



BOARD MEMBER HANDBOOK

Governance, Insurance,
and **Finance** basics in
Homeowner Associations



Governance Series

© 2019 ECHO • echo-ca.org

Table of Contents

Common Interest Developments	1
Types of Common Interest Developments.....	2
Legal Authority Governing Common Interest Developments	3
Governance	7
Roles and Responsibilities.....	7
Elections.....	13
Meetings	13
Rules and Enforcement.....	22
Volunteers.....	24
Finances.....	29
Treasurer Duties and Responsibilities	29
Reconciling Cash Accounts.....	30
Accounting Systems.....	33
Methods of Accounting	33
Financial Statements	34
CPA Services: Audit, Review, Compilation	43
Internal Controls.....	43
Financial and Tax Reporting Deadlines.....	47
Income Taxes.....	49
Future Major Repairs and Replacements	49
Frequently Asked Questions:	54
Insurance	57
Property Coverage	57
Premise Liability Coverage	59
Umbrella & Fidelity Bond Coverage.....	60
Additional Association Insurance Policies to Consider	61
Maintenance	65
Responsibility	65
Types of Maintenance	66
Maintenance Programs	68
Contractors	68

Printed March, 2019

Board Member Handbook. Copyright © 2019 by ECHO

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form, electronic, photocopying or otherwise, without the prior consent of ECHO.

Common Interest Developments

Common Interest Developments, as we know them, did not exist 50 years ago. They were created primarily for two reasons: to enable builders to build more homes on a given parcel, and to allow development on parcels which included both buildable and unbuildable land. Where a single-family detached housing development might place four to six homes on each acre of ground, attached housing can accommodate much higher densities: as many as ten to fifteen per acre. Furthermore, unusable land in a single parcel can be avoided through the expedient clustering of homes on the buildable land within the parcel. These issues have become extremely important to the housing industry as land prices have soared in urban areas, and flat, buildable land has become scarce.

Greater density and clustering of homes brings unique governance problems. Where single-family homes are maintained by the owner, attached housing usually requires community maintenance. High density living requires rules for resident behavior and the use of property not necessary in less dense developments. In short, the higher the density of the housing, the more that must be done to accommodate common, as opposed to individual, needs. High density attached housing has thus come to be referred to as a “Common Interest” Development, although you will also hear such projects referred to by various other names: homeowners associations, condos, town homes, or community associations.

Regardless of which name is used to describe a particular project, this type of housing has become extremely popular in California. Through 2012, more than 46,000 common interest developments have been built in this state. If the average size of such developments were just 100 units, (many are much larger), that would represent over 4,500,000 homes for perhaps as many as 9,000,000 people. In a state as populous as California, common interest developments are home to an estimated one-quarter of all residents.

Despite the variety and sheer number of common interest developments, each is governed in the same way: a Board composed of property owners governs the community. This Board derives its authority over the property from several governing documents which the builder of the property prepares in accordance with guidelines published by the California Department of Real Estate and other laws of the State of California.

With most attached housing, and in some detached housing, the Board, acting on behalf of the association, is responsible for the maintenance of the property. Boards are also charged with enforcing the governing documents, collecting assessments needed to pay the expenses of the association, and in general, providing for the welfare of the association and its residents.

It is important that each Board member understand the legal nature of a common interest development, the association's authority over the property and its owners, and the unique manner in which an association is governed – essentially an experiment in grass roots politics.

Types of Common Interest Developments

All of the land and property in a common interest development, regardless of type, is divided into two parts: the part owned by the individual owner, and everything else. The part that is owned by each individual owner, i.e. the property deeded to that owner, is that owner's "separate interest." Everything else is "common area." [CC§4095(a)]

California law recognizes four types of common interest developments, but we will discuss only the two most common types: condominiums and planned developments. [CC§4100] The major difference between these two types of projects is found in the nature of the owner's separate interest. Since many important rights and duties are determined by who owns what, it is very important that each Board member understand the difference between condominiums and planned developments.

Condominiums

Condominiums can be anything from a high rise to a single house, but are most commonly found as multi-story, multi-unit structures. If there is one unit on top of another, it is probably a condominium. The typical condominium project in California is either a high-rise steel and concrete building, or a low-rise wood frame structure consisting of several buildings each containing multiple apartment-style units. There are, however, many other architectural styles which can be condominiums – work/live space lofts, or office buildings, for example.

The separate interest deeded to an owner of a condominium is normally just the air space within the unit itself, and such other portions of the property such as parking spaces and storage lockers that the governing documents or deed describe as part of the owner's separate interest. The description of the owners "unit" (as the owner's separate interest in a condominium is usually described) normally includes everything on the warm side (inside) of the sheet rock. It includes all of the fixtures inside the unit, such as lights, stove, and plumbing fixtures, but generally not the plumbing (or electrical wiring) within the walls. [CC§4125]

All other portions of a condominium building are common area. This includes all of the structural elements of the building, the foundation, and all of the waterproofing components

such as exterior siding, windows, and roofs. The parking lot and all of the landscaped areas and recreational facilities adjacent to the building itself are also common area.

The owner of a condominium unit receives a deed to the unit itself and a percentage of all of the common area. For example, if there are 50 units in the project, each owner will own 1/50 of the common area in addition to his or her individual unit.

Planned Developments

Planned developments are typically composed of either single-family dwellings where the structure is a stand-alone building, or townhouses which share common walls. Attached housing in a planned development is typically comprised of townhouse or row house-style dwellings of one or two stories. The word “townhouse” refers only to an *architectural style* and does not, in itself, connote a planned development. There are also condominiums that are of the “townhouse” style.

The owner’s “separate interest” in a planned development is usually referred to as a “lot.” A lot in a planned development of attached housing is very similar to a lot in any single family development. It is a parcel of land with specific measurements, and has a residence on it. The owner of that lot owns the land, and all of the parts of the building on that land. Even though the buildings on the lots in an attached development have common walls, the boundaries of the owner’s separate interest can be determined with reference to the governing documents and to the parcel map recorded with the county. [CC§4175]

Therefore, the separate interest owned by an owner of a lot in a planned development includes all of the building components on that lot, including foundation, structure, wires, pipes, and all of the waterproofing systems, such as siding and roofs. The other owners in the planned development do not own any portion of the owner’s individual lot.

In a planned development, the common area is everything outside of the boundaries of the separate interest lots. This often includes streets, walkways, landscaped areas, and recreational facilities. The common area parcels are usually deeded to the association which then owns that property like any landowner, but subject to the rights and interests of the members of the association, as stated in the governing documents.

Exclusive Use Common Area

Exclusive Use Common Area is common area which is used exclusively by one or more owners. Examples include balconies, patios, walkways, driveways, and entries. The important thing to remember is that exclusive use common area is still common area, and except for the owner’s rights to such areas, it is held in common by all of the owners of the property (condominiums) or by the association (planned developments) in accordance with a deed from the developer. [CC§4145]

Legal Authority Governing Common Interest Developments

Common interest developments are a unique blend of Real Estate and Corporate Law. Real estate law governs the property itself, from the subdivision of the property to the restrictions on its use. Corporate law governs the creation and operation of the corporation which manages the property. And the Governing Documents, insofar as they do not conflict with State law, govern the structure and operation of the association.

Governing Documents

Almost all common interest developments, whether they are condominiums or planned developments, are managed by corporations governed by a Board of Directors. The corporations are called associations and are created as non-profit mutual benefit corporations under the authority of the California Corporations Code. The corporation itself is created by filing Articles of Incorporation with the California Secretary of State. The rules of the corporation, concerning everything from the number of directors to the dates of meetings are contained in the association's Bylaws.

Physically, common interest developments are parcels of land, and land in California is subject to the law of real property. Anything that causes a change in the status of land must be recorded with the county recorder in the county where the land is located. This is also true of anything that seeks to regulate the use of real property.

A modern common interest development could not exist if every owner had unrestricted use of his or her property. Because of the density of the property and of most attached homes, use of property is regulated. These limitations are contained in the development's Declaration of Covenants, Conditions and Restrictions. The declaration, or "CC&Rs," is signed by the developer or the sub-divider and recorded with the county recorder, before any of the individual lots or units are sold. Recording the CC&Rs extends their authority over all lots or units in the subdivision. [CC§4250]

The Articles of Incorporation, Bylaws, and Declaration of Conditions, Covenants, and Restrictions are the major governing documents of the association and the development. Also officially part of the governing documents are the operating rules and regulations promulgated by the Board and/or the members.

If there is a conflict between the governing documents, resolution of that conflict depends on the issue. In matters relating to the association as a corporation, first the Articles, and then the Bylaws, take precedence. In matters relating to the regulation of the real property, the CC&Rs have priority. In either case, however, state law can, but does not always, override the governing documents.

Articles of Incorporation

The Articles of Incorporation establish the corporation as an entity. They typically include a statement regarding the type of corporation being formed. The Articles of Incorporation are filed with the State of California and establish the corporate status of the association. Every other year each association must file a new corporate statement with the State. This filing includes the names of the association's officers and the business location of the association. All associations, whether incorporated or not, are also required to file a form with the state regarding the common interest development. Failure of an incorporated association to file these two forms every other year can mean the loss of corporate status for the association until the forms are filed and the corporation is formally "revived." While an association is not in good standing as a corporation, it is unlawful for the association to take most corporate action.

Declaration of Covenants, Conditions, and Restrictions (CC&Rs)

The Declaration of Covenants, Conditions and Restrictions (CC&Rs) is the document we look to for definitions and conditions of ownership. The Declaration usually contains language binding all owners together in an interlocking relationship and establishes the "mandatory membership" requirement for the association based on ownership of a unit or lot. It further establishes rights and responsibilities of the association and the owners.

Bylaws

The Bylaws establish methods and parameters of the conduct of business of the corporation. These include the number and term of Board members, conditions of meetings and business methodologies and parameters employed by the association.

Rules and Regulations

The operating rules of the association establish community controls and quality of life standards. The authority to adopt and enforce operating rules is typically found in the Declaration and Bylaws. The governing documents will give the Board the right and responsibility to "promulgate rules and regulations from time to time governing the use of the common area and the behavior of the members and their guests."

Every association is subject to the same hierarchy of authority. By understanding the hierarchy of documents, the Board has a good road map for determining the association's responsibility and authority in making business decisions to govern the corporation.

State Law

The governing authorities of the association, as well as the limitations upon that authority, are contained in the governing documents and in the laws of the State of California. State law on common interest developments is found in both statutory and case law. State statutes that regulate common interest developments are found in many places in the state codes, but primarily in the California Corporations Code and in the California Civil Code.

The California Corporations Code governs the operations of the association as a non-profit mutual benefit corporation. In most cases, the bylaws of the association will be sufficient to deal with questions regarding the day-to-day operation of the association as a corporation. The bylaws deal with such topics as the qualifications of a member of the association and of directors, election and removal of directors, the powers of the Board of Directors, and the meetings of the Board and of the members. Where the bylaws fail to address a subject, the Corporations Code will supply the law.

The California Civil Code, principally Sections 4000 through 6150, contains the provisions of the Davis-Stirling Common Interest Development Act. As its name suggests, the Act is a comprehensive collection of statutes dealing with the management of common interest developments. Unlike the Corporations Code, which in most cases defers to the association's bylaws, the Davis-Stirling Act contains provisions that supersede the association's bylaws or CC&Rs, as well as provisions that do not. The Board must refer to specific provisions of the Act to determine which, the Act or the governing documents, prevails.

Case Law

There are published cases decided by the appellate courts of California which contain precedent that is applicable to common interest developments. Where a case decided by an appellate court contains decisional law that is in direct conflict with a provision of the association's governing documents, the case law will prevail. The recent decisions of state appellate courts in the area of common interest development law provide guidance useful in interpreting the provisions of the governing documents.

Governance

Roles and Responsibilities

Associations are made up of many participants. All associations begin with the developer whose roles include: Declarant, Builder, Seller, first Board of Directors and Homeowner. Associations also include homeowner members, a Board of Directors, and committees.

We will examine the role of each of the participants individually. To be successful every association participant needs a clear understanding of his or her rights, responsibilities and roles in the creation and operation of the community.

Board and Officers

The association is established as a corporate entity as soon as the governing documents are filed. When that event occurs, the developer begins its role as the initial Board of Directors of the association. Most associations, when they are new, have a Board of Directors consisting entirely of developer representatives.

As the Board of Directors, the developer has the same fiduciary obligation to protect, maintain and enhance the value of the asset as homeowner Board members will later have. The developer, as the Board, must act in the best interest of the association and its members.

In general, the Board of Directors is responsible for the management and operation of the association. The Board also has the responsibility for enforcing the governing documents and rules and regulations.

It is important to note that the Board may delegate its authority to operate the association, (usually to a managing agent), **but cannot delegate its responsibility**. When the association hires a managing agent, or any other contractor, the Board is delegating authority to that entity for certain association operations. However, the Board is ultimately responsible for all aspects of the association.

The Board's authority is derived from state statutes (the Davis-Stirling Common Interest Development Act in California), the state corporate statutes, and the governing documents. Essentially the Board is a policymaking body responsible for the maintenance, administration and the financial well-being of the association.

The Board's responsibilities and duties fall into several categories. Overall, the Board acts in a fiduciary capacity for the members. As a fiduciary body, the Board must exercise care in all matters, acting in the best interest of the members and in the best interest of the community. In addition, the Board must act in accordance with state statutes, the governing documents and must act in "good faith" in all its dealings.

The decisions the Board makes must meet the test of "the business judgment rule." Simply put, this means the Board's decisions must be reasonable (i.e., made in good faith and based on the best interest of the community as a whole, not on a director's best interest) and be based on the best information available to the Board at the time the decision is made. The "best information" includes information from the manager, professional contractors, accountants, attorneys, trade associations like ECHO, as well as other professional resources.

President

The President is typically elected by the members of the Board and acts in the capacity of CEO and leader of the association. The President is ultimately responsible for the content of the agenda for Board meetings and running meetings according to the Board's policy.

The President also executes contracts and official documents on behalf of the association and acts as official liaison to the management company.

Vice President

The Vice President performs all duties assigned by the President and acts on the President's behalf in the President's absence.

Secretary

The Secretary prepares and distributes minutes and other official association documentation. The Secretary is responsible for attesting to the authenticity of all official corporate documents and correspondence including, but not limited to, minutes, notices and election results.

Traditionally many of the duties of the Secretary are delegated to the managing agent. However, some items should not be delegated. They include:

- Signing and dating the minutes of every meeting
- Authenticating (by signature of the Inspector of Election) the results of all elections
- Authentication of notices.

Treasurer

The Treasurer is the Chief Financial Officer of the association. As CFO the Treasurer is ultimately responsible for collection and expenditure of all assessments, though authority to do so may be delegated to the managing agent.

The Treasurer also reviews and monitors the financial reports and performance of the association and summarizes these for the other Board members at Board meetings. While the financial statements may be prepared by an outside entity (bookkeeper or managing agent) it is important that the Treasurer demonstrate an understanding of the financial position of the organization on a regular basis to fulfill the obligations of the office.

The Treasurer's verbal report to the Board might include:

- Cash on hand
- Status of reserves
- Unusual accounts payable and receivable
- Variance of actual-to-budget for month and year (if substantive)

Finally, the Treasurer will be responsible for signing any checks (if required) and monitoring the investment and collection policies of the association.

Clearly the role of the Treasurer is a very important one and may require training in areas regarding the understanding of financial statements and understanding investment policies. The association's bookkeeping and/or managing agent can be extremely helpful in this regard and should be called on for any assistance the Treasurer may require. Remember, the Treasurer, like all other Board members, may delegate authority but not the responsibility for the task of the office.

Members At Large/Directors

All members of the Board, whether they are officers or not, are responsible to come to the meetings prepared to conduct business in a professional manner. This means that each Board member must prepare ahead of time to make the important decisions that affect the business of the corporation.

Review of the materials in the informational Board packet is essential to fulfilling this responsibility. If a Board member has questions about the information after reviewing the material, that member should be advised to contact the manager to discuss the piece of business being considered or be prepared to discuss the matter at the meeting.

The following checklist is a useful guideline for members at large to follow:

- Come to meetings prepared - Do your homework
- Maintain a professional demeanor
- Ask questions ahead of time
- Accept and support the President as the leader
- Put personal issues aside
- Encourage others to participate by example
- Be open and fair
- Listen
- Keep a healthy perspective

Homeowners

The homeowner's role in the association is pivotal to the success of the community. Homeowners should be encouraged to participate in annual meetings, elections and on any committees the association establishes. It has been said, "The world belongs to those who show up." Perhaps this is truer in a homeowner association than anywhere else.

Homeowners have the right to expect their Board of Directors to deal fairly and honestly with them and create open channels of communication to keep them informed of important issues

facing the community. In return, homeowners should take every opportunity to participate in their community.

All homeowners in associations have the obligation to adhere to the covenants, conditions and restrictions set forth in the Declaration, to abide by the bylaws, and to comply with rules and regulations set forth by the Board. In addition, all homeowners are legally obligated to pay regular and special assessments in a timely manner.

Homeowner feedback at Board meetings, meetings of the members and annual meetings is critical to the Board's success. California provides for homeowner input via an open meeting law special just to community associations [CC§4900 - §4955]. We will address the open meeting law and homeowner communication later when we discuss meeting procedures.

Management

The role of the association manager is to implement policies and programs adopted by the Board in accordance with the management contract. The manager acts as the Board's immediate professional resource for information and guidance when considering policy and maintenance questions. In addition, the manager may act as the liaison to contractors, vendors, professionals and the homeowners. The manager may also act in other capacities as outlined in the management contract. These capacities might typically include bookkeeping, publishing the newsletter, performing property inspections, preparing resale disclosure packets on behalf of the association, collections and rules enforcement, preparing maintenance procedures and manuals, contractor oversight and the facilitation of bid specifications, and serving as Inspector of Elections.

Regardless of the management model the association adopts, the administrative functions listed above will need to be provided for. The determining factors may be many, but the job remains the same. Annual calendars, programs and budgets need to be created along with procedures to review the management functions and plans for their implementation. This can be a somewhat overwhelming task for many people. The key to success is to understand the needs of the community and then select the management model that best serves those needs.

As always, the Board may delegate implementation authority to the manager but may not delegate its responsibility for proper implementation of its policies, programs and/or operations. All management authority is derived from the Board and based on specific policies or directives of the Board.

Conceivably, the manager can deliver any service at any level for which they are qualified and that the association is willing to pay for.

Volunteer

The advantages of self-management are clear. Costs are lower than any other type of management and it affords the association direct control over all operations. In theory, because the managers are the Board and Committee members, homeowners can have greater and more immediate access to decision makers which may allow for quicker response to requests for information and service. Finally, this form of "sweat equity" (personal involvement) may lead to short-term lower assessments.

The disadvantages are just as clear. The association risks unnecessary costs due to lack of training and experience. In short, we may not know what we don't know. It may also be difficult to always find sufficient numbers of volunteers with the time required to manage the community. There is also the issue of occasional inadequate volunteer performance. This can be a difficult situation between neighbors and friends. Additionally, there can be a serious loss of continuity when volunteers frequently change or move. Finally, insuring the volunteers may become problematic at different times under specific circumstances.

This type of management may be best suited for small associations with few amenities and contractors, where the demographic tends to be retired individuals with the time and experience required to operate the association and become familiar with the complex laws governing associations.

Service Contractors

This type of management involves contracting with specialists in certain areas of the association's operations. Examples of contractors might be bookkeepers, landscapers and pool service professionals.

Using this type of management the Board can delegate time-intensive functions to outside contractors who have greater expertise and skill than the volunteers might. Contractors usually provide their own equipment resulting in cost savings to the association. Fewer volunteers will be required as much of the labor will be delegated to the contractors as well.

Disadvantages would include a lack of professional oversight of the contractors. The association would also be faced with drafting specifications and/or contracts, a task which might exceed the volunteers' personal and professional limitations.

Finally, using service contractors means the Board will be heavily involved in contractor selection and supervision – a task that can be daunting even for the most seasoned and well-trained professionals.

This type of management might best be suited for small- to medium-sized associations with few or no amenities.

On-site Paid Staff

The "paid staff" form of management usually involves the employment, under contract, of an individual manager to manage an individual property. The manager typically has an office on-site and devotes full time to managing the association. The manager is generally responsible for hiring and supervising all association personnel, and interfaces with the homeowners, Board and committees on a daily basis.

"Paid staff" management often allows for more Board control over the day-to-day operation of the community. Because the staff works for only one association, they may be more immediately responsive to the members' or Board's needs and offer a full time management presence. In addition, the Board can select a manager with a particularly well-suited personality and skill set for the association.

However, using this management model the Board may have to deal with personnel issues regarding the manager and employees. It can also be extremely difficult to find and retain skilled managers. Even if the right manager can be found, there can be a serious loss of continuity and institutional memory when the manager eventually moves on.

The association faces additional challenges in areas of vacation coverage and sick leave for the manager and staff. The lack of depth can lead to increased costs or time commitments on the part of the Board.

Finally, the close proximity of the working environment can place additional pressures on the staff, causing a loss of perspective, focus and impartiality in what can be a highly-charged political and performance-oriented operation.

The "paid staff" model of management is usually associated with large and/or well-funded communities.

Contract Management

Third-party contract management is the most common management model in use today. It involves the association hiring a full service management firm that assigns a manager to the

property. The manager typically divides his or her time between several associations and relies heavily on the resources of the company to assist in the performance of the management functions.

Most management companies offer a wide variety of services that can be tailored to the particular needs of an association. All the services being provided to the association will be detailed in the management contract, offering the association a yardstick against which to measure management performance.

The depth of personnel of the management company is a distinct advantage to the association. Should one manager leave, another can be assigned that will already be familiar with the company and association operations, thus minimizing service disruption. The management company typically has personnel with a wide assortment of diverse experience in many areas of management. When you hire the management company, you typically hire its cumulative management experience and expertise.

The management company will probably have policies and systems to offer that are proven to work in other associations. This minimizes the time and expense involved and prevents the association from having to “reinvent the wheel.” The management company also brings with it a list of proven contractors and resources that should help reduce the time and effort the Board must spend in searching out reliable vendors to work on the property. These established relationships can often mean cost savings to the community.

There are also some disadvantages to the contract management model. For example, the manager is not available daily on the site, and the Board must find the right management company for its property’s political and physical environment. A management company search can be an arduous process.

Hiring a management company can be more costly in the short term than hiring an individual manager or having the volunteers manage the association themselves. And finally, the Board will have limited control over the management personnel assigned to their property.

This type of management model is the most popular and can be found in every size association, regardless of the amenities or funding level of the community.

Committees

Committees can serve a useful role in the operation of the association. They offer members an opportunity to participate in the community and help the Board delegate tasks that would be too time-consuming or expensive for the Board or manager.

All committees serve at the will and direction of the Board. The chair is appointed by the Board or President and is assigned the responsibility of operating the committee in accordance with Board policy, the governing documents and any applicable state statutes. These guidelines should be set forth in a written document (usually referred to as a charter) for the Chair and committee members to follow. This document should be as specific as possible about how, when and why the committee is to perform specified tasks. The Board, in conjunction with the committee chair, can set the size of the committee and the members appointed to it.

To be effective, committees need specific direction regarding the tasks they are to perform and how they are to perform them. A committee without guidance from the Board can easily become a mob looking for a problem to solve. This occurrence, more often than not, becomes a detriment to the community and Board. The idea is to structure committees to allow the greatest participation in the most positive way possible while promoting the idea of community involvement.

Each committee should have a clearly defined goal and be given a time frame within which they can accomplish the goal. Each committee should also have a method of reporting its progress to

the Board. Reporting to the Board allows the Board to monitor the committee's performance and gives the Board an opportunity to meet with the committee chair privately to discuss any deviation from the goal that may arise.

Once the committee has performed its role and made its recommendations in accordance with goals and procedures outlined by the Board, the President should publicly and "grandly" thank the chair and the members of the committee for the hard work and diligence they have given to betterment of the community. It is impossible to thank the committee members loudly or publicly enough. By doing so, the Board creates motivation for others in the community to serve on a committee, or even the Board.

Committees usually fall into two distinct categories: standing and ad hoc. A few examples, (though certainly not the only ones), of standing committees are Architectural Control/Review (usually established by the Bylaws), Newsletter/Communication, Nominations (usually established by the Bylaws) and Social/Recreational. These committees would typically function throughout the year to assist the Board with the duties required. Ad hoc committees, on the other hand, generally serve for a specific purpose and then disband.

Elections

Members of the Board of Directors are elected by the members of the homeowners association, typically in a process that works in conjunction with the association's Annual meeting cycle. To prepare for the process, every association is required by law to adopt election rules with specific requirements that include [CC§5105]:

- Information about equal access to all association media and free use of meeting space for all candidates
- Qualifications for candidates and nomination procedures
- Qualifications for voting and voting procedures, including secret balloting
- Provision for independent inspection
- Reporting to the membership within 15 days of the election. [CC§5120]

This minimum 30-day mailed secret ballot election process applies to the election and removal of Board members, as well as to association membership voting on certain changes in assessments, to governing document amendments if member approval is required, and to certain other membership decisions identified in state law.

Meetings

The Association has meetings of members and meetings of the Board of Directors. Annual membership meetings were traditionally held once a year and were the forum for electing directors and taking other membership votes. Modernly, mailed secret ballots are required by law, thus the annual membership meeting or special membership meetings are now often an important social and reporting gatherings where information is shared but no formal votes are taken. Meetings of the Board of Directors, on the other hand, are held more frequently, usually monthly, and are for the purpose of deciding the day-to-day business affairs of the association.

One of the most important elements in the operation of a community association is the meeting process. Most associations hold monthly Board meetings as well as Annual and Committee meetings. From time to time it will also be important for the association to hold a special meeting of the homeowners (generally called a town hall meeting or informational forum) to discuss issues that the members may be called upon to approve by mailed secret ballot. It is important to be familiar with the procedural requirements for conducting most membership

votes (CC§5100 - §5145) as well as provisions of the Common Interest Development Open Meeting Act (CC§4900 - §4955).

The success of an association is often reflected in the quality and tenor of its meetings. Surprisingly, the meeting process is often ignored or misunderstood in many communities. We have all attended the tortuous three-hour Board meeting. We have also been at the occasional town hall meeting for members that nearly erupts into a riot because some controversial topic is being discussed.

There are ways to avoid these scenarios by using some of the following techniques for successful meetings and ways to implement them. Boards that do can generally streamline and control the meeting process. To begin, we examine some basic general assumptions about meetings.

Types of Meetings

In a community association, the Board is in charge of a corporation whose assets may be in the millions of dollars. A Board meeting is a gathering of the corporate Board to conduct the business of the association. Similarly, membership meetings and town hall forums are opportunities for the members of the corporation to gather to discuss association business that only the members can decide.

Committee meetings are slightly different. Committee meetings are held to explore ideas and avenues of operations assigned as tasks to the Committee. By their nature they are generally less formal than the other types of meetings. However, they must be organized and operated in a business-like manner to be successful. Again, these meetings are a manifestation of the multi-million dollar corporation to which the members belong.

How meetings are conducted will have a dramatic impact on the success of the community and will, more often than not, be responsible for whether members will be willing to serve in leadership positions in the future.

Annual or Member Meeting

The “Annual Meeting” of the members of the association is one of the few times the property owners come together, since the governing documents of most associations vest the management and most decision-making for the association in the Board of Directors in Board meetings. The notice of the annual meeting provides not only the time and place of the meeting, but also an agenda for the items that will be discussed at the meeting. By California state law, notice of an annual meeting must be sent to each homeowner not less than 10 and not more than 90 days prior to the meeting.

The stated purpose of nearly every Annual Meeting is to elect the directors of the association. Since Board elections are now conducted entirely by mail, the annual meeting will either be the meeting at which an Inspector of Election opens and tabulates the mailed ballots, or at which final nominations for director positions are accepted and after which ballots will be mailed to members (this depends on nominating provisions in the association’s bylaws). Since most decisions that members get to make are now the subject of mailed secret ballots, the annual meeting has become an important social and informational gathering for members to ask questions, make comments, and learn about the workings of their association.

Special Meeting

A Special Meeting is a meeting of members of the association, and may be called by 5% of the membership, or by the President of the Board, or as specified in the Bylaws, for any lawful purpose. Just as with the Annual Meeting, most “lawful purpose” issues are now decided by mailed secret ballot, with the result that most special meetings of members are generally informational on critical topics for which member support will be sought.

A membership meeting is modernly an informal gathering of the members for some informational purpose. No action is taken. Instead, the meeting is held simply to disseminate information to the community.

All pertinent information about the issues should be mailed to the members well in advance of such a meeting so everyone comes prepared. Just as with all other meetings, respectful information sent in advance can help promote a healthy meeting process.

Board Meetings

Association Board meetings are the time and place where most decisions regarding the functioning of the association are made. The conduct of Board meetings is defined in both statute (CC§4900 - §4955) and the governing documents of the association. Association Board meetings can be monthly, bi-monthly, or quarterly; again the association's governing documents will spell out the minimum required number of Board meetings per year. California statute (CC§4920) requires that all Board meetings be the subject of notice posted in the common area at least 4 days prior to the meeting and must include a published agenda.

While open to attendance by homeowners, Board meetings are conducted by and for the Board, and homeowner participation is limited to comment on agenda items only when solicited and during the member forum portion of the Board meeting. While homeowners may request that items be placed on agendas, the Board is under no obligation to do so and, with respect to the instant meeting, are prohibited by law from discussing non-agendized items.

Board meetings must achieve a quorum of Board members in attendance to commence business. Each Board member is entitled to one vote on matters that come before the Board. A majority of Board members present is sufficient to approve matters before the Board. Board members must vote personally and may not vote by proxy. Directors may attend Board meetings by conference or video call so long as at least one director is present at the meeting location at which members may attend and hear and be heard by the Board.

Once a quorum is established and duly noted in the minutes, the Board may consider reports from Officers, Management, Committees, and take action on items which have appeared in the previously published agenda.

In accordance with California law (CC §4910(b)), Boards of Directors may not discuss or take action on matters using email, unless such action is in the context of an Emergency meeting.

Executive Session

The California legislature has established reasons for which an association Board is allowed to adjourn to "executive session." These include:

- To discuss litigation matters
- To discuss personnel matters
- To discuss member discipline
- To consider a member's request for a payment plan for assessments
- To form contracts
- To approve initiating the foreclosure of existing liens.

When the Board adjourns to executive session to discuss any of the above matters, *detailed* minutes need not be kept. However, the Board is obligated to state that an executive session was held and the general purpose of the executive session in the minutes of the next open meeting of the Board.

Emergency Meeting

An Emergency meeting is defined as where "there are circumstances that could not have been reasonably foreseen which require immediate attention and possible action by the Board, and which of necessity make it impracticable to provide notice as required by this section." (CC §4923). An Emergency meeting may be called by the Board President or any two Board Members other than the President, and may be conducted in person, by conference call, or via email. Any decision made in an Emergency meeting conducted by email requires the *unanimous* consent of all Board members.

Preparation

Annual Meeting Preparation

The preparation for next year's Annual election of directors actually begins in conjunction with this year's Annual meeting. A nominating committee should be formed and charged with soliciting candidates for next year's election. Then the wait is on until it's time for the next annual election and for candidate solicitation forms to be distributed to all members. It is a primary responsibility of the Board to ensure that well-qualified candidates are sought and asked to seek election to the Board for the upcoming year.

Board Meeting Preparation

Time is precious, and the amount of time members spend in a Board meeting should not be squandered. To be certain time is not wasted, Board meetings should be viewed as working business meetings, not as performances for the general membership. In order to accomplish this, issues to be discussed at the meeting must be thoroughly briefed in a management report prior to the meeting. No issue should be raised that is not published on the agenda and the agenda should be in every Board member's hands at least three to five days prior to the meeting.

It is imperative that the Board meeting not be viewed as an opportunity for Board members (or the manager if there is one) to hear themselves talk. Board members are not obligated to speak to each issue that is raised. However, Board members' positions on issues being voted on *are* important to articulate before a vote is taken.

On the agenda will generally be a line for committee reports. No committee should report unless they have submitted their report, in writing, prior to the agenda's publication and all the Board members have had an opportunity to become familiar with it. This should become part of the job description for the chair of each committee and be part of each committee charter.

Committee reports do not have to be long documents. They can be a summary of the committee operation but should include any motion being requested of the Board by the committee.

If the association is professionally managed, the management report will also be part of the agenda. Again, this report should be in writing and in the hands of the Board members at least three to five days prior to the meeting. This is especially important because the management report will undoubtedly include items that require action by the Board. If the Board has the report ahead of time, they can contact the manager with any questions they might have and thus help the meeting run efficiently. The manager should most certainly contact each Board member prior to every meeting to answer any questions that have been raised regarding the report and issue clarifications as necessary so that when the meeting is called each director is prepared to make responsible decisions based on the information provided. In the event the community is not professionally managed, responsibility for the management report will fall to the President and various officers.

Agenda

Board meeting agendas must be posted along with the notice of meeting (CC §4920). With the following exceptions, Boards are not allowed to discuss or take action on any item not on the agenda. However, in accordance with Civil Code §4930, Board members or their agents (typically managers) may:

- Briefly respond to statements made or questions posed by a person speaking at a meeting
- Ask a question for clarification, make a brief announcement, or make a brief report on his or her own activities, whether in response to questions posed by a member of the association or based upon his or her own initiative

In addition, Board members may:

- Provide a reference to, or provide other resources for, factual information to the managing agent or other agents or staff
- Request the managing agent or other agents or staff report back to the Board of Directors at a subsequent meeting concerning any matter, or take action to direct the managing agent or other agents or staff to place a matter of business on a future agenda.
- Direct the managing agent or other agents or staff to perform administrative tasks that are necessary to carry out the directives above.

Any subject may be discussed and acted upon, following statutorily defined Board approval requirements:

- if there is an emergency at the Board meeting.
- if immediate action is needed on a matter which arose after the agenda was distributed
- If the item was on an agenda within the last 30 days and was continued to the current meeting.

To make the task of keeping the meeting on track and on time easier, it is a good idea to employ the use of a "timed agenda." A timed agenda simply lays out the approximate length of the meeting and the time that will be allotted each report or item for discussion. In its simplest form it looks like this:

Sample Board Meeting Agenda

1. Call To Order	- 7:00
2. Roll Call of Directors	- 7:00
3. Declaration of Quorum	- 7:03
4. Approval of Previous Minutes	- 7:04
5. Open Forum for Members	- 7:05 (15 min.)
6. Secretary's Report	- 7:20 (5 min.)
7. Treasurer's Report	- 7:25 (10 min.)
8. Management Report	- 7:35 (20 min.)
9. Committee Reports	- 7:55 (10-20 min.)
10. Unfinished Business (by line item)	- 8:15 (10 min.)
11. New Business (by line item)	- 8:25 (10 min.)
12. Adjourn	- 8:35

As you can see, in this typical scenario the meeting will last an hour and 35 minutes. This may even be a little long, as typically the unfinished and new business portions of the agenda are handled under the various reports which take place earlier on the agenda.

As you think about this process, keep in mind that it is not necessary to read the minutes of the previous meeting aloud. The minutes should have been in the Board members' hands with their packet of information at least three to five days prior to the meeting. All that is required is a motion to approve, or correct and then approve. If time permits, the manager may summarize the informational items in the management report but should move quickly to any action items that are part of the report. The Board should get on with the business portion of the meeting as expeditiously as is reasonable.

If the Board wishes to raise issues about the manager's contract performance, it should arrange a time for the President to meet with the manager to go over the Board's concerns. Unless the Board is making a motion to terminate the management contract, the manager's performance should never be an open issue at a Board meeting. Again, the purpose of the Board meeting is to make decisions. The President as the presiding officer should see to it that the meeting does not deteriorate into a general gripe session. This requires discipline, a degree of experience, and a commitment to success from each member of the Board. Successful meeting procedures are not imposed, they are mutually agreed upon.

We have left out one essential element to the Board meeting success. That is celebration. Prior to every adjournment someone should state the reasons the meeting was successful. There is always a reason even in the worst of meetings. No one was killed, no one went to jail, no one went bankrupt and, very likely, and no physical violence took place. There is always a reason to celebrate. Ending on a high note is one of the most important responsibilities of the Board. It provides a reason to come back and allows for positive success. A manager can thank the Board for helping the manager improve his or her management style or the operation of their company or the opportunity to explain why a certain thing was done a certain way. The same holds true for the Treasurer, Secretary and each participant in the meeting. Celebration is paramount to success.

Conducting a Meeting

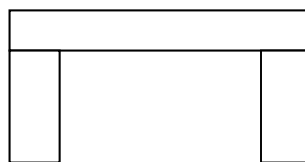
The conduct of the meeting, in conjunction with the preparatory steps outlined above, can make the most dramatic difference in the length and quality of the meeting. Many factors must come together for a successful meeting to take place. Among these are the location and meeting environment, the method of controlling the length and the willingness of the President and Board members to share the responsibility for conducting efficient, businesslike meetings. First let's take a look at the meeting environment.

The best place to conduct a working meeting is in a businesslike environment. To most associations this means having the Board meeting in a meeting room at a table set up for that purpose. But what if the association has no meeting room? Many association Boards find themselves meeting in a Board member's home. This is the least-recommended environment to try to have a business meeting. The psychology of someone's home is social, not business. An alternative place can almost always be found. Local schools, churches, hotels and other businesses have been known to donate space for Board meetings. If no alternative can be found and your meetings must be held in a Board member's home, meet at the dining room or kitchen table. That is where most business in a home is conducted. Try to set the psychology of a business meeting. Meeting in comfortable chairs in someone's living room should be avoided at all costs. It is practically impossible to maintain a semblance of professional conduct in a setting normally used to socialize.

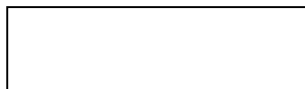
Room Layout

If your association is lucky enough to have a room that can be used for Board meetings, then consider the way the room is set up. What is the shape of the table? What is the seating arrangement? Do adversarial members often sit opposite one another? Is the seating arranged for work or for a performance for the homeowners?

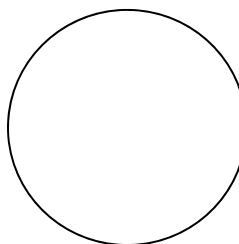
Below are some examples of table shapes and seating arrangements found successful in many businesses and communities. Keep in mind that different arrangements can be used effectively in different circumstances. However, for our purposes we are looking for the most successful arrangement for a working Board meeting.



Working & Presentation Arrangement



Presentation Arrangement



Working Arrangement

The best arrangement for a working meeting seems to be either a round table or oblong tables arranged in a "U" shape. Both of these allow the participants to interact with each other easily in a non-confrontational manner.

Some last tips on room arrangements:

- Do not sit adversaries opposite each other. Set them parallel to one another and separate them with one or two other members. This will make it more difficult to confront each other and will allow them to more easily focus on the issues at hand.
- Under no circumstances allow the consumption of alcohol prior to or during a meeting. To make good decisions the members should be of sound mind. This can easily become a legal issue (as to competency), as well as an operational problem.

Parliamentary Procedure

Robert's Rules of Order are merely a guideline to an effective meeting and decision making process." They can be flexible and only in the most extreme and formal of cases do they need to be followed to the letter. However, certain rules can be very useful in any meeting.

For instance, no discussion should take place about any item without a motion and a second being made to adopt or reject the item. Without this step, boards may hold a lengthy discussion on a topic that is of only marginal interest to the group. If this simple rule is adopted you may find your meeting taking on a more business-like tone and becoming a more productive.

The President has the power to limit discussion on any topic by announcing that "Discussion will be limited to one round of comments by each member." This will guarantee that each Board member may be heard, while limiting the informal filibuster that can be a problem in some meetings. Discussion should never be allowed to wander from the topic at hand, nor should too much repetition be permitted. If a member has nothing new to add to the discussion they should be encouraged to say that they agree with whatever opinion has already been expressed and the discussion should move on. In all cases it is the President or Chair's responsibility to see that Robert's Rules are implemented at the meeting. This can be difficult and politically sensitive, especially because none of us likes to appear as though we are foreclosing someone else's ideas.

Homeowner Input

In 1996 the California Legislature passed a bill requiring associations to allow homeowner input at Board meetings. However, the Legislature included language allowing the Board to restrict the amount of time any member would be allowed to speak on a topic. Input from the homeowners is an invaluable tool in the decision-making process. The proviso, as always in such matters, is that the time allotted should be "reasonable."

To accommodate owner input, the Board should establish a Member Open Forum that commences immediately after the Call to Order. Otherwise, there would be *no* place on the agenda for owner input because the Board meeting is to conduct Board business. The purpose of the forum will be to hear various members' opinions on *any* issue they care to raise (only the *Board* is limited by the agenda rules). The Board should listen carefully, take notes and respond only (and briefly) if a direct question is asked. An often heard response to request for action at these meetings is, "Thank you for bringing this issue to our attention. We will consider it between now and the next meeting and will take appropriate action. We will keep you informed of progress and may ask your advice if it looks as though we will be voting on this issue at the next meeting."

Again, the purpose of the forum is to allow the owners access to the process and to their elected Board members. When it is time for the business portion of the meeting to be addressed, the President should thank all owners for attending the forum, invite them to stay to watch the Board in action, and remind them that during the balance of the meeting the Board will conduct its business and only the Board is allowed to participate. The purpose of the Board meeting remains for the Board to conduct the business of the association and it falls only to them to decide the various issues. Thank the owners again for coming and sound the gavel to move the meeting along to the next item on the agenda.

Annual Meeting Conduct

Under California law, an Annual Meeting must be run in accordance with a recognized form of parliamentary procedure. This can be Roberts Rules of Order or any other set of procedures the assembly chooses to adopt.

Any member wishing to address the membership on any issue should be given ample opportunity to be heard. Maximum participation by those in attendance will assure a sense of inclusion in the process. With this in mind, it will still be necessary for the chairman to control the meeting. Perhaps a time limit for discussion and comment can be set prior to the meeting. In this way, all the members will be prepared to address their comments in as concise a way as possible.

Special Meeting Conduct

Like Annual meetings, Special meetings of the members must also be run in accordance with a set of parliamentary procedures. As with the Annual meeting, these can be Roberts Rules of Order or any other set of procedures the assembly chooses to adopt.

The conduct of a Special Meeting, like the conduct of any meeting, requires the same accommodations for members to be heard as discussed above.

Board Meeting Conduct

There are certain tools that can be used to assist in the goal of a quick, efficient meeting. The President can also appoint an official timekeeper. Often this is the secretary of the Board but it can be anyone, (including the President) who will occasionally remind the members of the time or that time has run out to discuss a particular item. This is especially important early in the implementation of a timed agenda when members are attempting to acclimate. These time reminders should be gentle nudges as opposed to authoritarian statements. No one likes to be bullied into moving on. A prominently placed timepiece can assure constant awareness of the need for efficiency on everyone's part.

- Hold a homeowner's forum to accommodate member input.
- Hold meetings at a regular time and on a regularly scheduled date, with notice and agenda posted in the common area at least 4 days prior.
- Use a timed agenda.
- Appoint a timekeeper.
- Do not read the minutes of the previous meeting aloud. All Board members should have these in advance and simply move for corrections or approval.
- Use parliamentary procedure.
- Allow no business to be discussed except that which appears on the published agenda.
- Do not discuss informational items; merely point out where they may be found in the written reports.
- Celebrate!
- Adjourn on time regardless of your place in the agenda.

After the Meeting

Annual Meeting/Election Follow-up

Minutes of the meeting should be typed and sent to all members of the Board immediately following the meeting. The election results become part of the corporate record as well. The Inspector of Election must certify the results of the election of directors, a copy of that certification is kept with the membership meeting minutes, and ballots are kept for at least one year and produced for inspection in the event a member requests a recount.

Follow-up to the annual election of directors includes reporting to the members on the results of the election within 15 days after ballots are opened and tabulated.

In addition to the members, the Association's attorney and insurance company will need to be notified of the change of directors and officers. In California, associations are required to file updated information with the Secretary of State biennially.

Finally, send a congratulatory letter to each candidate who ran for office. It is important that everyone volunteering to participate feels like a winner. If they weren't elected this year, they may be willing to run again next year. Candidates not elected are often willing to serve by appointment should the need arise. They are tomorrow's resource for the community.

Special Meeting Follow-up

Similar to an Annual meeting, Minutes must be typed and included in the corporate record. These will be approved at the next meeting of the membership. A report of the meeting should

be sent to the general membership announcing the results of any vote and reporting on the meeting itself.

The Board members and/or manager should be assigned whatever tasks are needed to carry out the directives of the meeting. If the actions taken alter the annual operating plan or budget these should be amended accordingly and distributed to the membership and affected professionals working with the association.

Board Meeting Follow-up

Follow-up to Board meetings will involve the President, Secretary, Treasurer and the various committees of the Board. It will also involve the manager.

One of the most important elements of following up on a Board meeting is to prepare minutes. Summarize actions that were taken and discussed. One good practice is to either post the (approved) minutes or publish them in the newsletter. In California, minutes are required to be made available to members within 30 days of the meeting, even if they have not yet been approved and are only stamped "Draft," but only upon request. This can be risky since the minutes are not approved until the following meeting. Good minutes generally contain little except the motions that were made, some details and bases for the decision, and the resolutions of those motions.

Each Board member should be promptly given an action list following each meeting which details not only the action he or she is expected to perform but all actions that will be taken as a result of the meeting. This becomes the Board's ongoing action calendar and can be reviewed at each meeting. Along these same lines the manager should send his or her action list from the meeting to each Board member to be certain there were no misunderstandings during the meeting. In addition, any legal actions that were taken should be implemented from the various action lists. These will include collections, executed contracts, rules and covenant enforcement, etc.

The Secretary should catalogue each resolution that was adopted and place it in the association's book of resolutions for easy access at subsequent meetings. The Secretary will also be responsible for executing and placing all approved minutes in the corporate record book of the association. This is an important record that must be updated each meeting. The minutes book is the official legal record of the corporation and should always be kept current and kept permanently. Finally, some associations have the Secretary send a copy of the minutes to their attorney, to keep them advised of the actions of the Board.

The Treasurer should regularly publish the Treasurer's report to the owners. One of the most effective methods would be the newsletter unless there are specific other legal requirements.

Rules and Enforcement

The creation and enforcement of effective rules is something every association faces. The Board is charged with the responsibility to maintain and protect the value of the property and promote the enjoyment by the members. To do this, the governing documents will generally give the Board the authority to adopt rules to assist them in this task, and the Civil Code requires that certain rules and procedures be adopted.

Legal Basis

The legal basis for rules adoption and enforcement comes from the same hierarchy of authority we discussed earlier. However, the authority relied on most heavily will be the Declaration of Covenants, Conditions and Restrictions (CC&Rs) and the Bylaws. For now, know that all rules

must be lawful, reasonable and enforceable. It will do the association no good to have rules that cannot be enforced or that inconvenience a majority of the members.

Creation

The rules of an association can cover a wide variety of the association's operations. They may include anything from architectural controls to the behavior of the members and their guests. The authority to create rules is generally vested, by the governing documents, in the Board. However, the Board may take suggestions from committees, the manager or other sources for guidance when adopting rules.

In rules creation, as in other aspects of association operations, it is a foolish Board that operates in a vacuum. It is not only wise to consult association members about proposed operating rules, state law now requires that Boards give the members the text of the proposed rule, explain its effect, and give the members at least 30 days to comment on the proposal. Emergency rule-making provisions are available, but rules adopted as emergencies must be re-adopted by the proper process within 120 days following the emergency adoption of the rule. Operating rules not made in conformance with the process outlined in state law are not enforceable, a harsh result but one that underscores the Legislature's wish that members have an opportunity to comment on proposed rules.

There are several steps that can be followed to create an effective rule. They are:

1. Determine the Board's authority to make the rule by checking the governing documents and the law.
2. Determine the need for the rule. Is the behavior or activity you are attempting to control an aberration or a constant? Is there a different method that can be employed to handle the situation? Are the current rules sufficient to deal with the problem?
3. Set the scope of the rule by determining exactly who and what will be covered.
4. Set the parameters and penalties for violations. Use simple clear language to state the rule. Determine reasonable enforcement procedures and penalties. A good method is to ask the manager, the association's attorney or consult ECHO materials to determine how other associations handle the same situation.
5. Test the rule for legal compliance by having it reviewed by the association's attorney.
6. Notify the members that the Board is considering the rule and solicit feedback over at least 30 days to determine support and consensus for the rule.
7. Pass the rule by resolution of the Board
8. Notify the members of the rule's adoption. (CC§4340 – §4370).

Enforcement

Enforcement of the rules can be one of the most uncomfortable aspects of Board service. It is difficult for many people to become confrontational with neighbors, and yet the Board may be required to do just that when it comes to rules enforcement. But focusing on a clearly-stated, fair process can smooth the way and help the Board avoid charges of unfairness or arbitrary enforcement.

"Due process" is an important element of successfully enforcing the rules and covenants. Adopting a due process approach to enforcement can help the Board be assured that it is applying the rules fairly and consistently. Generally the aspects of due process include:

1. A written notice of the violation including the rule being violated, the Board's authority to make and enforce the rule, (citing the covenant, bylaw or statute from which the authority is derived), and the anticipated penalties for noncompliance.
2. The notice should also give the violator a "reasonable time to cure" the violation or cease the offending behavior.
3. The "right to be heard" should also be included in the written notice. The "right to be heard" should give the alleged offender an opportunity to appear before the Board to present a case for why the rule should not apply or why he or she should not be charged with the violation. The notice should include the date, time and place for the meeting at which the Board intends to consider disciplining the member and advise the member of his or her right to attend the meeting and address the board.
4. Fines and penalties must be reasonable. Unreasonable fines and penalties may damage the association's right to enforce the rule. "Reasonable" can be different for every association and/or every rule or violation. It is best to consult with the association's attorney regarding reasonable fines and penalties prior to the adoption of a rule.
5. Notify the member within 15 days after any discipline is imposed.
6. Failure to timely provide the member with the notices described here will cause the discipline imposed to be unenforceable and the process to have to start again.

Focusing on the process above rather than the individuals involved should serve to make the enforcement of the rules as fair and consistent as possible. The Civil Code mandates procedures and alternative dispute resolution as a way to resolve disputes (CC§5900 – §5920, §5925–§5965).

Volunteers

There are many views and opinions about the role of the volunteer in community association operations. Some professional managers believe volunteerism should play no role in associations. Others believe volunteers are of great assistance in accomplishing the job of managing the association. Certainly, in self-managed associations the volunteer is essential to the community's success.

Volunteers play many different roles in associations. They serve as Board members, members of task force groups and on committees. In some communities they do the bookkeeping and all other management related functions. The level of volunteer involvement in a community depends on many factors. The size of the Board, the size of the community, and the current number of projects and activities all play a role. Often volunteer participation depends on problems being experienced by the association or some controversial issue that is being considered. Whatever the role of the volunteers, they must be involved and understood to be productive and successful.

Why People Volunteer

Understanding why people volunteer is an important element in understanding how best to work with them. The reasons are as diverse as the personalities involved. We can begin to understand these reasons by looking at the reasons any of us become motivated to action. The diagram below is "Maslow's Hierarchy of Human Needs". It is useful in the study of volunteers because it categorizes the various levels of human development that result in general behavior patterns. The act of volunteering is a behavior. So are the behavioral characteristics of the volunteer once he is assigned a task. Maslow is predicated on the supposition that all people work to achieve "self-actualization." That is, all of us are trying to achieve some feeling or state

of self-awareness and completeness. According to Maslow's theory all humans strive throughout life to achieve this goal.

Maslow's Hierarchy Of Human Needs



Volunteering falls in the diagram at any level. Whether a person is motivated to volunteer by positives or negatives is largely related to their position on the pyramid. Most members of an association have taken care of their physiological needs. That is to say they have food and shelter. However, perhaps they are still struggling to make that food and shelter secure. A tendency might be to relate the security level with physical security. This would be only partly accurate. Far more significant to homeowner associations is the area of financial security.

Perhaps the member has stretched himself too thin financially to be able to afford his unit. Perhaps his current employment is not secure, thereby posing a threat to his physiological needs. In this case we might find ourselves dealing with a recalcitrant owner who volunteers for the finance committee in order to work to keep assessments as low as possible.

If a member has achieved financial security he may be willing to volunteer to fulfill his socialization needs. This may involve a need to fill a larger role in the community or to have a greater say in the quality of life. Many volunteers in a community association serve out of a sense of obligation to the community. This too is considered service for socialization needs.

Still other volunteers come forward to serve for ego gratification. They enjoy the recognition from the other members of the community. They need the admiration of their peers and neighbors for the gift of time they are giving to make the community a better place to live.

Each of the levels of Maslow can result in a member serving out of a positive or negative sense of involvement. No one level should be seen as creating better service than another. Each position on the scale brings with it its own unique opportunities for the volunteer to feel personally rewarded for their service. Understanding these opportunities is the key to working with volunteers.

Elements of Volunteerism

Maslow lays out the basic reasons for why people volunteer. To many, these may seem abstract and not connected to the real world practice of community association management. If we were to put Maslow into more specific terms we could say that people volunteer for the following reasons:

1. Serve society (the greater good)
2. Seek meaningful satisfaction and achievement

3. Solve a specific problem
4. Improve quality of life (for themselves and/or others)
5. Protect their interest in the asset
6. Obtain information
7. Obtain exposure (personal and professional)
8. Continue a family tradition

This list covers many of the most common reasons people volunteer in a community association environment. The list is in no particular order of ranking but can serve as a starting place for dealing with volunteers in a real world setting. In a community that is short on volunteers it will be helpful to refer to this list occasionally to help identify those members that might be willing to give their time.

Whether a person is going to volunteer to protect their investment, solve a specific problem relating to them or to seek some sense of self-worth through their service to the community, you can begin to identify them by their behaviors.

For instance, suppose you have a member who is a chronic complainer about some issue related to the operation of the association. One of the best methods of dealing with this behavior is the classic co-opting technique used in behavior modification. When they complain that the parking rules are inadequate it might be useful to ask them to serve on the Rules and Regulations committee.

The danger here is that the member may focus exclusively on one issue. In that case it might be better for the Board to form a task force to address only the parking rules. Give it a fixed time frame to perform, (in accordance with good group process as described in an earlier chapter), and let the member solve his own problem. This will of course require close guidance and supervision by the Board but will allow the owner an opportunity to feel like part of the solution instead of being the problem.

It is relatively easy to understand a person's reasons for volunteering when they come forward. It is much more difficult to create an environment in which people feel a desire to come forward on their own in large numbers. Creating this environment has been the subject of most of this course. However, besides good group process and meeting techniques there are some other areas of understanding that will prove useful.

Motivating Volunteers

"It is impossible to motivate anyone. However, through effective leadership people can be inspired. Leadership is the ability to establish standards and manage a creative climate where people are self-motivated toward the mastery of long term goals, in a participatory environment of mutual respect, compatible with personal values."

- Mike Vance

If we agree with Mike Vance's statement then we must be willing to create the opportunities necessary for volunteers to come forward rather than always attempting to twist their arms to get them to serve. There are some tools we can use in our effort to make the task easier.

In order to recruit the volunteers needed to help the Board operate the community we must first get their attention. This can either be through a positive or negative event or occurrence. Getting the attention of the members can be centered on a number of association elements. Perhaps the event is financial. Members always seem to get interested in the operation of the association whenever a special assessment or substantial increase in the regular assessment is proposed. Or, it may involve a problem or controversy the community is experiencing as in the parking example above.

Perhaps the best way to get a potential volunteer's attention is through entertainment. As in the case of the annual meeting described in the meetings section above, there are ample opportunities for the association to get people's attention through entertainment and then ask them to help out.

Whatever the method, it is much easier to get someone to volunteer after a major change in their life. According to Dr. Frank Hirons, most people are willing to change their behavior and get involved in new activities within six months after a major change.

A major change can be interpreted to mean a change in employment status, death of a loved one, a move, a marriage or divorce, or a personal crisis of some kind. Whatever the change, if you can approach someone within the six-month window your chances of recruiting them to help are greatly increased.

Communication With Volunteers

Once the association has the attention of the volunteers, (and successfully solicited their participation), it is necessary to communicate with them on an ongoing basis to reinforce the value of volunteering. Several methods are available to help with this task. One of the most effective is to use the newsletter to continually talk about the good works of the various volunteers. To be effective, this will require that names be mentioned, interviews take place and photographs be taken to help raise the image of the volunteer as a positive model.

When dealing with committees as a group, probably the best reward they can receive is for the Board to take positive action on their recommendations in a public setting. If the Board assigns a specific task with a fixed time frame for achievement and a method of reporting the result, then it will be easy for the Board to adopt the committee's recommendation without discussion. The Chair of the committee may want to deliver a report summarizing the work of the committee at the Board meeting and recognizing the volunteers who helped. The Board should use this forum as an opportunity to publicly reward the members through recognition and support of their efforts.

Each time a committee or person gives of their time, they will be giving the most valuable asset they have to the community. Their reward must be in proportion to that gift. Maslow is a powerful influence and addressing the ego needs of the volunteer must be stressed when communicating with them and the community as a whole.

This presupposes that all the elements of good group process and effective meetings are being followed. Nothing will discourage a volunteer faster than having to spend endless hours in disorganized and fruitless meetings trying to accomplish seemingly endless tasks. Remember, the task given to volunteers to accomplish must be specific and monitored through ongoing communication. If the volunteer begins to stray from the appointed task and path of achievement, generally a gentle reminder is enough to bring them back on track. Unfortunately this may not always be the case.

Firing The Volunteer

When selecting volunteers to perform tasks for the community, special care needs to be given to appoint those people that possess the necessary qualifications for the job. More than once most of us have experienced the agony of watching a well-intentioned group of unqualified volunteers flounder in their task due to a lack of knowledge or expertise. This is debilitating not only for those volunteers involved but also for the potential volunteers who witness the chaos.

It is also possible that a volunteer will sometimes decide that their personal agenda is more important than that of the corporation. This can lead to conflicts with other members, the

manager and even outside vendors. The situation can easily develop into one of adversarial relationships and obstinacy on the part of the members involved.

Another scenario, which develops frequently, is the good-hearted volunteer who for one reason or another simply fails to perform. Perhaps they intended to do a good job and their other obligations interfered. Perhaps they are a supportive personality type and simply have a difficult time saying no. Either way, they are a non-productive resource for the community.

When any of the above situations occur the Board will be faced with the most difficult choice they must make relative to the volunteer work force. They will have to decide whether to fire the volunteer.

Here again, the community association Board needs to be reminded they are running a business. They are in charge of a large corporation with duties and responsibilities to its members that must be fulfilled. As in any corporation, if a worker is not fulfilling an obligation they previously agreed to they will need to be replaced. However, in a community association this becomes a delicate matter due to the political and personal relationships involved. Replacing the volunteer must be carried out with the utmost caution and only as a last resort.

No volunteer should ever be publicly humiliated for non-performance. A private meeting with the President or Board can be used to inquire into the volunteer's progress toward the goals established by the Board. Generally, the volunteer will recognize the problem and either correct it or agree to step down. Only when this does not occur should the Board take direct action to replace him.

There is opportunity in replacing a volunteer. It sends a clear message to the other owners that the community appreciates their support and time, but that their commitment to the group must be followed through. Surprisingly, this sometimes stirs greater interest in some members to volunteer as they begin to see the work of the association as serious business. They realize the Board is actually going to protect the interests of the members and see that work is accomplished. Again, this action by the Board begins to remove the psychological mindset of a club and moves it ever closer to that of a corporate business.

Summary

Working with volunteers can be one of the most rewarding aspects of community association management. However, to be successful, the volunteers must be guided and controlled in their efforts to contribute to the community. The Board must establish priorities and develop a work plan. A basic understanding of the priorities of the community must be in place. Finally, the Board needs to create a successful model for volunteers. That model must contain elements of recruitment, communication and reward if it is going to establish a positive and productive pattern that will entice members to volunteer. The Board must show their appreciation to those volunteers that contribute. Making the volunteer process as painless and easy as possible should be the goal. In this way the community members can feel involved, productive and successful in assisting in the protection of their asset and feeling like a valuable part of their community

Finances

Treasurer Duties and Responsibilities

A treasurer's duties as a member of the association board are spelled out in the California Civil Code, including Sections 4760, 5300 and 4525, in the association's governing documents and in the concept of fiduciary responsibility.

A treasurer's responsibilities include, but are not limited to, the following activities:

- Working with management or the bookkeeper on accounting reports.
- Reviewing cash disbursements - looking at invoices and signing checks.
- Reviewing cash receipts - looking at assessment delinquency reports.
- Reviewing bank reconciliations and supporting bank statements.
- Advising the Board about appropriate investments.
- Advising the Board about the potential for a bank loan, if needed.
- Advising the Board about the availability of bank lock box services.
- Reviewing periodic financial statements and comparisons to budget.
- Assisting in preparation of the annual pro forma operating budget.

- Assisting in selection of a reserve study preparer.
- Assisting in selection of a CPA for income tax and/or review/audit services.

The treasurer's role will vary depending on whether the association is professionally managed with full service management, partially managed with financial services provided by management or a bookkeeper, or self-managed with the bookkeeping performed by the treasurer.

While it is true that one need not be a CPA experienced in community association finances to serve as treasurer, the more background one has, the easier it is to serve the Board in this capacity. And even at professionally managed associations, the Board and particularly the treasurer must provide oversight to its professional managers! California Civil Code Section 5500 spells out specific oversight tasks that the Board of Directors must make at least quarterly. In financial matters, most boards look to their treasurer to ensure that they remain compliant with the law.

Included under the treasurer's broad responsibility is a myriad of tasks: signing checks and reviewing invoices; confirming that goods or services are received and their costs agree with the contracted amounts; ensuring that the collection policy is promptly and fairly implemented; monitoring expenses and, where they deviate from the budget, determining whether the "reasons" are reasonable. While these tasks keep the association operating properly, they also culminate in the experience and leadership that the treasurer provides the other directors at a board meeting when a critical issue arises and all heads turn to the treasurer.

Reconciling Cash Accounts

California Civil Code Section 5500 requires the Board of Directors to review a reconciliation of all association bank accounts at least quarterly. The reconciliation of the association's bank statements uses independent sources of information as a critical audit of the association's cash. It allows the treasurer to see if the association's banker and bookkeeper agree on the amount of cash it has.

A reconciliation should clearly identify starting and ending balances of both the bank and book sources and list major items which reconcile any differences between the two. Note that simply balancing the checkbook is only a part of the reconciliation process. A sample account reconciliation is given below for the fictitious Barcelona View Estates.

Balancing the bank account

Starting with a copy of the current period bank statement, the reconciliation starts with the statement's ending balance. To it are added any deposits in transit (deposits mailed or delivered to the bank but not yet reflected on the statement). From it are subtracted outstanding checks (checks written in the accounting period which have not yet cleared the account). Any other items (electronic transfers, NSF checks, etc) of which the preparer knows but is not reflected on the bank statement should be added or subtracted accordingly. By this process, a reconciled bank balance is achieved.

Balancing the books

After the bank statement has been reconciled, it remains to do the same to the association's books. This reconciliation begins with the prior period's ending amount. To it are added all the current period's assessment payments that were credited in the association's billing system, miscellaneous deposits (tax refunds, key deposits, etc), bank interest, and other credits. From

it are subtracted all the checks written in the accounting period, bank charges, rejected payments, electronic debits, etc. By this process, a reconciled book balance is reached.

The bank balance and the book balance must agree not only with each other but also with the cash balance showing in the Assets section of the association's balance sheet.

What to look for in a reconciliation

The balancing form should clearly display all the items that effect the reconciliation. Unless the treasurer is involved with the association's day-to-day operations, some of the details may fall outside personal review but there are a number of critical components that can and must be ascertained. First, it is critical that a copy of the bank statement be included with the reconciliation form so that the bank balances can be verified. Also, checks that have been outstanding for more than 90 days should be investigated as should all deposits that remain 'in transit' for more than one accounting period. Lastly, it is important the reconciled balances agree and match those on the financial statements.

Protecting the association's cash assets is the treasurer's most important duty and reviewing the account reconciliation is an essential part of that duty.

BARCELONA VIEW ESTATES HOA

BANK STATEMENT RECONCILIATION

HOMEOWNER BANK-OPERATING 123456789 FOR PERIOD ENDING July 31, 2011

			BANK STATEMENT BALANCE ON 7/24/11	14,690.20
OUTSTANDING CHECKS				
2944	MEL SANTO BACKFLOW SERVICE	7/22/11	(75.00)	
2947	BARCELONA VIEW HOA	7/26/11	(3,184.20)	
2948	ROSA POOL SERVICE	7/28/11	(329.00)	
				(3,588.20)
				=====
				(3,588.20)
RECONCILED BALANCE ON 7/31/11				11,102.00

			LEDGER BALANCE ON 6/30/11	10,445.13
DEDUCTIONS				
	CHECKS WRITTEN		(6,724.13)	
				(6,724.13)
ADDITIONS				
	JULY PAYMENTS		7,381.00	
				7,381.00
				=====
				656.87
RECONCILED BALANCE ON 7/31/11				11,102.00

Accounting Systems

Methods of recording and reporting financial transactions have developed over time into what is now known as “generally accepted accounting principles”. While even a cursory description of these is beyond the scope of this work, a summary will be provided here for board members with little or no exposure to accounting practices.

All the association’s financial transactions can be classified into categories called ‘accounts’ each of which bears a unique number and description. Taken together, these form the association’s Chart of Accounts. The accounts themselves are further classified into groupings that, when sorted and summarized, allow the bookkeeper to report thousands of financial transactions in a manner meaningful to the reviewer. These major groupings are Assets, Liabilities & Fund Balances, Income and Expense. The first set, assets and liabilities & fund balances, are balance sheet accounts. The second, income and expense, appear in the income statement. While an association typically has only a few income accounts, it will often have dozens of expense accounts, the latter being the means by which the association’s many expenses are classified. In the following section dealing with financial statements, we will show how these account classes are used to describe most effectively the association’s financial condition.

Books, ledgers, and journals are terms associated with accounting practices that pre-date computers but they are still used to describe where financial transactions are recorded in each accounting period. For most associations, an accounting period is one month, twelve of which comprise the “fiscal year”. For each period, the association’s financial transactions are entered into one or more journals. For example, a “cash disbursement” journal will include the payments the association makes to individuals, entities, and service providers. Another may record “accounts payable”, the association’s unpaid invoices. Most transactions are entered in the general purpose “General Journal”. Assessments billed, payments received, interest earned, reserves funded, depreciation of assets, etc. might be found in the general journal.

The transactions in these journals are combined with journals from other accounting periods to comprise the association’s “General Ledger” from which everything is sorted and summarized in the financial statements. Few board members need to see financial information at levels lower than the financial statements provide. However, for the treasurer, the devil is often in the details and the detailed, cumulative ledger listing is a valuable reference tool.

Methods of Accounting

Cash

The cash method of accounting recognizes *revenues when they are received and expenses when they are paid*. This method has the advantage of being simple to implement and understand. One disadvantage, however, is its failing to match revenues and expenses in the time period in which they occur. This means that the associations unpaid assessments, its “accounts receivable”, do not appear on its balance sheet. Moreover, monthly financial reports using a cash method may have little in common with the association’s annual review because the civil code requires CPAs to employ the accrual method in preparing that document. Since the annual review is the association’s ‘official’ financial document which is distributed to members and shown to prospective buyers, it should bear some reasonable semblance to the financial documents used by the board to manage the association.

Accrual

The accrual method recognizes *revenues as they are earned and expenses as they are incurred*. This method has the advantage of matching revenues and expenses in the time period in which they occur. It is the method preferred by most corporate entities and is required for financial statements prepared in accordance with generally accepted accounting principles (GAAP). For California community associations, the Civil Code requires that both the annual pro forma operating budget (Section 3.51) and the CPA-prepared reviewed or audited financial statements use the accrual method of accounting.

Modified Accrual

The modified accrual method is *a mixture of cash and accrual*. For community associations, expenses are commonly recorded on a cash basis (since most operating expenses do not fluctuate significantly from one month to the next) and assessments are recorded on an accrual basis (because keeping track of members who do not pay their assessments is essential). Management companies frequently use this method of accounting in the preparation of monthly or quarterly statements.

HOAs and Fund Accounting

Board members familiar with general accounting reports often find the “Fund” accounts appearing on association balance sheets confusing. Fund accounting involves the division of a not-for-profit’s financial organization into a group of separate entities or funds. As not-for-profit corporations, California homeowner associations normally distinguish two funds: the Operating and Reserve Funds. The former embodies those financial transactions necessary for the day-to-day operation of the association. The latter incorporates those transactions relating to the monies reserved for the association’s long term capital replacement. Understanding what these funds represent and how the financial statements report them is fundamental to assessing the association’s short and long term financial health.

Financial Statements

Many board members look on financial statements as unintelligible puzzles produced under arcane rules by an accounting priesthood and presented to the board principally to meet obscure legal requirements. There is a component of truth in this viewpoint. But for the board member patient enough to untangle the columns and consider the totals, financial reports are powerful tools necessary for the management of the association’s finances. Of all the financial reports inflicted on board members, the two most common are also the most important: the balance sheet and the income statement.

Balance Sheet

The balance sheet is the association’s financial report. A director can see at a glance a snapshot of the association’s fiscal health. Often on no more than a single page, the balance sheet lays out the fundamental accounting equation: $ASSETS = LIABILITIES AND WORKING CAPITAL$. The first component of the equation, assets, appears at the top of the report. Assets include the association’s cash accounts (money in the bank) as well as any money (e.g. accounts receivable) or services (e.g. prepaid insurance) owed to the association. Below assets are listed the association’s liabilities, the monies (e.g. invoices payable, bank loans, etc) and services (e.g. to homeowners for prepaid assessments) owed by the association.

After what the association owes (its liabilities) is subtracted from what it has (its assets), what is left is its working capital. In the case of an individual's finances, this would be called equity but for the homeowner association, it is its *fund balances*. The balance sheet takes its name from the fact that its first part (assets) must balance its second (liabilities + funds).

The importance of the balance sheet to understanding the association's finances cannot be exaggerated. Summarized in it is information from a host of other reports and source documents, many of which the board member may never see. For example, in the asset section of the balance sheet for the fictitious Barcelona View Estates (see sample Balance Sheet) are listed the cash balances in the various operating and reserve accounts. These figures should match exactly the totals of the reconciled bank statements. Further down are other assets of which accounts receivable is particularly important. This figure should match the total assessments owed by members shown on the association's Accounts Receivable and Prepaid report (see sample Aged Delinquency Report). In the "Liabilities" section is the accounts payable amount, a figure that should summarize the totals from association's accounts payable journals (rarely produced or distributed). Similarly, the "prepaid assessments" figure should agree with the sum listed in the association's Accounts Receivable and Prepaid report. (Note: balance sheets using the cash method show neither past-due nor prepaid assessments.)

Finally, there are the fund balances. For each fund, there are two amounts: a prior year and a year-to-date figure. For both operating and reserves, the prior year amount represents total in that fund at the end of the prior fiscal year. The year-to-date figure is the net of income and expenses for the current fiscal year. These amounts should exactly match the YTD profit/loss totals shown on the income statement (see sample Comparative Income and Expense to Budget Report).

Thus, the balance sheet shows the board member how much cash is available in the association's operating and reserve accounts, how effectively assessments are being collected, how much the association owes other entities, how large its funds were at the start of the current fiscal year and how closely its year-to-date income and expenses have tracked to budget.

Income Statement

The income statement lists, account by account, the association's revenues and expenses. Customarily, these amounts are given both for the current fiscal period (often one month) as well as year-to-date. Also customarily, the budgeted amount for the respective period is provided in an adjacent column for comparative purposes. In some cases, the difference between actual and budgeted amounts will be shown to highlight large variances (see sample Comparative Income and Expense to Budget Report with

pages for both the Operating and Reserve Funds). Accounts may be grouped and subtotaled by categories (administration, recreational facilities, building maintenance, utilities, etc) to assist the board and its committees in managing the association's expenses. At the bottom of each fund's section will be a "Net Income/(Loss)" line for the current period and year-to-date. If this amount is negative, then expenses have exceeded income. These figures should match the YTD fund balances on the balance sheet.

California civil code requires board members to compare the association's revenues and expense to its budget at least on a quarterly basis. Logic would dictate that, if the opportunity presents itself, such a review be done more often. But fear of a lawsuit is not the only or even the best reason for comparing the association's expenses to budget. The figures on the income statement serve as flags that the association's financial matters are on track or warnings that things are not going as the budget committee had planned. These warnings may be dire: persistent cash shortages stemming from widespread expense overruns signal the board that

their budget projections were too optimistic and the association may be under funded. Or they might be minor: a spike in the utility bill could signal nothing more than a contractor neglected to turn off the pool heater at the end of the season. Whatever the case, unless it performs a regular review of the association's income statement, the board is managing its finances in the dark.

General Ledger Listing

A YTD general ledger listing contains every single transaction that is summarized in the association's financial report (see sample General Ledger Listing). To help the treasurer, it organizes them by account number and date. This often compendious report is unnecessary for most directors but it is the treasurer's only recourse when asked to account for sums listed in the other reports. So when asked "why are landscaping expenses so over-budget?" or "has the roofing contractor been paid yet?" the treasurer will find in the ledger listing the date, amount and payee of every check written to that expense account.

BARCELONA VIEW ESTATES HOA
Sample Balance Sheet

July 31, 2011

ASSETS

CASH - OPERATING

103	HOMEOWNER BANK-OPERATING CHECKING	11,102.00

		11,102.00

CASH - RESERVES

109	HOMEOWNER BANK-RESERVE CHECKING	85,512.99
113	SAVINGS BANK CD 5/1/95 6.75%	36,727.84
115	NATIONAL FEDERAL CD 7/3/95 5.65%	57,902.68

		180,143.51

OTHER ASSETS

120	ACCOUNTS RECEIVABLE	931.70
125	WORKERS COMPENSATION DEPOSIT	415.00
155	PREPAID INCOME TAXES 12/31/93	882.00

		2,228.70

TOTAL ASSETS

193,474.21

LIABILITIES AND EQUITY

CURRENT LIABILITIES

301	ACCOUNTS PAYABLE	1,322.00
315	PREPAID ASSESSMENTS	1,452.00

		2,774.00

RESERVE FUND

400	RESERVE FUND-12/31/93	156,378.06
401	RESERVE FUND-YTD	23,765.45

		180,143.51

OPERATING FUND

410	OPERATING FUND-12/31/93	9,183.09
411	OPERATING FUND-YTD	1,373.61

		10,556.70

TOTAL LIABILITIES AND EQUITY

193,474.21

UNAUDITED: FOR INTERNAL USE ONLY

BARCELONA VIEW ESTATES HOA
Sample Aged Delinquency Report
AS OF 7/31/11

MEMBER	MEMBER NAME	TOTAL BALANCE	CURRENT	30 DAYS	60 DAYS	90 DAY
24	ROACH, JAMES & CHRISTINE	931.70	12.10	133.10	133.10	653.40
TOTAL DELINQUENT		931.70	12.10	133.10	133.10	653.40
PREPAID						
19	GRUBE, THEODORE L	(363.00)	(363.00)	0.00	0.00	0.00
41	NENCINI, JOHN CONSTANTINE	726.00)	(726.00)	0.00	0.00	0.00
46	GABRIANA, DENISE	(242.00)	(242.00)	0.00	0.00	0.00
49	MACKENZIE, NICOLAS	(121.00)	(121.00)	0.00	0.00	0.00
TOTAL PREPAID		(1,452.00)	(1,452.00)	0.00	0.00	0.00
GRAND TOTAL:		(520.30)	(1,439.90)	133.10	133.10	653.40

BARCELONA VIEW ESTATES HOA
Sample Comparative Income & Expense to Budget
For the 7 Month Period Ending July 31, 2011
OPERATING FUND

	Curr Month Actual	Curr Month Budget	YTD Actual	YTD Budget	Variance	Annu Budg
INCOME						
OPERATING INCOME						
510 DUES INCOME	7,260	7,260	50,820	50,820	0	87,12
520 LATE CHARGES	12	0	206	0	206	
540 TRANSFER FEES	0	0	100	0	100	
TOTAL OPERATING INCOME	7,272	7,260	51,126	50,820	306	87,12
TOTAL INCOME	7,272	7,260	51,126	50,820	306	87,12
EXPENSES						
OPERATING COSTS						
610 CORPORATE TAXES	433	100	2,139	701	(1,438)	1,20
611 INSURANCE	1	233	940	1,634	694	2,80
612 PG&E	361	383	2,471	2,684	213	4,60
613 CITY WATER & SEWER	598	525	1,666	3,675	2,009	6,30
614 CUSTODIAL	100	100	600	701	101	1,20
615 LANDSCAPE CONTRACT	978	850	6,028	5,951	(77)	10,20
616 LANDSCAPE MAINT & REPAIR	104	1,000	6,812	7,001	189	12,00
617 POOL PERMIT	0	14	179	101	(78)	17
618 POOL CONTRACT	521	148	1,256	1,038	(219)	1,77
619 POOL MAINT & REPAIR	164	100	145	701	556	1,20
621 MISC MAINTENANCE	75	203	2,484	1,420	(1,064)	2,43
631 ANNUAL MEETING	0	8	0	58	58	10
TOTAL OPERATING COSTS	3,335	3,667	24,720	25,666	945	43,99
ADMINISTRATION						
651 ACCOUNTING	0	106	800	744	(56)	1,27
652 OFFICE EXPENSE (SUPPLIES & PHONE)	205	278	1,642	1,945	303	3,335
653 LEGAL EXPENSES	0	25	300	176	(124)	30
TOTAL ADMINISTRATION	205	409	2,742	2,865	122	4,91
RESERVE ALLOCATION						
670 TRANSFER TO RESERVES	3,184	3,184	22,289	22,289	0	38,21
TOTAL RESERVE ALLOCATION	3,184	3,184	22,289	22,289	0	38,21
TOTAL EXPENSES	6,724	7,260	49,752	50,820	1,068	87,12
NET INCOME/ (LOSS)	548	(0)	1,374	(0)	1,374	0

BARCELONA VIEW ESTATES HOA						
SAMPLE COMPARISON OF INCOME AND EXPENSE TO BUDGET						
For the 7 Month Period Ending July 31, 2011						
RESERVE FUND						
	Curr Month Actual	Curr Month Budget	YTD Actual	YTD Budget	Variance	Annual Budget
INCOME						
RESERVE INCOME						
580 ALLOCATION TO RESERVES	3,184	3,184	22,289	22,289	0	38,210
590 INTEREST INCOME	527	0	3,440	0	3,440	0
TOTAL RESERVE INCOME	3,711	3,184	25,729	22,289	3,440	38,210
TOTAL INCOME	3,711	3,184	25,729	22,289	3,440	38,210
EXPENSES						
REPLACEMENT EXPENSES						
802 ROOFING	0	417	0	2,917	2,917	5,000
805 SWIMMING POOL	0	125	1,000	875	(125)	1,500
806 COMMON AREA REPAIRS	0	167	964	1,167	203	2,000
TOTAL REPLACEMENT EXPENSES	0	708	1,964	4,958	2,994	8,500
TOTAL EXPENSES	0	708	1,964	4,958	2,994	8,500
NET INCOME/ (LOSS)	3,711	2,476	23,765	17,331	6,434	29,710

BARCELONA VIEW ESTATES HOA
Sample General Ledger Listing
 Cumulative to July 31, 2011

	Date	Ck # Source	Item Description	Debit	Credit
	----	-----	-----	-----	-----
Account #:	613-1		CITY WATER & SEWER		
	1/07	2858	CITY OF SANTA ROSA/WATER 11/18-12/21/10	176.18	
	2/01	2872	CITY OF SANTA ROSA/SERVICE 12/21/10-1/20/11	32.33	
	3/01	2879	CITY OF SANTA ROSA/WATER 1/20-2/18/11	30.96	
	4/06	2896	CITY OF SANTA ROSA/WATER 2/18-3/22/11	81.24	
	4/07	2899	CITY OF SANTA ROSA/WATER 2/18-3/26/11	55.21	
	5/05	2912	CITY OF SANTA ROSA/WATER 3/22-4/20/11	307.70	
	6/01	2920	CITY OF SANTA ROSA/WATER 4/20-5/20/11	384.42	
	7/06	2939	CITY OF SANTA ROSA/WATER 5/20-6/21/11	597.56	
			Account Balance	1,665.60	
Account #:	614-1		CUSTODIAL		
	1/28	2868	BOB LAND/JANUARY	75.00	
	2/25	2877	BOB LAND/FEBRUARY	75.00	
	3/28	2889	BOB LAND/MARCH	75.00	
	4/20	2904	BOB LAND/APRIL	75.00	
	5/25	2916	BOB LAND/MAY	100.00	
	6/23	2931	BOB LAND/JUNE	100.00	
	7/26	2945	BOB LAND/JULY	100.00	
			Account Balance	600.00	
Account #:	615-1		LANDSCAPE CONTRACT		
	1/06	2857	PACIFIC LANDSCAPING/DECEMBER	850.00	
	1/27	2864	PACIFIC LANDSCAPING/JANUARY	800.00	
	3/01	2880	PACIFIC LANDSCAPING/FEBRUARY	850.00	
	4/06	2895	PACIFIC LANDSCAPING/MARCH	850.00	
	5/05	2910	PACIFIC LANDSCAPING/APRIL	850.00	
	6/01	2923	PACIFIC LANDSCAPING/MAY	850.00	
	7/06	2936	PACIFIC LANDSCAPING/JUNE	978.00	
			Account Balance	6,028.00	
Account #:	616-1		LANDSCAPE MAINT & REPAIR		
	1/17	2859	PACIFIC LANDSCAPING/REPAIRS	175.43	
	3/15	2884	PACIFIC LANDSCAPING/IRRIGATION	5,940.40	
	4/16	2902	PACIFIC LANDSCAPING/REPAIRS	515.81	
	6/07	2924	PACIFIC LANDSCAPING/SOIL	76.88	
	7/18	2942	PACIFIC LANDSCAPING/PLANTS	103.60	
			Account Balance	6,812.12	
Account #:	617-1		POOL PERMIT		
	5/01	2908	SONOMA COUNTY PUBLIC HEALTH DEPT/POOL PERMIT	179.00	
			Account Balance	179.00	
Account #:	618-1		POOL CONTRACT		
	2/01	2873	ROSA POOL SERVICE/JANUARY	125.00	
	3/15	2883	ROSA POOL SERVICE/FEBRUARY	125.00	
	4/15	2901	ROSA POOL SERVICE/MARCH	125.00	
	5/05	2911	ROSA POOL SERVICE/APRIL	180.00	
	6/01	2922	ROSA POOL SERVICE/MAY	180.00	

Additional Reports Included in the Annual Review

In California, when an association's gross receipts exceed \$75,000 in any calendar or fiscal year, an independent review must be done and distributed to the owners within 120 days of yearend, unless the association documents have a more stringent requirement. When a CPA (see CPA Services below) is involved in the review preparation, the following statements and reports are required in addition to a balance sheet and income statement.

Statement of Changes In Fund Balances

This report shows the changes in fund balances arising from operating, investing and financing activities. The most common source of a change is the income or loss generated by the association. Commonly this statement is incorporated into the bottom of the income statement to show the balance of the funds at the beginning of the period, the net income that results in the ending balance which in turn agrees to the fund balance on the balance sheet.

Cash Flow Statement

This financial statement shows the *sources and uses of cash* arising from operating, investing and financing activities. It helps to answer questions like "If my income is positive, why don't I have any cash?" (Perhaps because assessments are not being collected and the receivable is growing.)

Accountants' (or Auditors') Report

This one to two-page document describes the work performed by the association's independent certified public accountant. The three most common services are compilations, reviews and audits. If the CPA was engaged to perform an audit of the financial statements, the auditor expresses an opinion on the fair presentation of the materially correct financial statements after performing an examination of the financial statements. In a review only financial analyses are performed but no examination, and no opinion is expressed.

Notes To Financial Statements

Notes to financial statements reflect mandatory, and optional, disclosures of a financial nature that more fully describe the nature and amount of balances included in the four basic financial statements, balance sheet, income statement, changes in fund balance and cash flow statement. Common notes include a summary of significant accounting policies, assessments receivable, income taxes, future major repairs/replacements, related party transaction, and commitments/contingencies, among others.

Supplemental Information

The American Institute of Certified Public Accountants in their audit and accounting Guide for Common Interest Realty Associations requires additional disclosures for future major repairs and replacements. This typically comes from the reserve study and is an additional financial disclosure required as a part of the financial statements in addition to the disclosures required by CA Civil Code with the annual budget information.

CPA Services: Audit, Review, Compilation

Audit

The “highest” level of service rendered by an independent CPA are audited financial statements. In it, financial records are examined in accordance with generally accepted auditing standards (GAAS). Included are such tests of the accounting records and other auditing procedures as the CPA considers necessary. Because a detailed examination of all transactions is not performed, there is a risk that material errors, irregularities or illegal acts, may exist and not be detected. A CPA who is not independent with respect to the association may NOT prepare audited financial statements.

Review

The next level of service rendered by a CPA is a review. In it, the financial statements are subjected to analytical review and inquiry as a means of insuring compliance with generally accepted accounting principles (GAAP). Community associations increasingly use this service as a cost-effective compromise. A review (as opposed to an audit) is the lowest acceptable level of CPA services to be provided to an association whose gross receipts for the fiscal year exceed \$75,000 (Civil Code Section 5305). A CPA *must* be independent with respect to the association in order to review the financial statements.

Review Audit

Although certain Board members and managers have used this term from time to time, there is no such thing.

Compilation

The “lowest” level of service prepared, a compilation gives almost no assurance on the financial statements. Compiled statements are appropriate for those situations in which only conformity with generally accepted accounting principles (GAAP) is desired. This service frequently provides CPA- prepared cash flow forecasts and projections, budgets and interim (monthly or quarterly) financial statements. If a CPA who is NOT independent with respect to the association prepares compiled financial statements, this fact **MUST** be stated in the accountant’s compilation report (e.g. “We are not independent with respect to the ABC Homeowners Association.”).

Agreed Upon Procedures

In this type of engagement, the association and the CPA agree on the accounts and/or procedures to be employed, and the CPA’s report reflects such agreed-upon scope, and his/her findings. This service may be appropriate when a full audit is not necessary.

Internal Controls

Internal controls are the measures taken by an organization to safeguard its assets, check the accuracy and reliability of accounting data, promote operational efficiency and encourage adherence to policies. Routine review of reconciled bank statements (to confirm cash balances) or accounts receivable (to ensure assessments are being collected in a timely manner) are examples of controls.

The Board of Directors of a CID is responsible for the establishment and maintenance of effective internal controls. The Internal Controls Checklist has been developed by the ECHO Accountants Panel to help your board assess its own procedures. The checklist covers the major items that should be considered for an association's internal controls.

Items on the checklist can safeguard assets only from loss through processing errors or irregularities. They cannot protect assets from improvident management decisions (such as redeeming a certificate of deposit prior to maturity or purchasing material or services that later prove to be unsatisfactory or unnecessary) or from the intent to defraud. However, effective controls and the determination to maintain them create an environment in which financial decisions are more carefully considered and fraudulent activity acquires considerably greater risk.

Cash Controls

Dual signatures on checks greater than \$X

For the sake of expediency, a single signature on checks for relatively small expenses may be allowed but large amounts should have two signatures, at least one of which is a Board member. California Civil Code Section 5510 requires that the disbursement of funds from the association's replacement reserve requires two Board signatures, or a board member and an officer. Designated check signers should be readily accessible for that purpose and the bank signature cards are kept up-to-date. Many financial institutions require the submission of a Board resolution as well as appropriate signature cards before changing authorized account signers.

This control assures that no single individual has sole access to association funds. A check signer should never sign blank checks in advance for this totally defeats the control.

Cash disbursements to vendors should be based only on original invoices (NOT monthly statements or "duplicate" invoices).

The invoices should be inspected, their amounts checked for accuracy and initial-approved (ideally by both the manager and a Board member). Also, to avoid possible loss of funds resulting from alteration of a signed check, the last check signer or someone other than the check preparer should mail the signed check.

Cash receipts should be restrictively endorsed (i.e. stamped "Pay to the Order of ABC Homeowners Association, Account No. xxx ") and deposited promptly.

Cash receipts should NOT be commingled (i.e. mixed together in the same bank account) with either (1) funds from other associations, or (2) with operations and replacement (reserve) funds being together in a single account. Bank lockbox systems for collecting assessments achieves both these controls.

Account reconciliations should be performed for all bank accounts on a monthly basis, ideally by someone who does not also handle cash receipts or cash disbursements.

The preparer should initial the account reconciliation. Bank reconciliations should be reviewed and, ideally, initial-approved, by the Board of Directors at least quarterly. This control assures that cash is really in the bank and that the financial statement cash balances are correctly stated.

Bank signature cards should be kept up-to-date whenever Board members change, and such cards should be delivered to the bank independent of the management agent.

In addition, authorized check signers should be identified in the Board minutes and, on occasion, independently verified with the bank or financial institution.

No more than \$250,000 should be kept in any one federally insured financial institution because the federal government will not reimburse for bank failure losses in excess of this amount.

If your association uses electronic transfer systems to pay its bills you must make sure that the proper vendors are being paid through the review and approval of invoices and statements.

This system circumvents the check signing system and circumvents the intent of the legislature for replacement reserve expenditures.

If your association uses electronic transfer systems to receive funds, you must closely examine the bank reconciliation to see that all such receipts are properly recorded.

Make sure that all accounts are in the name of the association, not the management company or an individual.

Never make checks payable to "cash". Petty cash reimbursements should be made to the custodian of the funds.

Carefully control transfers between banks.

Checks should be made payable to the association and endorsed as "For deposit only/HOA name/Bank name and account number" before the check is signed and deposited. Be particularly wary of transfers from replacement accounts to the operating account. The state requires two authorized signatures on withdrawals from the replacement funds to keep them from disappearing so easily.

Account for any missing checks or gaps in the pre-numbered check sequence.

Assessments Receivable

California Civil Code Section 5310 (a)(7) requires that a statement describing the association's policies and practices enforcing lien rights or other legal remedies for default in payment of its assessments again to its members shall be annually delivered to the members not less than 30 days nor more than 90 days immediately preceding the beginning of the association's fiscal year. This statement tells homeowners what actions the Board of Directors will take, and when, in the event that assessments are not paid in a timely manner. Treating all owners fairly and consistently in accordance with a well-written, attorney-reviewed delinquency policy, can help keep overdue assessments to a minimum.

Monthly review of the aging of overdue assessments will help insure that owners do not fall seriously behind in the payment of assessments, late charges and interest. California statute allows the imposition of late charges equal to the greater of \$10 or 10% of the monthly assessment 15 days after the due date of the assessment. In addition, interest at a rate which does not exceed 12% per annum may be imposed on unpaid account balances beginning 30 days after the assessment due date. In addition, actual costs of collection (lien fees, legal fees, etc.) may be recovered on seriously delinquent accounts.

Electronic transfer systems and bank lockbox systems are convenient but also make it easy to misapply a payment and difficult to find it later. Consequently, the review of the assessment aging becomes critical, along with agreeing the total due on the aging to the general ledger to assure that the aging is a complete listing of all that is due to the association.

Property and Equipment

Inventory all property in order to establish accountability. Each item should be individually “tagged” (labeled with a pre-numbered self-adhesive label or engraved with an electric scribing tool). The property list should include date acquired, description/serial number, cost and physical location. All movable property and equipment should be physically inspected and inventoried at least once a year. Consideration should also be given to photographing such items for insurance purposes.

Establish a capitalization policy whereby expenditures over \$xxx for personal property items are recorded as assets (rather than expenses) and depreciated (written off) over its estimated useful life. For control purposes, certain smaller expenditures may be recorded as assets (and tagged and inventoried as described above), and depreciated (written off) in one year.

General Controls

Review an income and expense statement for the association’s operating and reserve accounts on at least a quarterly basis. This control, especially when the financial statements show actual receipts and expenditures compared to budget, gives the Board assurance that money is being spent as planned, or highlights deviations from the budget.

Budgeting is an extremely important internal control. Any deviations in actual income and expense from the budget will stand out in the Income Statement and be subject to a higher degree of scrutiny.

Avoid conflict of interest or even the appearance of conflict of interest. Board members should not receive compensation or payment in any form for either services provided or items sold to the association. If the appearance cannot be avoided, make sure that everyone knows of the potential conflict and what steps are being taken to avoid favoritism and partiality.

Some examples of conflict of interest or related party dealings, potential self-dealing:

- The board is responsible for investing association funds and a board member is an investment broker.
- Board members or members of their families should not perform contract work for the association.
- The manager’s spouse is the painter, gardener, or contractor.

Carry proper insurance and review the coverage annually, including fidelity bonds on anyone handling cash and workers compensation insurance even if the association has no employees. This insurance will cover board members if they perform any work around the association and any independent contractors who do not carry their own worker compensation policy and work on the premises. The association should follow a policy of requiring workers compensation coverage from any vendor that performs services on the premises. This includes janitors, swimming pool maintenance companies, handymen, gardeners and landscaping companies, and specially any major repair work such as painting and roofing.

Review the internal control structure with the Board on an annual basis so that the entire board is aware of the safeguards that are built into the system. This will also serve as a yearly reminder and a training session on fiduciary responsibility.

Financial and Tax Reporting Deadlines

The following dates are based upon a calendar year-end (for fiscal year-end associations, if different, the month and day of the fiscal year is indicated in bold print- e.g. for a June 30 year end, Form 1120 is due the 15th day of the 4th month, or October 15):

Due Date	Reporting Authority and Requirement
January 31	<u>Form 1099 (Federal)</u> to report payments of \$600 or more to unincorporated providers of services and all attorney fees paid during the preceding calendar year. One copy goes to the service provider (the person that the association paid) and the other copy goes to the government by January 31 along with Form 1096. This deadline exists for all associations, even those with non-calendar year-ends.
January 31	<u>Form 1096 (Federal)</u> to the respective tax authorities along with copies of Forms 1099 (see deadline comments at January 31 above).
April 15	<u>Form 1120 (Federal) and Form 100 (California)</u> , corporation income tax returns, unless extension of time to file is requested. Fiscal year associations are due on the 15th day of the 4th month. To request a federal extension of time to file, Form 7004 must be mailed by April 15 and all taxes paid. The extension is automatically granted unless terminated by the IRS by mailing a notice of termination at least 10 days prior to the termination date stated in the notice. For a California extension, Form 3539 "Payment Voucher for Automatic Extension for Corporations and Exempt Organizations" must be sent in with any taxes owing. If no payment is due, DO NOT SEND THE PAYMENT VOUCHER. The extension is automatically granted if the tax return is filed by the extended due date
April 15	<u>First quarter estimated income taxes</u> , if any, are due. Federal taxes are paid electronically using the IRS EFTPS system, not through a bank or with a return. See the IRS website to set up payments. Estimated taxes payable to the California Franchise Tax Board may be mailed in along with Form 100-ES (which is generally provided by your CPA). Fiscal year associations are due on the 15th day of the 4th month.
April 30	<u>Year-end audited or reviewed financial statements</u> due to all owners if association gross receipts during the preceding calendar year exceeded \$75,000. Generally, these statements must be distributed within 120 days after year-end. Fiscal year associations are due on the last day of the 4th month.
May 15	<u>Form 199 (California)</u> exempt organization annual information return, unless extension requested. Fiscal year associations are due on the 15th day of the 5th month.
June 15	<u>Second quarter estimated income taxes</u> , are due. See filing comments at "first quarter estimated income taxes" by April 15, previously. Fiscal year associations are due on the 15th day of the 6th month.

- September 15 Third quarter estimated income taxes, are due. See filing comments at “first quarter estimated income taxes” by April 15, previously. Fiscal year associations are due on the 15th day of the 9th month.
- October 15 Form 1120 (Federal) corporation income tax is due if extended. A copy of the extension request form should be attached to the tax return. Fiscal year associations are due on the 15th day of the 10th month.
- November 15 California Form 100 corporation income is due if extended. Fiscal year associations are due on the 15th day of the 11th month.
- December 1 Pro forma budget prepared in with California Civil Code Section 5300. This budget must be distributed between 30 and 90 days before fiscal year end - not earlier or later.
- December 15 Fourth quarter estimated income taxes are due. See comments at “first quarter estimated income taxes” by April 15, previously. Fiscal year associations are due on the 15th of the 12th month.
- December 31 Delinquency policy statement (i.e. statement of collection actions to be taken by the Board of Directors in the event of nonpayment of assessments) due to all owners. This statement must be distributed during the last 60 days of the association’s fiscal year. Fiscal year associations are generally due between the 1st day of the 11th month and the last day of the 12th month.

Additional deadlines exist for those associations with payroll tax, real and personal property tax and sales/excise tax filing requirements. Consult your CPA or appropriate taxing authority. The Secretary of State requires the filing of a notice of officers biannually in the month of your incorporation, and failure to file is a common reason for the loss of corporate status.

Within 20 days of making payment(s) to an independent contractor who is an individual, not a corporation or partnership, totaling \$600 or entering into a contract for more than \$ 600, you must report to the Employment Development Department certain information. This includes their name, address, social security number and contract information. This is reported on the form DE 542. A similar reporting of new employees is required on form DE 34. These are for the enforcement of the child support obligations.

Insurance and alternative dispute resolution (ADR) disclosures must be made annually as well as the delinquency policy statement. You probably also want to remind the members of the Association Rules and Regulations. There are notice requirements spelled out in your documents about the annual members meeting notices as well to be distributed. Do amend and modify this list for your own needs.

HINT: To reduce possible future aggravation and help ensure proof of filing, send all income tax returns, estimated tax payments and correspondence (e.g. response to official tax notices) to federal and state authorities either by certified mail, return receipt requested, or (as a less desirable alternative) utilizing the U.S. Post Office’s “proof of mailing” service. Each time you respond to an IRS or FTB notice, be sure to include as attachments copies of all prior notices and correspondence.

Also, all payments can be made by electronic funds transfer if you sign up and get setup for it. You receive a confirmation for the funds transfer and its application to the appropriate taxes, and a further confirmation on your bank statement where the transfer was made. The IRS and FTB actually prefer that taxes be paid this way.

Income Taxes

Most California community associations are classified as mutual benefit nonprofit organizations. Although such associations are “nonprofit” organizations, with rare exception, most pay tax on net nonmember income (generally interest income, less directly attributable expenses). Income taxes are paid to both the state (the California Franchise Tax Board -FTB) and Federal (the Internal Revenue Service - IRS) governments on an annual basis. Unlike individuals whose taxes are due 3-1/2 months after year end, most community associations are corporations whose taxes are due 2-1/2 months after year end (e.g. March 15 for a calendar year association), unless an extension of time to file (not pay) is requested.

As a California corporation, a community association is subject to a minimum annual corporation tax. Fortunately, a residential association can apply for exemption from the state’s (currently) \$800 corporation minimum tax by completing FTB Form 3500 (and attaching certain required statements and documents). If granted (and most are), this exemption still requires that tax, at prevailing rates, be paid on net nonmember income, defined above. In addition to the California income tax return, the association must annually file an information return, Form 199 after the exemption is granted. The 199 is due 4-1/2 months after year end.

For Federal tax purposes, a community association may choose to file as a homeowner association under Internal Code Section 528 or as a membership organization under Internal Revenue Code Section 277. Under IRC Section 528 the association pays a 30% tax on net nonexempt function - income tax terminology for association income and expenses that are not related to the exempt purposes for which the association was formed (e.g. interest income). Under IRC Section 277 the association pays a graduated income tax, starting at 15%, on net non-membership - income tax terminology for association income and expenses not related to the membership purposes for which the association was formed (e.g. interest income). If this last option is selected, the association’s owners must annually approve a tax election resolution. See your CPA for the appropriate resolution wording for your particular association.

Future Major Repairs and Replacements

Future Major Repairs - Overview

On an annual basis California community associations are required to review both their operating and long- term replacement reserve budgets and communicate significant information about these budgets to owners in the pro forma operating budget.

In addition, at least once every three years, the association is required to have a more extensive review of their long-term major maintenance program commonly referred to as a reserve study. The reserve study consists of two basic parts: a physical visual inspection of the property resulting in current estimates of component useful life, remaining life and current replacement cost known as a component study, and the manipulation of this information in the form of a financial spreadsheet to determine long-term funding known as a funding plan. While California law does not currently require “full funding” (see discussion of the percentage reserves are funded), industry practice and most community association governing documents require the Board to reasonably plan for the future repair and replacement of common area major components. Generally, a prudent funding plan will accomplish this last purpose without the need to resort to (significant) special assessment(s).

Future Major Repairs - Reserve Component Study

Tranquility Homeowners Association

Reserve Component Study
As of December 31, 2011

ABC Consulting
1234 Main Street, Suite 567
Any town, CA 98765

Independent Consultant's Report

30-Year Component Repair And Replacement Costs
Definitions, Limitations, Assumptions, Qualifications, Etc.

Maintenance Suggestions For Longer Component Life
Component Cost/Life Detail And Photo Documentation

Major component is a common area element such as roofing, painting or paving, which (1) has a useful life in excess of one year but less than the life of the building(s), (2) is greater than some minimum dollar amount in cost, and (3) is the responsibility of the association (as opposed to the individual owners) to maintain, repair or replace. Consideration should be given to having the association's attorney review the governing documents when establishing the major component list.

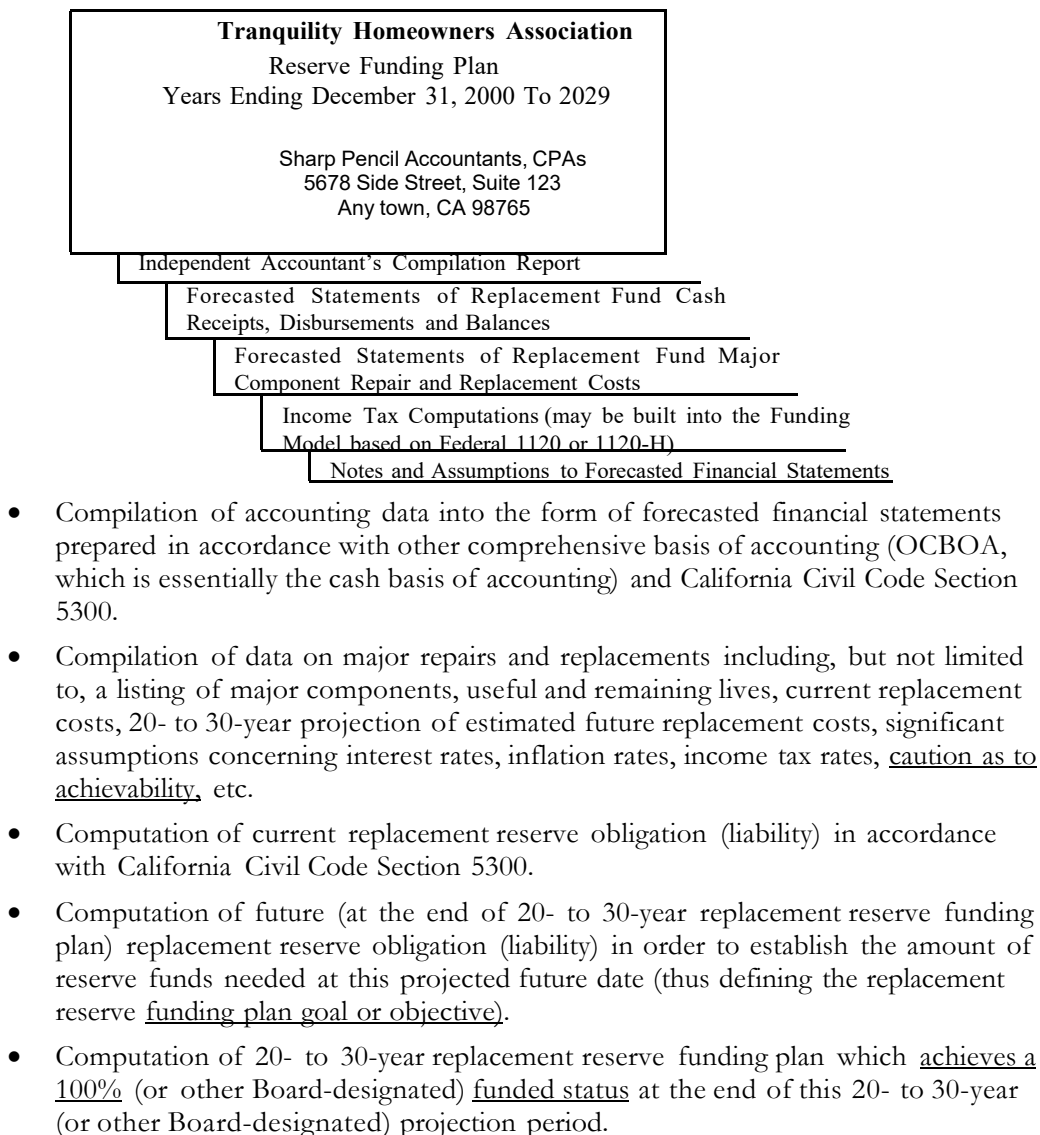
Useful life is the total number of years that a major component, when new, is expected to serve its intended purpose, given proper original installation and ongoing maintenance.

Remaining life is the presently expected number of years that a major component will continue to serve its intended purpose prior to repair or replacement, based upon its present condition. This estimate should be determined by a detailed, on-site physical inspection of the components.

Current replacement cost is the cost, in today's dollars, to repair or replace a common area major component with one of like kind and quality. If local building codes require a different kind or quality of replacement, this information should be obtained for the long-term funding plan.

Component information may come from the Board of Directors, licensed or unlicensed contractors, architects, engineers and/or independent construction consultants. Most industry professionals do not consider the original developer budget to be a good source of component information because it is often incomplete and/or not adjusted for replacement costs in specific geographic areas. Many component study preparers (also known as "reserve study" preparers) also give associations valuable advice concerning the proper maintenance of common area components, and, in certain instances, may alert the Board of Directors to readily obvious (i.e. "patent") or potential (i.e. "latent") construction defects. The accuracy of the resulting long-term funding plan (see Sections 3.30) and pro forma operating budget (see Section 3.60) are directly related to the accuracy of the component information obtained by the association.

Future Major Repairs - Reserve Funding Plan



Future Major Repairs - Annual Provision and Accumulated Reserve

Annual Provision

The annual provision represents the one-year's wear of all major components, expressed in dollars, for a period of one year. The example above depicts the computation for a single component. The provision represents the accrual-basis expense of the replacement fund for a one-year period. California Civil Code Section 5300 requires disclosure of the accrual-basis expense in the association's pro forma operating budget.

Accumulated Reserve

The accumulated liability represents the total wear since last replacement of all major components, expressed in dollars, as of a particular point in time (usually at month end or year end). The example above shows the computation for a single Component at the end of the 10th year of the component's life. California Civil Code Section 5300, requires disclosure

of the ratio of actual replacement fund cash reserves to the estimated liability as of the end of the current fiscal year in the association's pro forma operating budget.

Future Major Repairs - Pro Forma Operating Budget

Tranquility Homeowners Association

Pro Forma Operating Budget
Year Ending December 31, 2012

Sharp Pencil Accountants, CPAs
5678 Side Street, Suite 23
Any town, CA 98765

Independent Accountant's Compilation Report

Forecasted Statement of Revenues, Expenses, and
Changes in Fund Balances

Notes and Assumptions to Forecasted Financial Statement

Forecasted Schedule of Major Component Replacement
Provision for the Year Ending December 31, 2012 and
Estimated Liability at December 31, 2011

- Compilation of accounting data into the form of a forecasted financial statement prepared in accordance with generally accepted accounting principles (GAAP, which is essentially the accrual basis of accounting) and California Civil Code Section 5300. This compilation includes both the day- to-day operating budget, and certain replacement reserve information.
- Compilation of data on major repairs and replacements including, but not limited to, a listing of major components, useful and remaining lives, current replacement costs, significant assumptions concerning interest rates, inflation rates, income tax rates, caution as to achievability, etc.
- Computation of current replacement reserve obligation (liability) in accordance with California Civil Code Section 5300.
- Computation of percentage reserves are funded at December 31, 2011, in accordance with California Civil Code Section 5300
- Computation of future (at the end of 20- to 30-year replacement reserve funding plan) replacement reserve obligation (liability) in order to establish the amount of reserve funds needed at this projected future date (thus defining the replacement reserve funding plan goal or objective).
- Explanation, in words, of 20- to 30-year replacement reserve funding plan which achieves a 100% (or other Board-designated) funded status at the end of this 20- to 30-year (or other Board-designated) projection period.

Future Major Repairs - Civil Code Section 5300

Unless the governing documents impose more stringent standards, the association shall prepare and distribute to all of its members the following documents:

(a) A pro forma operating budget, which shall include all of the following:

(1) The estimated revenue and expenses on an accrual basis.

(2) A summary of the association's reserves based upon the most recent review or study conducted pursuant to Section 5500, based only on assets held in cash or cash equivalents, which shall be printed on boldface type and include all the following:

(A) The current estimated replacement cost, estimated remaining life, and estimated useful life of each major component.

(B) As of the end of the fiscal year for which the study is prepared:

(i) The current estimate of the amount of cash reserves necessary to repair, replace, restore, or maintain the major components.

(ii) The current amount of accumulated cash reserves actually set aside to repair, replace, restore, or maintain major components.

(iii) If applicable, the amount of funds received from either a compensatory damage award or settlement to an association from any person or entity for injuries to property, real or personal, arising out of any construction or design defects, and the expenditure or disposition of funds, including the amounts expended for the direct and indirect costs of repair of construction or design defects. These amounts shall be reported at the end of the fiscal year for which the study is prepared as separate line items under cash reserves pursuant to clause (ii). Instead of complying with the requirements set forth in this clause, as an association that is obligated to issue a review of their financial statement pursuant to subdivision (b) may include in the review a statement containing all of the information required by this clause.

(C) The percentage that the amount determined for purposes of clause (ii) of subparagraph (B) equals the amount determined for the purposes of the clause (i) of subparagraph (B).

(D) The current deficiency in reserve funding expressed on a per unit basis. The figure shall be calculated by subtracting the amount determined for purposes of clause (ii) of subparagraph (B) from the amount determined for the purposes of clause (i) of subparagraph (B) and then dividing the result by the number of separate interests within the association, except that if assessments vary by the size or type of ownership interest, then the association shall calculate the current deficiency in a manner that reflects the variation.

(3) A statement as to all of the following:

(A) Whether the board of directors of the association has determined to defer or not undertake repairs or replacement of any major component with a remaining life of 30 years or less, including a justification for the deferral of decision not to undertake the repairs or replacement.

(B) Whether the board of directors of the association, consistent with the reserve funding plan adopted pursuant to Section 5550, has determined or anticipates that the levy of one or more special assessments will be required to repair, replace, or restore any major component or to provide adequate reserves therefor. If so, the statement shall also set out the estimated amount, commencement date, and duration of the assessment.

(C) The mechanism or mechanisms by which the board of directors will fund reserves to repair or replace major components, including assessments, borrowing, use of other assets, deferral of selected replacements or repairs, or alternative mechanisms.

(D) Whether the association has any outstanding loans with an original term of more than one year, including the payee, interest rate, amount outstanding, annual payment, and when the loan is scheduled to be retired.

(4) A general statement addressing the procedures used for the calculation and establishment of those reserves to defray the future repair, replacement, or additions to those major components that the association is obligated to maintain. The report shall include, but need not be limited to, reserve calculations made using the formula described in paragraph (4) of subdivision (b) of Section 5570, and may not assume a rate of return on cash reserves in excess of 2 percent above the discount rate published by Federal Reserve Bank of San Francisco at the time the calculation was made.

The summary of the association's reserves disclosed pursuant to paragraph (2) shall not be admissible in evidence to show improper financial management of an association, provided that other relevant and competent evidence of the financial condition of the association is not made inadmissible by this provision.

Notwithstanding a contrary provision in the governing documents, a copy of the operation budget shall be annually distributed not less than 30 days nor more than 90 days prior to the beginning of the association's fiscal year.

Frequently Asked Questions:

Can our property manager sign checks on our operation account? Our reserve account?

A property manager can be allowed to sign operating checks. This is sometimes done from an operating efficiency viewpoint, because it is sometimes difficult for the property manager to physically get all checks to a Board member for signature. If it is allowed, they the Board should take additional steps to strengthen internal controls, such as reviewing a check register each month and closely reviewing the monthly or quarterly financial statements. California Civil Code Section 5510(a) requires all withdrawals from the association's reserve accounts be signed by either two Board members or one Board member and an officer of the Corporation. The property manager should never be allowed to sign checks or make withdrawals from reserve accounts, even if named as an officer.

Do we have to have a separate reserve account? Do reserve transfers have to be made monthly?

The Board of Directors is obligated to account for reserve funds separately from operating funds. Therefore the funds should be physically separated. It is also a preferred practice to make monthly transfers of the budgeted replacement fund assessments from the operating account to the reserve account, but they can be made quarterly, semiannually or on some other scheduled interval.

Do we have to fund reserves?

Currently the Civil Code does not require that reserve funds be accumulated. Instead, there is a disclosure requirement. Civil Code Section 5550 requires that a reserve study includes "An estimate of the total annual contribution necessary to defray the cost to repair, replace, restore or maintain the components ...". Although it is not a prudent policy, the Board could special assess for every reserve fund expenditure. However, the reserve study would still have to disclose the estimated annual special assessments anticipated over the next 30 years as part of their annual budget disclosures (Civil Code Section 5300(b)).

Can the Board do the reserve study? Can our CPA?

A reserve study (Civil Code Section 5550) requires (1) identification of the major components which the association is obligated to repair, replace or restore; (2) identification of the probably remaining useful life of the components identified based on a physical inspection; and (3) an estimate of the cost of repair, replacement, or restoration. A CPA is not qualified to perform these tasks. Most Boards of Directors also are not qualified. Instead, the Board should engage an outside qualified expert to perform the study. A CPA is qualified to assist in an annual updating of the funding portion of the reserve study.

What is “percent funded” and what percentage should we be?

Percent funded is a measurement of how an association’s reserve cash compares with an estimation of the cash needed to repair, replace, restore, or maintain its major components. The percentage is determined by dividing the former by the latter. State law requires it to be disclosed to homeowners as part of the annual budget. Commencing 2005, the California civil code standardized the calculation of this “percent funded” in the manner described in “Future Major Repairs - Reserves Percent Funded Computation” section above. The legislated method employs simple accrued expense from a single point in time to estimate the cash reserves needed. Easy to compute, it provides a uniform standard for the industry. However, it does not incorporate more complex but important factors like cash flow, inflation, interest, etc. What percent funded is truly sufficient? The answer will vary depending on each association’s replacement schedule, actual cash flows and future funding plans. Fortunately, more sophisticated funding projections are often included in the reserves studies supplied by reserve analysts, making the association’s reserve study the primary reference for this and related questions.

If we are unincorporated, do we still have to file tax returns?

Any association, whether or not incorporated, that has more than \$100 in interest or other taxable gross receipts is required to file both Federal and California income tax returns.

Can Board members be paid or have their assessments reduced? Can we have a special Board dinner at the end of the year?

Most associations are incorporated as nonprofit, mutual benefit organizations. All associations should carry directors’ and officers’ liability insurance. This insurance is predicated on the assumption that Board members serve on a voluntary basis and are not compensated for their services. Reducing Board member assessments or having special functions for Board members only is a form of compensation subject to payroll compensation reporting and therefore can invalidate the directors’ and officers’ liability insurance. Having functions where all members of the association are invited such as group pot lucks is quite acceptable.

At the end of each year, should the Board transfer any operating surplus to the replacement fund?

Initially the Board needs to accumulate sufficient operating surpluses to use for operations. For example, the accumulated surplus should be large enough to allow for the annual payment of the insurance premium and still allow for a cushion in case operating expenses exceed operating income in a particular year. However, once this surplus is accumulated then it is prudent to transfer any additional excess to the replacement fund or reduce future assessments by using the surplus for operating costs.

Do we need to adopt the tax resolution each year if we only file a Form 1120H?

The annual tax resolution is only needed if the association files Form 1120 or 1120A. It is not required if the association files Form 1120H. If the association is not sure which form will be used, there is no harm in passing the resolution and then filing either Form. The resolution should be passed prior to the end of the fiscal year anyway so it is a good idea to pass it as a

regular procedure at your annual membership meeting even if it is only a month into your fiscal year.

Can we give owners a discount on their assessment payment if they pay in a lump sum at the beginning of the year?

Giving owners a discount for a lump sum payment should be avoided as it can create potential taxable income for the association. For example, if the annual assessments is \$1,200 (\$100/month), and the association allows individual owners to make a lump sum payment of \$1,100, then the annual assessments really becomes \$1,100. By collecting \$1,200 from other owners, the association could be construed as receiving \$100 in interest income from each of these owners.

Should we keep our books on the cash or accrual basis of accounting?

Either method is acceptable. However, the accrual basis of accounting is more appropriate for larger associations. All associations should at least consider using at least a modified cash basis of accounting where assessments are accounted for on the accrual basis. This method creates control over the collection of assessments.

Can our Treasurer or Chief Financial Officer perform the Civil Code Section 5500 quarterly review or should the whole Board be involved?

Even though the Treasurer may be the most knowledgeable, the Board as a whole is responsible for the quarterly review and all of the members should participate. We further urge you to document the review when done by either a signoff sheet or a discussion and notation in the minutes.

As part of the Section 5500 quarterly review, how does the Board review the reserve fund activity since often there is no income statement or detail available? For example, was the pool resurfacing over/under budget per the reserve study?

The Board should ask questions and instruct their financial statement preparer to include this information (detail and budget to actual comparisons). Most bookkeeping systems are not adequate for this item.

Can the association use reserve funds to pay for replacing a component that is not listed as a component?

Yes, as long as the item is considered a major component. For example, the association may not have had the tile roofs listed on the component list because the estimated remaining life was over 30 years. However, if an incident happens where major roof repair was necessary. In such an instance, this would be considered a legitimate reserve expenditure. A couple of cautions are in order. First you may need to update the funding plan to adjust for future assessments. Perhaps a telephone call to the reserve preparer is in order. Second, there can be issues involving capital improvements that are not apparent or even a question as to if the item is truly a major component. If in doubt, contact your professionals—Reserve Study Preparer, CPA or attorney.

Insurance

Property Coverage

Building Blanket Limit

Covers the replacement cost of the buildings with like kind and quality, for which a description and limit is shown on the Policy Declarations and is subject to the original specifications for quality and design provided by your original builder. Master Policies are built in correlation with the Insurance Requirements set in the Association's CC&R's. This coverage should include but is not limited to the following items when on the same premises:

- Permanent fixtures, machinery and equipment such as heating and air conditioning and elevators used to provide building services.
- Additions and extensions to the described building. We also cover garages, storage sheds and swimming pools used in connection with your business.
- Yard fixtures such as fences, lampposts and flagpoles.
- Fire and Specified Perils Legal Liability

- Construction materials and supplies that you intend to use to alter, repair or expand an insured building.
- Personal property you own and use to service or maintain the building including fire extinguishing equipment, outdoor furniture, floor coverings, and appliances for refrigerating, ventilating, cooking, dishwashing and laundering.

Electrical and plumbing fixtures, interior partition walls, improvements and alterations comprising a part of the building and refrigerators, heaters, air conditioners, cooking ranges, dishwashers, clothes washers, dryers, kitchen cabinets, countertops and floor coverings contained within the units and owned by the association or unit-owner. These items must have been initially installed or replaced in accordance with the original condominium plans and specifications

Replacement Cost

Your Association should be insured for the full replacement cost values, as most CC&R's require this. Building Replacement cost values are calculated through Marshall Swift Boeckh (www.marshallswift.com), an industry wide program. To properly determine the replacement cost, it's important to complete a physical inspection of the property, use correct square footage and properly research the association for special characteristics.

Building Ordinance Coverage (BOC)

Building Ordinance coverage is commonly overlooked, but is a very important coverage to carry. Standard property forms provide coverage for the indemnification of the actual physical structure and for returning the building to the condition it was prior to the loss from a covered peril. What is not covered under the property coverage form, and is specifically excluded, is the increased cost of rebuilding, repair or remodeling enforced by local, state and federal building codes. Building Ordinance coverage, also known as Ordinance or Law coverage, was created to fill the gaps created by these exclusions.

BOC A: Coverage for Loss to the Undamaged Portion of a Building

This coverage responds when only a portion of the building is damaged. If the undamaged portion of the building is rendered as unusable, or condemned, by an ordinance then it would have to be torn down and a total loss of the building would be incurred.

BOC B: Coverage for the Cost of Demolition

This coverage pays the cost to demolish the undamaged portion of the partially damaged building (the property coverage responds to demolition and debris removal of the damaged portion of the building).

BOC C: Coverage for the Increased Costs of Construction

When a building or structure is built, it has to meet all current building codes. A building that was built to code at one time may not be in compliance at a later date. The time from being compliant, at the construction date, to being out of compliance can vary from months to several years depending on the frequency and nature of changes in city ordinances or laws. The ordinance and requirements can originate from many sources: local, state or federal. A common

Example of a Federal code is the American with Disabilities Act (ADA), requiring building owners to build with the proper additions to aid disabled people and make common area element more accessible.

An example of a loss most likely to affect your association triggering Ordinance coverage: A unit is completely damaged and upon reconstruction, the city requires the

installation of sprinklers and a fire suppression system to the entire building to bring it back up to code.

Premise Liability Coverage

Comprehensive General Liability

Provides protection on behalf of persons insured for all sums which they become legally obligated to pay while their policy is in force arising out of the following:

- Personal Injury
- Bodily Injury
- Fire and Specified Perils Legal Liability
- Property Damage
- Liquor Liability

You must meet or exceed the Liability Insurance Requirements set forth in your Association's CC&R's.

Freddie Mac/Fannie Mae Lending Guidelines require a minimum of \$2,000,000 Liability for Associations with fewer than 100 units, and \$3,000,000 Liability if the common interest development consists of more than 100 units.

Medical Payments

Will pay for the reasonable medical expenses that arise for each person who requires medical services because of bodily injury caused by your operations. The ISO standard policy will pay up to \$5,000 for the medical expenses per person injured. Medical payments are provided regardless of whether it is due to Association's negligence or if it's simply an accident.

Example: Necessary medical, surgical, x-ray and dental services for a covered loss.

This coverage is designed to deter larger Liability claims from occurring. If you pay medical bills promptly, the injured party is less likely to sue.

Directors and Officers Liability

As board members, you are in charge of making day to day decisions on behalf of the Association. D&O liability covers the legal liability of the condominium officers and directors acting in their legal capacity as association officials and also includes duly appointed committee members. It is important to make sure your D&O policy also includes coverage for property managers.

Example: A board member fails to comply with their fiduciary responsibility and is sued by a third party.

- **"You failed to maintain proper lighting outside of my unit and I fell down the stairs and broke my hip."**
- **"You failed to keep the pine needles cleaned up during rainy season and I slipped and fell."**
- **"You painted my unit pink and diminished the real estate value of my home, which I can no longer sell because of the undesirable color."**

Non-Owned Auto Liability

Covers the insured from an accidental event arising out of the use, including loading and unloading, of any non-owned automobile in your business by any person other than you.

Example: The treasurer drives to the post office to purchase stamps for the association.

Hired Auto

Covers vehicles hired by the insured with or without a driver.

Example: The association hires a moving truck for a community garage sale.

Umbrella & Fidelity Bond Coverage

Excess Umbrella Liability

Pays on behalf of the insured when the insured is legally responsible for personal injury or property damage. It protects the Association's assets against the large, unexpected lawsuit which would seriously cripple, even bankrupt most Associations.

There are important components to consider when determining the appropriate limit of liability and your potential risk for liability claims. What common liability exposures live on your premises?

- Pools, Ponds & Lakes (drowning exposure) - Where there is water, there is exposure). HOA's should consider higher limits of liability by adding an Umbrella Policy to extend over underlying liability limits.
- Trails and Walkways - (trip and fall exposures)
- Tot lots and playgrounds - (child injury exposure)
- Cracks in Paved surfaces- walkways/driveways etc. (trip and fall exposure).

Fidelity Bond Coverage

A Fidelity Bond covers the Association should a board member or property manager steal the association reserve funds. When coverage is shown in the Declarations for Employee Dishonesty, we agree to pay you for the loss of money, securities and other personal property for an amount not exceeding the limit of liability shown in the Declarations. This coverage applies to any fraudulent or dishonest act committed by any of your employees, whether acting alone or in collusion with others.

As an insurance standard, the Davis-Stirling Act recommends the Association carry coverage in the amount of the reserves plus three times the monthly operating expenses. It is important to review the financials annually to make sure the funds are properly covered.

Example: A board member steals the reserve funds and travels to Mexico for a life-long vacation.

Additional Association Insurance Policies to Consider

Earthquake

You might not think you live in earthquake country, but at least 41 states are considered to be in moderate to very high risk earthquake areas. According to the United States Geological Survey (USGS), Alaska, Alabama, Arkansas, California, Hawaii, Illinois, Kentucky, Montana, New Mexico, Oregon, South Dakota, Virginia, Washington and Wyoming have all been hit with a 4.0 or above magnitude earthquake since 2003.

Lessons Learned

Some of the largest earthquakes have been in our backyard (California). The 1989 Loma Prieta earthquake in Northern California, measured 7.1 on the Richter scale. The destructive quake caused 63 deaths, 3,757 injuries and \$6 billion in property damage. Five years later, Southern California was hit with a major earthquake. The Northridge earthquake had a 6.7 magnitude and was felt up to 2,000 square miles away. The quake killed 60 people, injured 11,000, left 20,000 homeless and damaged more than 40,000 buildings.

The good news is that the industry has learned a great deal since these earthquakes occurred. We invite you to learn more about earthquakes, how they may affect you and what you can do to protect one of your biggest financial assets – your home.

For a map of California showing the location and size of recent earthquakes see <http://quake.usgs.gov/recenteqs/latest.htm>

Frequently Asked Earthquake Questions

Doesn't my Association's Master Policy cover loss due to Earthquake?

No. Most standard homeowners, condominium, and renter's insurance policies do not cover earthquake damage. Similar to flood insurance, earthquake insurance must be purchased separately.

Many people assume their residential insurance policy fully protects them, but in fact, the policies specifically exclude coverage for an earthquake loss. If an earthquake strikes tomorrow, will you have the financial resources to pay for earthquake damage to your home and its property?

When you consider your resources, ask yourself how much of the investment in your home you are willing to put at risk. For many California homeowners, their home is their biggest financial asset. Without earthquake insurance, how do you plan to protect that asset from the costs of earthquake damage? If you have a typical home loan and deed of trust, did you know you remain responsible for the loan balance even if your home is damaged or destroyed by an earthquake?

Is there any scenario under which I would have coverage from my Association's Master Policy?

Yes. According to most insurance company adjusters, if a fire started as a result of an earthquake and you didn't have earthquake coverage on your home, the insurance company would pay you for the damage to your home as a result of the **fire**, after the earthquake.

If my Association suffered an Earthquake loss, won't the Government be there to help?

The Federal Department of Homeland Security's Federal Emergency Management Agency (FEMA) and the Governor's Office of Emergency Services (OES) in California respond to, plan for, and help mitigate effects of disasters. Government disaster-relief programs are designed to

help you get partly back on your feet, but cannot replace your home and everything you lose. The primary form of federal disaster relief is a low-interest loan—as a loan, it must be repaid. Because it is a loan that must be repaid, some people do not qualify for the loan. FEMA grants for post-disaster emergency home repairs and temporary rent assistance are only available to individuals and households who do not qualify for loans.

What are my earthquake risks?

No part of California is "immune" from earthquakes—in other words, there is no “low-risk” area in California for Earthquakes—there are only areas of lower or higher risk. In general terms, your home’s risk level depends on where you live in relation to earthquake faults, the age and type of dwelling you live in, and the soil types where you live.

Some parts of California that have not experienced earthquakes for 200 years or more might be more susceptible to earthquakes than areas that have experienced recent earthquakes. Why? Earthquake faults build up tension over long periods of time; we experience an earthquake when this tension is suddenly released. It is theorized that relatively recent earthquake activity means that faults have released built-up tension—a lack of earthquake activity can mean that tension is still building and could be released at any time as an earthquake.

Can I buy my own Earthquake Insurance Policy? What is CEA coverage “Mini-policy”?

Individual earthquake coverage is available and offered by the California Earthquake Authority. In 1996, by act of the California Legislature, a reduced-coverage, catastrophic earthquake-insurance policy became available. This earthquake "mini-policy" is intended to protect a policyholder’s dwelling—to provide a "roof over your head"—while excluding coverage for costly non-essential items such as swimming pools, patios, and detached structures. The base CEA policy is based on and authorized under the mini-policy law. Such mini policies are intended to provide a basic level of \$75,000 loss assessment coverage to help the policyholder in the event of a catastrophic loss, while keeping premiums more affordable for consumers.

A CEA policy is designed to assist the homeowner in paying the “Per Unit Loss Assessment” they would be responsible for paying in the event of a loss. A homeowner can buy this insurance whether or not the Association has a master earthquake policy but if it does, then the premium for this CEA policy will be less. Because CEA coverage is a basic level policy, the homeowner should be advised that this policy is designed to help supplement a catastrophic earthquake loss. CEA coverage is not full replacement cost coverage, as it does not provide enough coverage to completely rebuild the dwelling. However, individual CEA coverage can be purchased to supplement the loss assessment deductible from the Association’s Master Earthquake Policy.

Flood Policy

Anywhere it rains, it can flood. Many conditions can result in a flood: overtopped levees, outdated or clogged drainage systems and rapid accumulation of rainfall. Just because you haven't experienced a flood in the past, doesn't mean you won't in the future. Flood risk isn't just based on history, it's also based on a number of factors: rainfall, river-flow, flood-control measures, and changes due to building and development. Flood-hazard maps have been created to show different levels of risk for your community, which also determine the cost of flood insurance based on your location/ flood zone. You can visit www.Floodsmart.gov for additional information and talk to your Insurance Agent to discuss proper ways to insure an HOA.

Workers Compensation Policy

There has long been a debate on whether your Association should or shouldn't carry workers compensation coverage. **The Answer: You should.**

- **For Associations that HAVE direct employees on payroll:** It's an easy decision for Associations that have direct employees on payroll. It is required by both California Law and the CC&R's that you purchase and maintain Workers Compensation Insurance.
- It is important that you provide your agent with the Employee's complete scope of work as some Workers Compensation Carriers exclude coverage in the event of a claim if the insured failed to inform the carrier of all operations performed by the employee.
- **For Associations that DON'T HAVE direct employees:** Even if an Association has no employees, it can still have workers compensation liability exposure. In a recent decision, the Court of Appeals held that an Association and its managing agent were both liable to pay workers compensation benefits to an injured worker employed by an uninsured and unlicensed contractor.

Potential Claim Examples

- Unit Owner John Smith is leaving for work one morning and notices that a Soccer Ball is stuck in his tree. He asks one of the nearby HOA landscapers to bring his ladder and take the ball down. While the landscaper is climbing his ladder (as a direct order given by the unit owner), he falls and breaks his leg. *Who is liable and how would a California Court rule?*
- Best Ever Management Company prides itself on being very thorough. They annually obtain proof of insurance from their licensed and insured vendors showing proof of Liability and Workers Compensation coverage. Best Ever Management obtains the certificate at renewal, reviews it, and files it away until next year. Little did they know that 45 days after they obtained the certificate, their landscaper let their insurance lapse for non-payment. There is an accident and the landscaper is hurt. The landscaper decides that because he doesn't have Workers Comp Insurance, he is going to sue the Association. *Who is liable and how would a California Court rule?*

There is a simple solution. Associations that don't have direct employees should carry a minimum premium Workers Compensation policy that is priced around \$600 a year and protects the Association in the event they are found liable for a Workers Compensation loss.

Maintenance

Every association has certain obligations for maintenance and repair of common area elements. These responsibilities are outlined in the governing documents of the association and require planning and financing to be effective. In this course we will examine the various types of maintenance a Board will be required to perform and methods that have proven effective for fulfilling these obligations in a responsible and professional manner.

Responsibility

The governing documents of the association will outline the maintenance responsibilities of the association and individual owners. There are many questions to be answered and each association may have its own unique definitions for common area, limited (or exclusive use) common area and individual unit ownership and responsibility.

It is important to check your Declaration of Covenants and By-laws for specific responsibilities relative to your association.

Common Area

Typically, the governing documents of association will assign the cost and responsibility to repair and maintain the common area to the association. Common area/element often includes structural and external building components, landscaping, roads, parking lots, and amenities.

On the surface this would seem a simple proposition. However, governing documents are not always clear and associations have spent countless dollars for legal opinions regarding what is, and what is not, a common element. If the Board is unclear about responsibility for repair and maintenance of a common element, it should consult its attorney for assistance. Do not guess!! Guessing wrong can needlessly cost the association considerable sums and set damaging precedents for the future.

Exclusive Use Common Area

Typically, but not always, the association will be responsible for the repair, maintenance and replacement of those elements defined in the governing documents as "limited common elements". Generally, these are elements limited to the exclusive use of an individual owner or are appurtenant, (attached) to an individual unit.

Some examples of typical limited use common elements are balconies or decks, storage lockers and garage spaces. There are many others and again, the place to look for what they are in your association is the Declaration of Covenants, Conditions and Restrictions and the By-laws.

Responsibility for maintenance of these items can be vague and the Board should consult its attorney whenever there is a question about what must be maintained and who must maintain it.

Types of Maintenance

Regular

Routine maintenance involves tasks that are required on a regular basis to maintain the cleanliness, safety and/or upkeep of the property. These items might include cleaning and custodial chores, life safety equipment inspection and testing, pool and other amenity maintenance.

Sometimes these routine chores (changing burned out light bulbs, etc.) can be done by a handyman or cleaning service. Others will require hiring a contractor with specialized expertise.

Whatever the case may be, a written schedule of inspections and maintenance tasks needs to be maintained by the association. This will assist in tracking expenses and help identify opportunities for improvement in the routine maintenance of the property.

Preventative

The advantages of a preventative maintenance program are obvious. Prolonging the life of common elements and mechanical systems can save the association members huge sums of money overtime.

A preventative maintenance program involves a schedule of cleaning, care and repair of facilities and equipment, which is designed to prolong its useful life. Pumps, motors, roofs and gutters, community gates, irrigation and plumbing systems, and virtually all other major components require preventative maintenance. A good place to look to help identify these items might be the replacement reserve study. It will usually include most items that will benefit from a preventative maintenance program.

An effective preventative maintenance program will include a written schedule of inspections to be performed for each of the included elements. Some will require annual inspection. Many will require more frequent inspections.

A written maintenance calendar is useful to make certain no item is overlooked. Maintenance schedules and procedures for most components can be acquired from the manufacturers; still others may require the input of a licensed contractor who can be hired to draft preventative maintenance specifications. Many association management firms can also be contracted to help create a preventative maintenance program and will work with outside experts to assemble the required documentation and specifications.

Deferred

Deferred maintenance is maintenance that the association might choose to defer for either economic or other practical reasons (i.e., contractors are unavailable, supplies are not available, inconvenience to the members, season of the year). Most associations face the question of deferred maintenance on a regular basis. The question almost always boils down to, “What can we afford and when can we afford it?”

A good reserve study can help with planning for the economic impact of maintenance. However, the best reserve study in the world will not help if the reserve is inadequately funded. Remember, whatever the cost of the item today, it will nearly always be more expensive tomorrow.

If the Board decides to defer a maintenance item certain key questions must be answered:

- Will other elements/systems be affected?
- What will the additional associated costs be down the road?
- Who will be most impacted?
- Will the health or safety of the residents be jeopardized?
- Will the structural integrity of the building or any of its components be jeopardized?

Emergency

Occasionally, an association will be faced with the need to perform maintenance outside of the maintenance plan. Unforeseeable circumstances can arise that require immediate attention. These occurrences may create a threat to the health, safety and welfare of the residents or the structural integrity of the building. When this happens it is useful to have an emergency plan in place.

An emergency maintenance plan includes procedures for dealing with contractors, homeowners, governmental agencies and even the press in some cases. A good emergency maintenance plan might include:

- Organizational chart of responsible parties (who calls whom, who does what?)
- Emergency phone numbers
 - General contractors
 - Emergency cleanup companies
 - Insurance agents/adjusters
 - Disaster relief agencies/contacts
- Evacuation procedures
- Temporary housing procedures

Creating and following a detailed maintenance plan can help minimize the risk of ever needing to perform emergency maintenance. However, it is always better to be prepared than to be caught unprepared.

Maintenance Programs

The first step to creating an effective maintenance program is to define the scope of the requirements. Conduct a thorough inspection of the entire property to check the condition of the buildings and equipment. As mentioned earlier, the current reserve study is a good tool to use to help determine what items should be inspected. This will require creating an inventory of the property (if one does not exist). You will need to define the warranty period for all equipment being maintained and, as mentioned above, you may need to contact the manufacturer to determine maintenance procedures.

The second step is to define the association's maintenance goals and standards. Determine the greatest areas of financial impact first. Then look at the issues that affect the quality of life of the members. Keep in mind that curb appeal plays a major role in the value of the units. You will also need to check the governing documents for any standards they may establish. Finally, contact professionals and contractors for recommendations regarding the equipment and elements that need to be maintained.

Once the need has been established for a good maintenance program to be put into place, the association is faced with determining how best to implement its plan. There are alternatives. In-house maintenance and contract programs each have their own advantages and disadvantages. We will examine each in the following section.

Contractors

In-House Vs. Outside Contractors (Employee vs. Contractor, insurance, worker's comp, etc.)

Many large associations, and some smaller ones as well, choose to perform maintenance by using "in-house staff" rather than outside contractors. In larger associations this might involve hiring a maintenance person who helps draft and then implement the plan. In some smaller, self-managed associations volunteers take on the responsibility.

The advantage of volunteers performing the required tasks seems obvious. It may save money. Keep in mind things may not be what they seem.

The perceived savings is accompanied by disproportional risk. In-house maintenance programs staffed with volunteers may create the need for additional insurance to cover the volunteers in case of injury or death. In addition, should a maintenance task be substandard the association will not have much recourse against a volunteer member of the association. Finally, it may be difficult, on an ongoing basis, for the association to find an adequate volunteer labor force willing to be trained and to perform the required functions. For all of the reasons stated above, in-house programs that rely on volunteers are not recommended.

In-House Contractors

In-house programs that rely on hired staff are another matter. This type of program generally gives the association more control over the activities and work being performed as part of the maintenance program. In-house staff also brings immediacy to the work required. They are typically available when and where work needs to be done.

There is a down side however. In-house staff is usually more expensive than using outside contractors. Hiring, training, insurance, supervision, employment policy, taxes, cost of tools and vacation coverage all factor in. For larger association there may be an economy of scale but for most medium and small sized associations this type of program is cost prohibitive.

Outside Contractors

Using outside contractors to execute the association's maintenance plans has advantages and disadvantages as well. Using an outside contractor allows the association to create a contractual obligation to adhere to the standards it sets. Most outside contractors will be able to bring a higher level of expertise to a wider variety of areas than a limited in-house staff. In addition, using outside contractors eliminates the need for capitalization of tools & equipment. Finally, contractors typically require little or no direct supervision. By contract they will be responsible for work being performed according to the specification of the contract.

The disadvantages of outside contractors might include a loss of control by the association over how certain functions are performed. It is also likely that an outside contractor might be less immediately available for emergencies. Finally, in some cases, the association may experience higher costs for certain work or functions.

Choosing a Contractor

Service Contract

This type of contract typically covers recurring maintenance that needs to be performed on a regular basis. Examples are pool and landscape maintenance. All service contracts need to be based on detailed specifications and can be negotiated annually to suit the association's fiscal abilities.

Specific Repairs

Specific repairs or maintenance contracts are targeted at one time repairs or maintenance projects that are infrequent or occur at less than regular intervals. Examples of this type of contract might be a painting, asphalt or roof repair project. Again, this contract will need carefully drafted specifications and may also require the use of a licensed contractor acting as project supervisor.

Preventative Maintenance

A preventative maintenance contract provides for regular inspection and maintenance of building and mechanical elements. Examples might be HVAC systems, boilers, water systems, elevator service contracts, etc.

Maintenance Contracts

Specifications

Most associations create a policy for triggering the need for specifications. Frequently this policy involves a dollar limit above which specifications will be required. Something to keep in mind when creating your policy is that work costing as little as \$1000 may be as important and as complex as a job costing hundreds of thousands of dollars. A good yardstick is to take cost and impact of the work into consideration when deciding whether specifications are required.

After the policy is in place the association should hire a qualified professional to draft the necessary specification. All too often associations unwilling to pay a professional will ask the manager to draft a specification for free, try to draft one themselves or worse, ask a contractor to write a bid for the work and then send that bid to other contractors as a basis to bid the project. Setting aside the ethical considerations, what the association will receive back from

other vendors are bids based on the job as the first contractor saw it rather than the job as specified by a disinterested third party professional. All these bids will likely vary in scope and methodology and it will be extremely difficult to “compare apples to apples”.

To protect itself and to be certain adequate specifications are drafted the association is well advised to seek the services of a qualified outside professional. While this may be a little more expensive in the short term it nearly always pays dividends long term.

Specifications should include the scope of work to be performed, exact requirements of the job and performance schedules, in some cases, materials to be used, payment terms (including a delay of final payment to give the association’s construction manager a reasonable opportunity to inspect the work), penalty clauses and requirements for appropriate licenses and insurance coverage. The specification should also include communication procedures including contact personnel and procedures for handling change orders.

Bidding

After the specification has been approved it can be let out to bid. Be reasonable in the number of contractors you select to send the bid to. Often three or four bids are sufficient. You can ask the professional who drafted the specification for any recommendations he/she might have. It will also be a good idea to hire this individual to evaluate the bids as they are received and even to make a final recommendation on the contractor to hire based on the bids. Relying on the advice of an expert involving work that falls outside the association’s expertise helps assure the association is performing in accordance with the “business judgment rule” and may help minimize its liability if something goes wrong.

If there will be multiple bidders on a project, you may want to hold a “bidders conference” on-site to discuss your expectations of the process. Setting the level of expectation early will result in clearer and more useful bids. Be certain to check references of the contractors and try to visit other jobs they are performing or have performed. Check the contractor’s current business licenses and insurance certificates. Ask pertinent questions about their work with other associations and any legal or financial difficulties they may be having. Finally, select a contractor that seems to best be able to perform the work according to the specification. When you have made your selection it is a good idea to ask the association’s attorney to review the contracts before they are signed and work begins.