdrawal from the reserve accounts⁹), proper check handling and timely bank reconciliations¹⁰. She also emphasized that the board “must know what is going on financially”. Finally, her article included a reprint of ECHO’s *HOA Internal Controls Checklist* that was designed so that the Association’s internal control system could be documented and evaluated by the board of directors, see Schedule A.

In addition to the controls cited in this article, there are other significant areas of internal accounting controls that should be established. The following internal accounting controls are designed to provide you with a starting point, they are not intended to be exhaustive. They should be adapted to meet the individual needs of your Association.

CASH RECEIPTS

Members’ Assessments – All assessments should be paid with a check. When paid with cash (including cashier’s checks and money orders), a pre-numbered cash receipt should be prepared (record the amount received, date, members name and unit number, and sign the receipt) and give the original to the member. A copy (consider a 2-part NCR receipt book) should be maintained by the treasurer or manager.

Other Cash Receipts – All other cash receipts should be paid with a check. When paid with cash, a pre-numbered cash receipt should be prepared (see member assessments)

⁸ August 1996, Vol. 25, No. 8, page 1.

⁹ CC § 1365.5(b).

¹⁰ CC § 1365.5(a).

and given to the individual making the payment. Again, a copy should be maintained by the treasurer or manager.

Deposit Slips – All checks, which should be restrictively endorsed (for deposit only), and cash should be recorded on a bank deposit slip and taken to the bank on a daily basis.

Lock-Box Deposits – A bank lock-box system (where available) should be used. Under this system, all (or most) members make their payments directly to the Association's bank. The payments are directly deposited to the Association's account and a report is provided by the bank on a monthly basis.

Reconciliations – The daily deposit slips (remember to account for all pre-numbered cash receipts) along with the lock-box deposit statements should be reconciled to the bank statements on a monthly basis, and to the financial statements on at least a quarterly basis (more often, if financial statements are prepared monthly).

The individual reconciling the bank statements should not be the individual making the deposits.

CASH DISBURSEMENTS

Operating and Reserve Expenditures – All expenditures should be made with pre-numbered checks. These checks should not be made payable to cash.

Signatures – Operating and reserve checks and withdrawals should require two signatures. For operating accounts, signers can be members of a management company; however, for reserve accounts, both signers must be either members of the board or an officer and a board member.

Canceled Checks and Bank Transfers – All canceled checks should be examined for alterations to amounts and/or payees, and verified that endorsements are not to unauthorized recipients (e.g., one of the check signers). Also, verify that all bank transfers go from one Association account to another Association account.

Reconciliations – The canceled checks (remember to account for all pre-numbered checks) and bank transfers should be reconciled to the bank statements on a monthly basis, and to the financial statements on at least a quarterly basis (more often, if financial statements are prepared monthly).

The individual reconciling the bank statement should not be a check signer.

Signature Cards – The president of the board of directors should send the signature card directly to the bank. The board of directors should periodically verify directly with the bank who the authorized signers are and how many signatures are required.

INVESTMENTS

All investments (including cash) should be held in a bank or savings institution that provides \$100,000 in FDIC or FSLIC insurance coverage (do not put more than \$100,000 in any one institution), or in an investment that is backed by the full faith and credit of the federal government (e.g., treasury bills).

Your fiduciary duty suggests that you should not use the Association funds to speculate in the market. These funds have a specific short-term or long-term purpose, and they should not be put at risk – you may lose it all.

COLLECTIONS OF DELINQUENT ASSESSMENTS

Davis-Stirling requires that “[a] statement describing the association’s policies and practices in enforcing lien rights or other legal remedies for default in payment of its assessments...shall be annually delivered to the members...”¹¹

The Association’s collection policy should be based on Davis-Stirling¹² and it should be followed without exception for all members on a timely basis. Notices of deficiency should be sent, late charges and interest should be added, liens should be filed and other legal action should be taken as soon as possible. This will prevent the delinquency from getting out of hand for most members.

In addition, if the member has been paying their dues timely, but the funds have been diverted, you will have a built in early warning system from the member.

INSURANCE

Make sure your Association has insurance in effect that covers a cause of action in tort (liability insurance) and that meets the minimum coverage standards set by Davis-Stirling¹³. The Association must maintain general liability insurance coverage of at least \$2,000,000 if there are 100 or fewer separate interests; or at least \$3,000,000 if there are more than 100 separate interests.

Don’t forget liability insurance for your volunteer board of directors¹⁴. The minimum coverage is \$500,000 if there are 100 or fewer separate interests; or \$1,000,000 if there are more than 100 separate interests.

¹¹ CC § 1365(d).

¹² CC §§ 1366(d) and 1367.

¹³ CC § 1365.9.

¹⁴ CC § 1365.7.

LICENSED CONTRACTORS

Always use licensed contractors to provide services for the Association. These contractors should have their own liability and workers' compensation insurance policies naming the Association as an additional insured before any work can begin. Make sure that their insurance company is required to notify you immediately of any changes or a lapse in coverage.

PROFESSIONAL ADVICE

The law requires that a CPA provides an annual review of the financial statements of all Associations with gross income in excess of \$75,000.¹⁵ However, **the review cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist.**

Because every Association has different needs and resources, you should talk to your accounting professional to help you evaluate and/or set up your own system of internal accounting controls.

Whenever you suspect something may be wrong, you should immediately contact your legal and accounting professional. They can assist you in determining whether additional safeguards are necessary (close the barn door with the horse still in), or you have to take action to recover lost assets (close the barn door after the horse got out). Remember, when they give you advice, **follow it.**

INCOME TAXES

The Internal Revenue Service (IRS) and California Franchise Tax Board (FTB) have established various guidelines for Associations to follow for record keeping, cash segregation, elections, and filing choices. Recently, the IRS's biggest concern is over the proper handling of reserve funds. They have indicated that the commingling of resources (reserve and operating funds) and failure to make a timely IRS Revenue Ruling 70-604 election (by the membership) can result in additional income taxes being assessed along with penalties and interest.

As you might expect, inviting the wrath of the IRS or FTB could significantly drain the financial resources of your Association. You should contact your accounting professional for safeguards in this delicate and sometimes uncertain area.

¹⁵ CC § 1365(b).

MINUTES OF BOARD MEETINGS

The minutes of the board of directors meetings should reflect all financial decisions made by the board; such as, contract approvals and major expenditures. In addition, changes in relationships should also be recorded; such as, banks, management company, accountant or attorney.

If contracts are approved or major expenditures agreed to, the amounts should be recorded in the minutes. This will enable the board (and your accountant) to compare the approved amounts against the actual expenditures reported in the financial statements.

CHECKLIST

The ECHO Accountants Resource Panel prepared an *HOA Internal Control Checklist*, see Schedule A.

This checklist includes a series of questions with "YES", "NO" or "N/A" answers. It is designed not only to answer questions about the existence of internal controls, but to educate the board and/or managers about the types of controls that are available. It should always be used when establishing or evaluating your system of internal controls.

CONCLUSION

As you can see, safeguarding assets of homeowners' associations is significantly more involved than simply watching the cash. You need to establish a system of internal accounting controls, prepare meaningful budgets, monitor financial activity against the budget, reconcile bank balances, invest conservatively, collect assessments, have adequate insurance, use licensed contractors, seek professional advice and hire and train competent personnel.

Don't forget that the most important asset is **THE VALUE OF THE ASSOCIATION'S PROPERTY**. The board of directors should always meet their fiduciary responsibilities, not the least of which is to repair, restore, replace or maintain the common property.

SCHEDULE A

HOA INTERNAL CONTROLS CHECKLIST

GENERAL CONTROLS: (Those that have an indirect impact on the accounting system; their contribution is to provide an environment that is conducive to the protection of assets.)

A. ORGANIZATIONAL STRUCTURE

- | | |
|--|--|
| 1. Is there a coordinated insurance program, reviewed annually? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 2. Is there adequate comprehensive liability insurance for the association's assets? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 3. Is the liability insurance level in accordance with CC § 1365.7? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 4. Is association personal property listed and tagged with an association ID? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 5. Is there an accounting capitalization policy? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 6. Does the general membership vote on earthquake insurance annually? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 7. Is there a Directors & Officers liability policy in force, conforming with governing document requirements? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 8. Are there records retention policies and procedures? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 9. Do budget and insurance disclosures conform to CC § 1365? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 10. Is a reserve study performed every three years per CC § 1365.5 and updated annually? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 11. Does the board clearly understand the duties, authority and responsibilities of each member? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 12. Are there written job descriptions for each member of the board? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 13. Does the board have a written manual of policies and procedures? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 14. Does the board keep accurate minutes of board and of committee meetings? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |

B. ACCOUNTING ADMINISTRATION

- | | |
|---|--|
| 1. Is there an accounting manual listing items in each general ledger account? * | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 2. Is there a general ledger account for each association budget line item? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 3. Does the board receive prompt financial reports at least quarterly? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 4. Does the board regularly compare financial results to the budget and review variations? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 5. Is the comparison done in accordance with CC § 1365.5? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 6. Does the board obtain bids for services and document decisions for acceptance of all bids? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |

* **NOTE:** Lack of an accounting manual or defined chart of accounts can lead to inconsistent accounting treatment or misclassification of revenue or expenses from one period to the next. Such misclassification can deter comparability from period to period and make it difficult for the board to understand financial results or make meaningful comparisons to the budget.

SPECIFIC INTERNAL CONTROLS: (Those that relate to specific assets such as cash and receivables.)

C. CASH AND BANK ACCOUNTS

- | | |
|---|--|
| 1. Are bank and investment accounts in the name of the association? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 2. Are bank signature cards current? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 3. Are persons handling association cash bonded? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 4. Total cash balances with any one financial institution do not exceed \$100,000? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 5. Are cash deposits in FDIC insured accounts? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 6. Are bank statements reconciled monthly by someone with no other cash receipts or disbursement functions? ("Other cash functions" include making bank deposits, recording cash receipts, writing checks or approving payments.) | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 7. Does the reconciler receive the bank statement unopened (to prevent loss or alterations)? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 8. Does the reconciler compare check details with journal entries? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 9. Does the reconciler examine checks for signature, alterations, or irregular endorsements? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 10. Does the reconciler compare bank dates of deposit with the cash receipts journal? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 11. Are long outstanding checks (over 90 days) reviewed for disposition? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |
| 12. Are bank reconciliations reviewed and approved by the board at least quarterly? | <input type="checkbox"/> Y <input type="checkbox"/> N <input type="checkbox"/> N/A |

(continued)

INSURANCE

HOMEOWNERS INSURANCE:

WHY IT'S SO IMPORTANT

by Merl Scott

President, Diablo Insurance Agency

Homeowners' Insurance - when it comes to making important decisions about protecting your home and personal belongings, it can be very confusing indeed.

Your home and possessions are probably your most valuable assets. Your losses could be tremendous if they were damaged or destroyed by fire or another disaster. Proper insurance coverages can help soften the blow and pull you through such a disaster.

But how do you know you're fully or properly insured? How do you know you wouldn't be a victim of your insurance company like so many were in the Oakland Hills fire? Often you don't find out until you have gone through such an event. By then it may be too late.

To avoid the anguish experienced by so many homeowners in the East Bay Hills fire, you should take the time now to review your existing insurance coverages and revise them as necessary to meet your personal needs.

To help ensure that you don't get caught without adequate insurance protection as a condominium or single family homeowner in a master-planned community such as Crow Canyon, we'd like to share some tips on what to look for in the most comprehensive insurance coverage.

First, as a CONDOMINIUM OWNER, you may be covered by a Homeowners Association master policy. These policies typically cover on structural damage to building walls and offer no coverage for personal contents or liability. We recommend additional protection such as the following:

1. Look for Full Value Contents Coverage. When stolen or destroyed personal property is covered properly, you should be paid the full amount the new item would cost today (less your selected deductible). There should be no deduction for depreciation.
2. Make sure you have adequate Loss Assessment Coverage which protects you against losses the HOA may not be fully insured on your behalf (like a liability lawsuit due to a serious accident at the community pool). In other words, you may need more protection than the standard liability limits in a HOA policy or individual homeowners' policy. Everything you own could be jeopardized if someone makes an injury or property damage claim against you as a member of an HOA under its master policy. The normal coverage limit is \$1000, but it may be increased up to \$50,000.

3. Additional living expenses can be costly during repair or reconstruction. Check to see if your insurance carrier has provided you with adequate Loss of Use Coverage to take care of reasonable living expenses for as long as it takes to repair or rebuild your home. This has been a problem for many Oakland Hills homeowners who had inadequate Loss of Use limits. Many had only one year limits or dollar ceiling that were too low and used up well before their homes were completed.

4. Make certain that your Additions and Alterations limit is adequate. Additions and Alteration coverage provides additional coverage for shelves, cabinets, built-in bars, upgraded carpeting, wallpaper, draperies, etc.

Secondly, as a **SINGLE FAMILY HOMEOWNER** you are a member of the Homeowners Association. However, no master policy typically applies to your real property. Therefore, you need individual coverage which includes the structure, your personal contents and liability. You should make sure your insurance company or broker representing the company you've selected, provides you with the following:

1. Your insurance coverages should include 1., 2. and 3. noted under the condominium owner coverage.
2. You should confirm that your property coverage is based on a realistic and current replacement cost basis. Check to see if your policy offers Guaranteed Replacement Coverage--a guarantee from your insurance company that it will cover the cost of repair or rebuilding of your home, even if the cost is more than the amount of coverage you carry on your home. Without this additional coverage, you might have to pay part of the cost yourself, settle for less house than you had before the loss or worse, incur financial ruin. You should also make sure your insurance company is not one of those that "force a property owner to use outdated repair techniques" that will not provide for the security and stability of the new structure, nor protect the home's equity.
3. You may also require Scheduled Property Coverage. Valuable personal property such as jewelry, furs, artwork, collections, silver, etc., may need to be individually insured. Often, these items need more coverage than a "basic" policy provides. They can be added to your present policy by endorsement, giving you broader coverage, with no deductible when you have a loss.
4. A careful annual review of your existing policy coverages and exclusions needs to be done. Make sure you and your broker or agent update your policy as needed to verify adequate limits, additions and deletions. In other words, keep up with changes.
5. An insurance company with a solid reputation for settling claims promptly and fairly; one that will stand behind their clients when called upon; one that has the highest standards of underwriting to ensure clients have proper coverages is vital for all homeowners.

Article provided courtesy of
Wayne Rudick, Pleasanton Valley Insurance

INSURANCE DISCLOSURES

Insurance Coverages (New 1995)

Upon Issuance or Renewal of Insurance, But No Less Than Annually.

Effective January 1, 1995, an Association must give notice to the membership of the limits of insurance carried under its general liability and individual director's and officer's liability policies. The notice must also state whether the limits carried meet the requirements of newly enacted Civil Code section 1365.9 to prevent owners from being held individually liable in certain types of lawsuits brought against the Association. These suits are generally for injuries or property damage arising out of the negligent operation of the common areas.

The notice must address the possible consequences of an association's being or not being insured to the levels stated in the statute. If the association's insurance do not meet the requirements of the statute, the notice must inform the members that they may be individually liable for the entire amount of a judgment. If the association is insured to the extent defined, the notice must inform the members that they may be individually liable only for their proportional share of any special assessment that might be levied to cover the amount of any judgment exceeding the limits of the insurance.

The law does not require an association to maintain the limits of insurance stated below, only that it disclose the insurance coverages it has and the possible financial consequences to the members. The level of insurance specified in the statute for associations with 100 or fewer lots or units, general liability and director's and officer's liability coverages of at least \$2 million per occurrence.

The new law states that notice of the association's liability coverages must be made upon issuance or renewal of the policies, but at least annually. It is suggested that the notice and required statements be issued annually within thirty days of receipt of the evidence of insurance. Immediate notice is particularly important if the association opts not to, or cannot, obtain insurance in the limits specified in the statute.

Excerpts from BERDING & WEIL

LOMAA 1994

INSURANCE:

A. LIABILITY

Currently most association liability insurance is \$3,000,000 aggregate and \$1,000,000 each occurrence. Most occurrences of any consequence are claimed higher than \$1,000,000. Current (1993) premiums for the basic liability and Board of Governors is about \$800. An additional \$1,000,000 per occurrence may be written for an annual increase of about \$200. The liability coverage would then be \$3,000,000 aggregate and \$2,000,000 each occurrence.

Should an association be sued and the awarded claim is more than - in the current case - \$1,000,000, then there are two ways of getting sufficient funds.

1. If Suit names association only: Association special assessment.

This is an assessment of all Owners for the amount of the award that is above the policy amount. Owners can obtain loss assessment coverage up to \$50,000 for about \$25/year under their HO- policy. This seems to be the maximum amount written.

2. If Owners are named in the lawsuit. Then the individual HO policy picks up under the liability clause and umbrella policy.

There are commercial umbrellas available but their cost is a bit steep.

Example:

\$1 M	\$1,250	\$4 M	\$3,500
\$2 M	\$2,000	\$5 M	\$4,250
\$3 M	\$2,750		

It may be that the increased Association liability coverage is to your association's advantage.

TAXES

L. O. M. A. A.

WORKSHOP JUNE 8, 1993

TAXES

Your administrator/auditor calculates and prepares your association's taxes. However, it is the responsibility of the association board of governors to ensure this is being done properly.

In the past, the administrators of Oakmont's Maintained Areas Associations filed either of two forms (1120 or 1120-H), whichever they considered most beneficial to an association's financial situation.

IRS Code Section 528, enacted in 1976, established Form 1120-H which is a one page form that sets a flat tax rate of 30%. This form substituted for the more complicated Form 1120 which at the time had a higher effective tax rate. The Tax Reform Act of 1986 changed that. Currently, Form 1120 has a graduated tax rate that starts at 15% for the first \$50,000 of taxable income.

If an association elects to use the Form 1120 it should, annually at the general meeting, vote to apply excess income (home owner dues in excess to the needs of the association) to one of the following:

- 1) to next year's maintenance assessments;
- 2) in refund to the members; or
- 3) to the reserve funds.

If this is not done, then such income is subject to tax.

Included herewith are two suggested Resolution formats for your use.

It recommended that associations discuss the forgoing with their tax advisor.

_____ OWNERS ASSOCIATION

RESOLUTION OF THE _____ OWNERS ASSOCIATION

RE: EXCESS INCOME TRANSFERRED TO REPLACEMENT FUNDS

WHEREAS, the _____ OWNERS Association is an association organized under the Oakmont Village Declaration No. ___ of Protective Restrictions dated _____, 1986.

and

WHEREAS, the members desire that the Association shall act in full accordance with the rulings and regulations of the Internal Revenue Service;

NOW, THEREFORE, The members hereby adopt the following resolution by and on behalf of the _____ Association:

RESOLVED, that any amounts collected by or paid to the Association in excess of operating expenses for the year ended December 31, _____ shall be set aside for future major repairs and replacements and allocated to capital components as provided by the guidelines established by Revenue Rulings 70-604, 75-370 and 75-371. Any such amounts shall be deposited into insured interest-bearing accounts. Any amounts so added to replacement funds shall be allocated to the various components at the discretion of the Board of Governors.

This resolution is adopted and made part of the minutes of the meeting of

BY: _____
Chair

ATTESTED: _____
Secretary