

DIVISION OF FLORIDA CONDOMINIUMS, TIMESHARES,
AND MOBILE HOMES

DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION



BUDGETS & RESERVE SCHEDULES

A Self-Study Training Manual for Beginners



1940 NORTH MONROE STREET, NORTHWOOD CENTRE , TALLAHASSEE, FLORIDA 32399-1032

Budgets & Reserve Schedules
A Self-Study Training Manual for
Beginners

PUBLISHED BY THE
Department of Business and
Professional Regulation
Division of Florida Condominiums,
Timeshares, and Mobile Homes

Revised: May 2007

TABLE OF CONTENTS

FIGURES & TABLES.....	5
PREFACE.....	6
1 GETTING STARTED	8
WHY DO ASSOCIATIONS HAVE A BUDGET?	8
WHEN TO BEGIN THE BUDGETING PROCESS	8
MEETINGS HELD WHILE DEVELOPING THE BUDGET	8
SAMPLE NOTICES.....	9
ABOUT ACCOUNTING RECORDS	9
ACCOUNTING SOFTWARE.....	10
GOOD ACCOUNTING PRACTICES	10
PROVIDING ACCESS TO ACCOUNTING RECORDS.....	10
SUMMARY OF CHAPTER 1	11
PRACTICE EXERCISES	14
ANSWER KEY.....	15
2 THE BUDGET	16
SECTIONS OF THE BUDGET	16
USE OF RESERVES FOR OTHER PURPOSES.....	16
INVESTING ASSOCIATION FUNDS	18
FISCAL YEAR	19
SUMMARY OF CHAPTER 2	19
PRACTICE EXERCISES	25
ANSWER KEY.....	27
3 RESERVES.....	28
WHAT ARE RESERVES?	28
DEFERRED MAINTENANCE & CAPITAL EXPENDITURE RESERVES	28
EXAMPLES OF CAPITAL EXPENDITURES	29
PRACTICE EXERCISES	30
DIFFERENT TYPES OF RESERVES.....	30
POOLED RESERVES	31
WHY ESTABLISH RESERVES?	31
WAIVING OR REDUCING RESERVES.....	32
PRACTICE EXERCISE	34
TYPES OF RESERVES TO ESTABLISH.....	35
ESTIMATING RESERVES	35
SUMMARY OF CHAPTER 3	36
ANSWER KEY.....	36
4 RESERVE SCHEDULE.....	38
WHAT IS A RESERVE SCHEDULE?	38
RESERVE SCHEDULE DISCLOSURES	38
STEP SIX COMPUTE THE CURRENT YEAR FUNDING REQUIREMENTS AND WRITE THE REQUIREMENTS ON THE SCHEDULE	41
ADJUSTING THE SCHEDULE.....	44
PREPARING THE POOLING SCHEDULE	44
POOLING METHOD RESERVE SCHEDULE DISCLOSURES	47
HOW TO FUND RESERVES	49
PRACTICE EXERCISES	50

ANSWER KEY	51
5 OPERATING EXPENSES.....	52
THE BUDGET	52
THE ASSOCIATION'S ACCOUNTING INFORMATION SYSTEM	52
ACCRUAL BASIS OF ACCOUNTING AND CASH BASIS OF ACCOUNTING	54
ESTIMATING THE ASSOCIATION'S OPERATING EXPENSES	54
HISTORICAL DATA	55
CONTENTS OF THE OPERATING SECTION OF THE BUDGET.....	56
TIPS ON PREPARING THE BUDGET	57
BUDGET LINE ITEMS EXPLAINED.....	58
SUMMARY OF CHAPTER 5	58
6 ASSESSMENTS.....	59
HOW DO I COMPUTE THE ASSESSMENTS?	59
PRACTICE EXERCISES	61
THE BUDGET ADOPTION PROCESS.....	62
BOARD APPROVED BUDGET	62
UNIT OWNER-APPROVED BUDGET.....	62
BUDGET EXCEEDS 115 PERCENT OF PRIOR YEAR'S ASSESSMENTS.....	63
PRACTICE EXERCISES	66
COLLECTION OF ASSESSMENTS.....	67
SUMMARY OF CHAPTER 6	68
ANSWER KEY	69
7 REVIEW	70
FINAL PRACTICE EXERCISES	72
ANSWER KEY	75
CONCLUSION	76
APPENDICES	77
<u>REFERENCES</u>	81
<u>GLOSSARY</u>	81

FIGURES & TABLES

Table 1.1 Summary of Chapter 1	11
Figure 1.1 SAMPLE NOTICE THAT IS PROPER	12
Figure 1.2 IMPROPER SAMPLE NOTICE	13
Table 2.1 Summary of Chapter 2	19
Figure 2.1 Sample Operating Section of the Proposed Budget	20
Figure 2.2 Sample Reserves Section of the Proposed Budget	23
Table 2.3 Examples of How To Compute the Vote To Use Reserves For Other Purposes	24
Table 3.2 Summary of Chapter 3	36
Figure 4.1 Completed Sample Reserve Schedule Using the Segregated Method	43
Figure 4.2 Reserve Schedule Using the Pooling Method	45
Figure 4.2 Continued Reserve Schedule Using the Pooling Method	46
Figure 5.1 Sample Accounts Receivable Subsidiary Ledger	53
Figure 6.1 Budget Increase Does Not Exceed 115% of Prior Year's Assessments	64
Figure 6.2 Budget Increase Exceeds 115% of Prior Year's Assessments	65
Sample Budget For the Fiscal Year January 1, 2002 through December 31, 2002	78

PREFACE

Our Goals

- To describe the budgeting process, and highlight the statutory requirements for preparing the association budget and reserve schedules. This manual relates to associations in which the developer is no longer in control of the association.
- To provide a self-study training manual for condominium association board members and unit owners who are not familiar with preparing the association budget.
- To provide illustrative examples of all related schedules and materials.

Programmed Instruction.

The manual includes practice exercises are included so that you will be able to put your knowledge to work right away. You will benefit from the material more if you master the concepts in each chapter before moving on to the next.

Self-Study / Self-Paced.

The manual provides the basic knowledge needed to prepare a proposed budget and reserve schedule. You can progress and learn at your own speed. The chapters are short to make it easier for you to learn the material and organize the content for future reference.

Teaches Concepts in Sequence.

The manual is arranged so that you learn from start to finish how to prepare a proposed budget and reserve schedule. We suggest that, as you progress, you look at your own association's budget and reserve schedule and compare it to the information provided. Another alternative is to use the manual to develop a proposed budget and reserve schedule for your own association as you learn the concepts.

A review is provided after all of the chapters have been completed. In addition, you will have the opportunity to assess your level of knowledge by responding to some questions. The more you apply your knowledge, the more information you will retain.

Based Upon Statutes and Administrative Rules.

Although not needed to complete the manual, you should review the Condominium Act, and Chapter 61B-22, Florida Administrative Code.

Is This Manual For You?

The manual is designed for board members and unit owners with limited knowledge or experience in preparing a budget or reserve schedule. The manual should also be of assistance to experienced board members who would like a refresher course, or someone who has just volunteered to serve on the budget committee.

Additionally, you should have a copy of your association bylaws and declaration of condominium available for reference.

The manual was written at an introductory level to assist individuals who fulfill the criteria stated above. Therefore, topics such as multicondominiums, limited common elements, and issues pertaining to associations that are still controlled by the developer are only briefly addressed. It must be recognized that the complexity and sophistication of budget preparation will vary based upon the size of the association. In other words, there is no “one size fits all” sample budget, and budgets for different associations will not look the same. However, all budgets must contain those disclosures required by the Condominium Act and administrative rules.

Others who *might* benefit include newly licensed community association managers, managers who need to refresh their memory about basic statutory and administrative rule requirements, and certified public accountants and developers who are not familiar with condominium or cooperative budgeting requirements.

Suggestions For Improvement?

If you have any comments or suggestions for improvement of this manual, please submit your ideas to the Division of Florida Condominiums, Timeshares, and Mobile Homes, Attention: “Budgets and Reserve Schedules,” 1940 North Monroe Street, Northwood Centre, Tallahassee, Florida 32399-1032.

1 Getting Started

This chapter addresses why associations should have a budget, when to start work on the proposed budget, how various meetings should be noticed, and provides information about accounting records.

Why Do Associations Have A Budget?

Operating an association can be compared to running a business. The board of directors of every corporation must have a plan to anticipated revenues and expenses for the upcoming year. The board protects the stockholders by estimating how much money must be earned in order to pay the corporation's expenses. Condominium associations are operated in much the same manner.

An association's budget assists the board of directors by projecting expenses and creating a benchmark by which to compare the board's stewardship of the financial assets of the association. The budget provides for control over certain restricted funds of the association. It also identifies how much money must be collected from the unit owners and how often the collection must be made. Basically, the budget is simply a map that will guide the board in making decisions during the course of the year. Since the budget is only an estimate of future expenses unexpected events may occur that will require the board to make changes to the budget during the budget period.

When to Begin the Budgeting Process

It is a good idea to start gathering information needed to prepare the proposed budget three months before it becomes effective. This should give you plenty of time to do such things as compare historical budget versus actual performance, research the payment histories of association members, identify and talk to key people about the costs of equipment and services, and determine whether additional expenditures are needed to maintain the property, etc.

Meetings Held While Developing the Budget

Often, the board or budget committee will meet to gather and discuss information and make decisions as the proposed budget is developed. Notice of these meetings must be posted appropriately and open to the unit owners. You need to be aware of the laws about noticing these meetings. The Condominium Act, Chapter 718 of the Florida Statutes, and the related administrative rules provide guidance on this topic. In short, they indicate that board meetings and committee meetings have the same notice requirements.

Note that any meeting at which the budget will be considered for adoption requires a 14 day notice. Board and committee meetings at which the budget will not be considered for adoption require 48 hour notice to the unit owners.

Some tips for preparing board and committee meeting notices are:

- Ensure you have plenty of time to prepare the notice. Specify the date, time, and location of the meeting on the notice;

- Include a list of specific agenda items to be addressed in the meeting; and
- Post the completed notice in a conspicuous location on the property at least 48 hours before the meeting. (A specific location for posting meeting notices should have already been designated.)

If there is no property to post the notice on, it must be mailed or delivered to the unit owners at least 14 days before the meeting. Keep in mind that if the condominium documents (e.g., declaration of condominium, bylaws, and articles of incorporation) provide guidelines that are more restrictive than the statutes, then the documents must be followed. For example, the law addressing notice of board and committee meetings requires 48 hour notice preceding the meeting except in an emergency. If the condominium documents require 72 hours notice before the meeting, the association must provide 72 hour notice. On the other hand, if the documents require 24 hours notice before the meeting, the association must provide at least 48 hours notice.

Sample Notices

Figures 1.1 and 1.2 on pages 12 and 13 are examples of proper and improper notices of board meetings at which the budget is being developed. Notices you prepare do not have to look exactly like the notice in Figure 1.1. The important point to remember is that your notice must include all required information and be posted by the appropriate date. Check your documents for additional requirements that do not conflict with the statute. Please review the sample notices before proceeding to the next topic.

About Accounting Records

Accounting records consist of all those records that record, measure and communicate financial information, whether maintained electronically or otherwise. These records include items such as:

- Accurate, itemized, and detailed records of all receipts and expenditures;
- A current account and a monthly, bimonthly, or quarterly statement of the account for each unit designating the name of the unit owner, the due date and amount of each assessment, the amount paid upon the account, and the balance due;
- All audits, reviews, accounting statements, and financial reports of the association;
- All contracts for work to be performed. Bids for work to be performed are official records and must be maintained for a period of one year; and
- Any other records that identify, measure, record, or communicate financial information.

NOTE: Multicondominium associations must maintain separate accounting records for itself and for each condominium it operates.

NOTE: The accounting records must be maintained within the State of Florida and retained by the association for at least seven years.

Accounting Software

To facilitate recording, maintenance, and retrieval of accounting information, you may want to consider purchasing some type of accounting software. Software packages, such as spreadsheets and others that are specifically tailored for condominium associations are readily available. The Division cannot recommend specific software. You may want to contact your CPA, licensed community association manager, or other software experts to assist you in locating the software that is appropriate for your association.

Good Accounting Practices

Accounting records should be maintained according to good accounting practices. This means that the accounting records should be maintained in sufficient detail so that when someone inspects the records, that person will be able to determine the assets, liabilities, cash flows, as well as all of the revenues and expenses of the association. Good accounting practices also include controls to protect the financial assets of the association.

As the size of an association increases the complexity of the financial record keeping will also increase. In addition, associations of all sizes are vulnerable to fraud and embezzlement. You should consult a CPA or other professionals to obtain more information on developing adequate internal controls and safeguards.

Providing Access to Accounting Records

One more item to keep in mind before moving on to developing the budget is the concept of access to records. The Condominium Act provides that the accounting records are open to inspection by any unit owner or authorized representative at all reasonable times. Additionally, if a written request for access to the records is received by the association, the records must be made available within five working days. The unit owner or authorized representative has the right to make or obtain copies from the association. A fee cannot be charged for simply accessing the records. Associations may adopt reasonable, clear, and understandable rules addressing:

- How unit owners should provide the association with notice for requesting access (e.g., whether the notice must be in writing and sent by certified mail, to whom the notice should be given, what information the notice must contain, etc.).
- Frequency of access, reasonable restrictions on number of times per week or month that access will be granted.
- Time of access, including all reasonable working hours.
- Manner of inspecting the accounting records (e.g. whether a board member or other designated individual will be present during inspection, whether or not the records can be removed from the location, etc.).
- Location where the records may be inspected or copied.

Note: If the association fails to allow unit owners access to the records the statutes provide for certain remedies, including monetary damages for the unit owner. Please refer to Section 718.112(2), Florida Statutes.

Summary of Chapter 1

The following table summarizes the main points about what you must know to begin developing the proposed budget and reserve schedule.

Table 1.1 Summary of Chapter 1

Three Months Preparation Time	Records Retained for at Least Seven Years
Open Board & Committee Meetings	Good Accounting Practices
Proper Notice of These Meetings	Unit Owner Access to Records
Accounting Records Kept in Florida	Reasonable Rules for Access to Records

Figure 1.1 SAMPLE NOTICE THAT IS PROPER

CANASTA CONDOMINIUM ASSOCIATION, INC.

NOTICE OF BOARD MEETING

TO:	All Unit Owners / Residents
FROM:	Canasta Condominium Association, Inc. Post Office Box 1234 Notices, Florida 54321
DATE:	April 1, 2002

Notice is hereby given that the board of directors will meet on Friday, April 4, 2002, at 7:30 P.M. The meeting will take place in the clubhouse.

AGENDA ITEMS

Call to Order

Statement of Quorum

Proof of Meeting Notice

Approval of Minutes of March 5, 2002

Old Business - Refinish Swimming Pool

Development of the 2003 / 2004 Operating Budget

New Business – Hurricane Shutters

Set Date of Follow-up Meeting

Adjournment

Figure 1.2 IMPROPER SAMPLE NOTICE

CANASTA CONDOMINIUM ASSOCIATION, INC.

NOTICE OF BOARD MEETING

TO:	All Unit Owners / Residents
FROM:	Canasta Condominium Association, Inc. Post Office Box 1234 Notices, Florida 54321
DATE:	April 1, 2002

Notice is hereby given that the board of directors will meet on Friday, April 4, 2002, at 7:30 P.M.

AGENDA ITEMS

Old Business

New Business

Adjournment

ITEMS <i>with an X</i> ARE MISSING
<u> </u> Date. <u> </u> Time. <u> X</u> Location. <u> X</u> List of designated agenda items.

PRACTICE EXERCISES

The board of directors of your association has appointed you to the Budgeting Committee. You're responsible for noticing any committee meetings held to develop the proposed budget package. *(Use this scenario to answer questions 1, 2, and 3.)*

- 1) What is the statutory time frame for noticing these meetings? *(Circle one.)*
 - a) At least 24 hours.
 - b) At least 72 hours.
 - c) At least 48 hours.
 - d) Not addressed by the statute.

- 2) Identify the information that must be on the committee's meeting notices.
 - a)
 - b)
 - c)

- 3) The bylaws state that the board and committee meeting notice must be posted 24 hours prior to the meeting. What will you do? *(Circle one.)*
 - a) Post the notice 24 hours prior to the meeting.
 - b) Post the notice at least 48 hours prior to the meeting.

- 4) Complete the following sentence.

The accounting records must be maintained in _____ and kept for at least _____ years.

- 5) Accounting records must be maintained according to good accounting practices. Based upon the size of the association, the specific practices that are used may vary. Which of the following statements identifies what is meant by the phrase "good accounting practices"? *(Circle all that apply.)*
 - a) The phrase implies a standard of conduct that must be established for good controls over the accounting records and financial assets of the association.
 - b) The phrase implies that the accountant should practice accounting every day.
 - c) The phrase implies that the records should be maintained in sufficient detail to allow for tracking revenues, expenses, assets and liabilities.

- 6) The Condominium Act states that the accounting records are: *(Circle one.)*
 - a) Private records are not accessible by unit owners.
 - b) Open to inspection by any unit owner or authorized representative at all reasonable times.
 - c) Accessible only if the owner or representative makes the request in writing.

- 7) Mrs. Smith mails a letter to the board identifying various accounting records she would like to see. Within what time frame after receiving the written request must the board allow Mrs. Smith access? (*Circle one.*)
- a) 10 business days.
 - b) 5 calendar days.
 - c) 5 business days.

ANSWER KEY

- 1) C. The Condominium Act provides that board and committee meetings held to develop a proposed budget package must be noticed at least 48 continuous hours prior to the meeting. The notice must be posted conspicuously on the property with an identification of agenda items.
- 2) Notices of board or committee meetings held to develop a proposed budget package must include, at a minimum, the following items:
 - a) Date of the meeting.
 - b) Time of the meeting.
 - c) Location of the meeting.
 - d) A list of specific agenda items.
- 3) B. You will post the notice at least 48 hours prior to the meeting because the statute, in this case, is more restrictive than the bylaws requirement of 24 hours.
- 4) The sentence should have been completed as follows:
The accounting records must be maintained in **FLORIDA** and kept for at least **SEVEN (7)** years.
- 5) A. and C. Although the size of the association will determine the specific accounting practices that will be utilized, all associations should adopt accounting practices that fulfill these two criteria.
- 6) B. The records are accessible at all reasonable times. The statutes do not require that a request be made in writing. However, if a written request is made, the association then must allow access within 5 business days.
- 7) C. The records must be made available within 5 business days. It's a common misconception that the association has 10 business days to allow access. Waiting 10 business days creates the presumption that the association *willfully* failed to allow access.

2 The Budget

This chapter addresses the two main sections of the budget, restrictions on reserve funds, investment restrictions on association funds, and the budget period.

Sections of the Budget

The budget has two main sections - operating and reserve. Figure 2.1 on page 20 is an example of the operating section, and Figure 2.2 on page 23 is an example of the reserve section. The operating portion of the budget identifies the categories of expenses (called line items) that relate to the day-to-day operation of the association. These expenses can be anticipated to be incurred on a fairly regular basis such as monthly or annually.

The dollar amounts assigned to each line item are the estimates of how much money may be spent on that particular line item for the budget period. Operating expenses are not restricted to the estimates provided and the board can use money allocated to one operating line item for other purposes. In other words, money in the operating section of the budget is not restricted to any particular purpose.

Examples of line items that are generally found in the operating section of the budget include:

- Bad Debt
- Salaries
- Office Supplies
- Management Fees
- Utilities
- Taxes
- Insurance
- Vending Machines
- Accounting
- Division Annual Fees
- Corporate Fees
- Legal
- Postage
- Office Equipment

The other section of the budget is the reserve section. The reserve section contains funds that are restricted for specific purposes. The Condominium Act requires that reserves be established for certain items including: roof replacement, building painting, pavement resurfacing and any other item of capital expenditure or deferred maintenance that exceeds \$10,000.

Use of Reserves for Other Purposes

As opposed to the operating section, funds that are a part of the reserve section can only be used for the purpose intended, unless approved by a vote of the unit owners. If the board identifies a need elsewhere for the funds, the board cannot simply withdraw and use them. Chapter 3 will cover more specifics about how the funds must be used. The main point here is that reserves can only be used for the purpose intended. Subsection 718.112(2)(f)3., of the Florida Statutes (F.S.)

indicates that reserve funds and reserve interest must be used for authorized reserve expenditures unless their use for other purposes is approved in advance by a vote of the majority of the voting interests at a duly called meeting of the unit owners. In other words, if “just over half” of the voting interests present, or represented by limited proxy, at a meeting of the unit owners. The Division has created a Sample Limited Proxy Form to assist associations with their use. Limited proxies are used if an owner cannot, or chooses not to, vote in person at the meeting. The following example illustrates the steps an association will typically go through to obtain this type of vote:

Example:

Due to recent storm damage the building’s roof needs to be replaced before it was scheduled. The association plans to use funds from the roof replacement reserve account, and it will file a claim with the insurance company. However, this will not generate sufficient funds to pay for the work. The board of directors has determined it will be in the best interests of the association to pull funds from the pavement resurfacing reserve to cover the shortfall. Before this can be done, the board must determine the following:

- 1) The number of units in the condominium.

Assume, for this example, a condominium has 100 units.

- 2) The vote assigned to each unit.

Assume, for this example, that the assigned voting interest is one vote per unit.

- 3) The number of the voting interests needed to establish a quorum. (A quorum must be established at the meeting, in person or proxy, before business can be conducted.)

Assume for this example that the association needs at least a majority (just over half) of the total voting interests need to be present or represented by proxy to establish a quorum. At least 51 of the 100 voting interests are required for the quorum.

- 4) The procedures for calling a unit owner meeting. If proxies are used, a limited proxy, substantially the same as the Division’s Sample Limited Proxy, Form must be provided to the owners.

The board is then able to call the unit owner meeting, and 80 voting interests are present in person and by proxy. Since 80 is more than the required minimum quorum of 51, a quorum is established and the meeting can continue. After counting the votes, 41 votes approve of using a portion of the pavement resurfacing reserve to help pay for the roof replacement.

In this example, the association needed to establish a quorum at the unit owner meeting and obtain approval from at least a majority, or just over half, of the voting interests present or represented by limited proxy to use reserve funds for other purposes. Since a quorum was established and 41 votes (a majority of the 80 votes present or represented by limited proxy) approved the action the board can withdraw the funds needed to help pay for the roof replacement. Note that general proxies may be used for the purpose of establishing a quorum, but only limited proxies may be used to conduct the vote.

Table 2.3 on page 24 provides examples that should assist you in computing the required vote. Please review this before reading the next topic about maintaining association funds.

NOTE: Multicondominium associations should refer to Rule 61B-22.005(7), F.A.C., for procedures on voting to use reserve funds for other purposes.

Investing Association Funds

While the Condominium Act does not restrict the types of investments that associations may use to generate a return on its funds, there are a few things that board members should keep in mind about investing association funds. First, board members have a fiduciary duty to the membership, such relationship requires prudent investment decisions that carefully consider risk and return. Next, board members should consider the deposit limits that are insured by the federal government. The risk to association funds can be limited by spreading the bank accounts out so that no one account has excess exposure. Associations should also consider using separate accounts for operating and reserve investments. There are several reasons that this may be a good idea. Since most associations collect monthly assessments, the operating cash should be highly liquid (readily available) and is usually kept at a level necessary to cover monthly expenses, plus a cushion. On the other hand, reserve funds are usually maintained with less liquidity in mind and generally have higher average balances in the accounts than operating funds. Using a separate account for the restricted fund investments is also a good control procedure that helps ensure that the board does not unknowingly spend funds that are set aside for one purpose on something other than what was intended. Note that section 718.111(14), F.S., prohibits associations from commingling operating and reserve funds except for investment purposes. Investment purposes means that there is an expectation of a return on the principal deposits. Tax implications of the association investment decisions are beyond the scope of this manual. You should seek the advice of your tax professional before making your investment decisions.

NOTE: It is possible that an association may place its funds in accounts other than bank accounts. The term “bank accounts” was used here for the ease of explanation.

NOTE: Multicondominium associations should refer to Rule 61B-22.002, F.A.C., for information on how to maintain the accounting records.

Fiscal Year

The budget must cover an annual operating period known as the fiscal year. The fiscal year may be the calendar year or some other 12 month period. Most Florida condominium associations use a calendar year for their fiscal year (January 1 through December 31). However, alternative fiscal years such as April 1 through March 31 or October 1 through September 30 are also used. The bylaws will usually indicate the fiscal year for the association. You must know what the fiscal year is for the association in order to draft the annual budget.

Summary of Chapter 2

The following table summarizes this chapter's concepts about the budget.

Table 2.1 Summary of Chapter 2

Budget Is Divided Into Two Sections – Operating & Reserve	Operating and Reserve Funds Cannot be Commingled except for investments
Money In Operating Section Is Not Restricted to any Particular Purpose	Bylaws Usually Identify the Fiscal Year
Money in Reserves Section is Restricted to Its Original Purpose	Fiscal Year = Accounting Period of Twelve Months, Usually the Calendar Year
Unit Owners Must Approve Using Reserves For Other Purposes	

Figure 2.1 Sample Operating Section of the Proposed Budget

For the Fiscal Year January 1, 2002 through December 31, 2002

REVENUES	
Assessment Income:	\$345,600
Interest Income:	
Operating Account	\$3,510
Savings Account	<u>2,610</u>
Total:	6,120
Other Income:	
Miscellaneous	\$108
Drinks	4,800
Fax	250
Laundry	9,640
Snacks	600
Games	<u>5,508</u>
Total:	\$20,906
TOTAL REVENUES	<u>\$372,626</u>
Reserves:	
Roof Replacement	\$8,000
Pavement Resurfacing	3,504
Building Painting	18,008
Elevators	800
Clubhouse	3,000
Walkways	<u>3,000</u>
Total	\$36,312
Administration:	
Accounting	\$5,004
Bad Debt	1,054
Annual Condominium Fee	640
Annual Corporate Fee	62
Insurance (D&O, Fidelity, Flood, P&C)	32,004
Legal	804
Licenses and Taxes	
Licenses	504
County	144
State	804
Management Fees	6,000
Office Supplies	2,400
Postage	660
Total	\$50,080
Salaries:	
Casual Labor	\$204
Maintenance Staff	80,012
Payroll Taxes	15,004
Worker's Compensation	17,600
Total	\$112,820
Maintenance and Repair:	

Buildings	\$8,004
Elevators	4,000
Fire Systems	3,000
Grounds	7,008
Supplies and Tools	8,008
Swimming Pool	6,408
Tennis Courts	660
Laundry	5,000
Miscellaneous	504
Total	\$42,592
Utilities:	
Electricity	\$23,004
Pest Control	4,008
Sanitation	14,004
Sewer	28,500
Telephone	1,404
Water	12,504
Total	\$83,424
Vending:	
Drinks	\$2,000
Fax	120
Soap Products	3,000
Snacks	360
Games	120
Total	\$5,600
Other Expenses:	
Security	\$25,008
Rent for Recreational / Other	0
Commonly Used Facilities	0
Taxes on Association Property	0
Taxes on Leased Areas	0
Operating Capital	
Special Enhancements	7,250
Contingency	9,540
Total	\$41,798
ADDITIONAL EXPENSES FOR A UNIT OWNER	
Rent For Unit Subject To Lease	0
Rent Payable by Owner Directly to Lessor	0
Under Recreational Lease / Lease for	0
Commonly Used Facilities	0
Total	\$0

EXPENSES FOR ASSOCIATION & CONDOMINIUM

MONTHLY OPERATING EXPENSES	\$31,052
NET INCOME (LOSS)	\$0
ASSESSMENTS FOR EACH UNIT (160 units)	
Annual	\$2,158
Monthly	\$180
OPERATING EXPENSES (w/o reserves)	\$336,314
TOTAL OPERATING EXPENSES	<u>\$372,626</u>

Figure 2.2 Sample Reserves Section of the Proposed Budget

SCHEDULE OF DEFERRED MAINTENANCE & CAPITAL EXPENDITURE RESERVES (for the fiscal year of January 1, 2002 through December 31, 2002)					
Reserve Items	Estimated Total Useful Life (in years)	Estimated Remaining Useful Life (in years)	Estimated Cost for Deferred Maintenance/ Capital Expenditure (\$)	Estimated Fund Balance as of 12-31-01 (\$)	Funding Required for Proposed Budget Period (\$)
Roof Replacement	12	1	\$95,000	\$87,000	\$8,000
Pavement Resurfacing	18	7	55,000	30,472	3,504
Building Painting	5	4	92,000	19,968	18,008
Elevator Repair & Modernization	25	14	20,000	8,800	800
Clubhouse Roof Replacement	12	1	60,000	57,000	3,000
Walkway Improvements	10	9	30,000	3,000	3,000

TOTALS \$352,000 \$206,240 \$36,312

NOTE: This schedule is for illustrative purposes only and does not represent the Division's position regarding the life expectancies or costs of reserve assets.

NOTE: Multicondominium associations have additional disclosure requirements for the proposed budget and reserve schedule. Refer to Rule 61B-22.003, F.A.C., for more information.

Table 2.3 Examples of How To Compute the Vote To Use Reserves For Other Purposes

Number of Units As Stated in Documents	50	100	150
Assigned Voting Interest in Documents	1 per unit	40 units get ½ vote each 60 units get 1 vote each	1 per unit
Quorum Requirement As Stated in Documents	<p>Majority of Total Voting Interests</p> <p><u>How To Compute</u> 1 vote x 50 units = 50 voting interests</p> <p>$50 / 2 = 25$</p> <p>-therefore- majority of 50 = 26</p>	<p>Majority of Total Voting Interests</p> <p><u>How To Compute</u> ½ (or .5) vote x 40 units = 20 voting interests</p> <p>1 vote x 60 units = 60 voting interests</p> <p>$20 + 60 = 80$</p> <p>$80 / 2 = 40$</p> <p>-therefore- majority of 80 = 40.5</p>	<p>30 Percent (or .3) of Total Voting Interests</p> <p><u>How To Compute</u> 1 vote x 150 units = 150 voting interests</p> <p>$.3 \times 150 = 45$</p> <p>-therefore- 45 voting interests are required</p>
Voting Interests Required by Statute To Use Reserves For Other Purposes	<p>Majority of Voting Interests Present</p> <p><u>How To Compute</u> Must first establish quorum of 26</p> <p>Vote Required = Majority of Voting Interests Present in Person or by Limited Proxy</p>	<p>Majority of Voting Interests Present</p> <p><u>How To Compute</u> Must first establish quorum of at least 40.5</p> <p>Vote Required = Majority of Voting Interests Present in Person or by Limited Proxy</p>	<p>Majority of Voting Interests Present</p> <p><u>How To Compute</u> Must first establish Quorum of 45</p> <p><u>Vote Required</u> Majority of Voting Interests Present in Person or by Limited Proxy</p>

PRACTICE EXERCISES

1) (Complete the sentence.) A budget is divided into two main sections -

and

2) Money in the operating section of the budget: *(Circle one.)*

- a) Is restricted to the line items to which it is allocated.
- b) Is not restricted to any particular purpose.
- c) Represent the limit that can be spent on each line item.

3) Funds that are a part of the reserves section: *(Circle one.)*

- a) Can be used for all major expenses that occur regardless of the purpose.
- b) Can be used for any purpose as long as there is plenty of money in the reserve.
- c) Can only be used for the purpose intended.

4) Your association's board of directors wants to begin setting money aside for the flood insurance premium that's due in three years. The board wants to ensure these funds are not accidentally used for everyday expenses. What could the board do? *(Circle one.)*

- a) Create a line item entitled "Flood Insurance Premium" in the operating section of the budget, and put the money with the operating funds.
- b) Create a line item entitled "Flood Insurance Premium" in the reserves section of the budget, and put the money with the reserve funds.

5) Your association needs to repair the roof that was damaged in the storm. The roof reserve has some money but not enough. The board has decided to pull money from the pavement reserve to supplement the roof reserve funds. What vote is required to do this? *(Circle one.)*

- a) A majority of the entire board.
- b) A majority of the voting interests present at a unit owner meeting.
- c) A majority of the total voting interests.
- d) Whatever is set forth in the documents.

- 6) Section 718.111(14), F.S., requires that operating and reserve funds be maintained in a certain manner. *(Circle the correct statement.)*
- a) Operating and reserve funds can be commingled for investment purposes.
 - b) Operating and reserve funds cannot be commingled unless approved by a vote of the unit owners.
 - c) Operating and reserve funds cannot be commingled.
- 7) An association's bylaws indicate that the operating year is a calendar year. When does this association's operating year begin and end? *(Write your answer in the space provided.)*

ANSWER KEY

- 1) The sentence should have been completed as follows:
A budget is divided into two main sections - OPERATING and RESERVE.
- 2) B. Money in the operating section of the budget is not restricted to any particular purpose. The board can generally use money allocated to one line item for other purposes if the need arises.
- 3) C. As opposed to the operating section, any funds that are a part of the reserves section can only be used for the purpose intended.
- 4) B. Since (a) the board wants to ensure that funds will be available in three years to pay for the flood insurance premium, and (b) money in the reserves section of the budget must be used for the purpose intended, the board could create a line item for this in the reserves section. If the money is placed in the operating section, there's a greater chance that the insurance premium funds would be used for everyday expenses.
- 5) B. The Condominium Act states that reserve funds and reserve interest must be used for authorized reserve expenditures unless their use for other purposes is approved in advance by a vote of a majority of the voting interests present or represented by limited proxy at a duly called meeting of the unit owners.
- 6) A. Associations are prohibited from commingling, operating and reserve funds except for investment purposes.
- 7) The response is JANUARY 1 TO DECEMBER 31. A calendar year by definition is an accounting period that begins on January 1 and ends on December 31.

3 Reserves

This chapter addresses reserves, why they are established, what types of reserves must be included in the proposed annual budget, and the different reserve funding methods. This chapter also provides some ideas on obtaining estimates for reserve items.

What Are Reserves?

Reserves are monies set aside for specific expenditures that will be incurred in the future. Usually, such expenditures relate to the cost of major repairs to, or replacements of, the condominium property. If money is not set aside for these expenses, unit owners will usually have to pay a special assessment at the time such repair or replacement occurs. Reserves may also be established for other types of expenditures that are paid infrequently, such as a premium for a three-year flood insurance policy.

When funds are set aside for a specific use, whether it's for repairs to or replacements of the property or for other purposes, means the association must comply with certain requirements such as disclosing reserve information in the budget as well as in the year-end financial reporting disclosures.

The definition of reserves is found in Rule 61B-22.001(5), F.A.C.

DEFINITION ALERT

Reserves means any funds, other than operating funds, that are restricted for deferred maintenance and capital expenditures, including the items required by Section 718.112(2)(f)(2), FS, and any other funds restricted as to use by the condominium documents or the condominium association. The reserves required by the Condominium Act are discussed below.

Deferred Maintenance & Capital Expenditure Reserves

Examples of capital expenditure and deferred maintenance reserves include:

- Roof Replacement
- Building Painting
- Pavement Resurfacing
- Balcony Restoration
- Sidewalk Improvement
- Boardwalk Replacement
- Seawall Replacement
- Air Conditioning Replacement

It is important that you determine the purpose of each reserve item maintained by the association so that you will know what restrictions have been placed on the expenditure of the reserve funds and when it is OK to make expenditures from the

operating account or the appropriate reserve account. The title of each reserve account should specify the purpose for which the funds can be used.

Reserve funds that are restricted for these purposes may not be used for frequent or routine maintenance of the property. These expenses should be paid with operating funds, and the operating portion of the budget should include such estimated routine expenses. The definition of ‘reserves’ includes the terms ‘deferred maintenance’ and ‘capital expenditure.’

DEFINITION ALERT

Deferred maintenance means any maintenance or repair that will be performed less frequently than yearly, and will result in maintaining the useful life of an asset.

Example:

An example of a deferred maintenance reserve is building painting. Painting a building is usually done less frequently than annually, and it results in maintaining the life of the building. Deferred maintenance can be confused with regular or routine maintenance. Touch up painting is a routine maintenance item that should be included in the operating section of the budget and should be paid for with operating funds.

DEFINITION ALERT

A capital expenditure means any expenditure of funds for the purchase or replacement of an asset whose useful life is greater than one year, or a repair to an asset that will extend the useful life of the asset for a period greater than one year.

Examples of Capital Expenditures

An example of a capital expenditure is the purchase of a swimming pool heater. The association may pay for this expenditure with funds from its reserve account titled “Pool-Heater Purchase”.

Another example of a capital expenditure is the purchase of a new lawn tractor to replace the one currently owned by the association. This account could be called “Lawn Tractor Replacement.”

Another type of capital expenditure is a repair such as replacing the pilings to a dock. The dock’s useful life expectancy will be extended by more than one year. This is different from replacing a board here and there on the dock.

It is important to clarify the purpose of a reserve at the time it is created. If a reserve entitled, “Tennis-Court Resurfacing” were established, then the funds in this reserve should not be used to replace the lighting system.

It’s important for the board to clearly identify the purpose of each reserve. Although not required by the Condominium Act, the board should identify the purpose of each

reserve in the minutes. The minutes can be used as a reference for future boards as they make decisions about the use of the reserve funds. If the association's documents require certain reserves, the board should ensure the purpose for each is clearly identified in the documents and in the minutes.

PRACTICE EXERCISES

- 1) *(Complete the sentence.)* Repairs or maintenance that will be performed less frequently than yearly and will result in maintaining an asset's useful life are called

- 2) *(Complete the sentence.)* Spending reserve funds to purchase or replace an asset with a useful life of more than one year or to extend the useful life of an asset more than one year is called

- 3) The board has established a reserve entitled, "Swimming Pool Capital Expenditure Reserve." For which of the following may the board use the funds? *(Circle one.)*
 - a) Purchase pool supplies.
 - b) Replace the pump.
 - c) Clean the Pool.
- 4) The board has established a deferred maintenance *and* capital expenditure reserve entitled, "Golf Cart Replacement." For what purposes may the board use the funds? *(Circle all that apply.)*
 - a) Replacing a golf cart with a new one.
 - b) Replacing the battery (occurs once every few years).
 - c) Paying for the electricity to recharge the battery (occurs daily).
 - d) Replacing the tires with new ones (occurs once every few years).
 - e) Repainting scuff marks caused by frustrated golfers (occurs daily).

Different Types of Reserves

The association is required to by statute to establish reserves for roofing, painting, and paving, and any other deferred-maintenance or capital-expenditure items expected to cost more than \$10,000. In addition to the specific deferred-maintenance and capital-expenditure reserves required by the law, the association may establish other reserves. Examples of other types of reserves can include: insurance premium, general deferred maintenance and capital expenditure reserve, or reserve for purchase of recreational equipment for the clubhouse. Many associations want to have a reserve called "Contingency Reserve." The purpose of this account would be to fund items for which reserves have not been established or to cover unanticipated operating expenses. However, it is inappropriate to create a

“reserve” account for this purpose as there is no apparent restriction on the use of the funds. Consequently, the account does not meet the definition of a reserve, and associations that desire to have a contingency account should budget for a surplus in the operating fund. As stated above, the association may create a reserve for general deferred maintenance and capital expenditures. Funds in this account may be used for any deferred maintenance or capital expenditure project, but not for ordinary operating expenses.

Pooled Reserves

Effective December, 2002, Rules 61B-22.003 and 61B-22.005, Florida Administrative Code, were amended to allow associations to establish “pooled” reserve accounts instead of, or in addition to, individual reserve accounts. This means that an association may have a single source of funds to pay for multiple categories of reserve expenses. For example, if an association establishes a pooled reserve account for roof replacement, building painting and pavement resurfacing, funds may be drawn from this account to pay for any of the three items. Prior to the change in the rules associations were required to maintain separate accounts for each of these items and approval from the membership would be required in order to use funds from one category to pay for another.

Note: Unit-owner approval is required in order to use pooled funds to pay for any expenses that are not allocable to the categories included in the pool. Continuing the prior example, unit-owner approval must be obtained in order to use the pooled funds to pay for a seawall replacement. Also, a pooled reserve account is not the same as a general deferred maintenance and capital expenditures account because the pooled account is restricted to the items specified in the pooled reserve schedule and a general deferred-maintenance-and-capital-expenditures account may be used for any items meeting the definition of these two terms. Consequently, a pooled account may meet the statutory requirements by including the items required by the law, but a general deferred-maintenance-and-capital-expenditures account is not a reserve account required by the law because it is not required to be based on any known expenses at the time the account is established.

Why Establish Reserves?

A Condominium association’s main source of income is assessments (often called maintenance fees) collected from the unit owners. The primary purpose for establishing reserves is to spread the cost of major expenditures over the lives of the assets to be maintained or replaced in order to avoid periodic large assessment increases or special assessments.

Example:

An association repaints the building every five years. The last time the association painted the building it cost \$20,000. The association funds a painting reserve each year in the amount of \$4,000 in order to avoid making a special assessment of

\$20,000 every five years. Note that this example excludes factors such as inflation and interest earnings.

Additionally, reserves add a degree of accountability or control that is not applicable to operating funds. In other words, there are no restrictions (other than using the funds to pay for proper common expenses) for operating funds, but reserve funds may only be spent for the specified purposes unless the unit owners approve a different use of the funds.

Waiving or Reducing Reserves

While a fully funded reserve schedule, as described in chapter 4, must be included in the proposed budget, associations may waive the requirement that reserves be funded or reduce the amount of the proposed funding. It is the board's responsibility to include reserves on the proposed budget and to fully fund those reserves that are not waived or reduced by a vote of the unit owners.

DEFINITION ALERT

The term "fully funded" has two meanings: first, it means that when the proposed budget is provided to the owners, it must show the amount of money that will be required to ensure that, when the time comes, sufficient funds will be available for deferred maintenance or a capital expenditure; and second, it means that, as the association collects assessments during the year, it must set aside all of the money included in the reserve schedule section of the budget.

After the proposed budget is provided to the owners (at least 14 days prior to the budget meeting), vote to waive or reduce the funding of reserves may be taken. Most condominium documents provide the board with authority to adopt the budget, but only the unit owners can waive or reduce the reserve funding requirements. It is helpful to plan the association meetings in such a way that the vote taken to waive or reduce reserves is taken on the same date as the vote to adopt the budget. Keep in mind that a vote to waive or reduce reserve funding is only good for one annual budget. If reserve funding is to be waived for the *next* annual budget, then another unit owner vote must be obtained. Also, a vote to waive or reduce the funding of reserves is not required unless the association intends to waive or reduce the reserve funding.

Table 3.1 on the next page provides some examples of how to compute the vote to waive or reduce the funding of reserves. You will note that the table shows the same requirements for waiving and reducing reserves as for using reserves for purposes other than intended.

Table 3.1 Examples of How to Compute the Vote to Waive or Reduce the Funding of Reserves

Number of Units As Stated in Documents	50	100	150
Assigned Voting Interest As Stated in Documents	1 per unit	40 units get ½ vote each 60 units get 1 vote each	1 per unit
Quorum Requirement As Stated in Documents	Majority of Total Voting Interests <u>How To Compute</u> 1 vote x 50 units = 50 voting interests $50 / 2 = 25$ -therefore- majority = 26	Majority of Total Voting Interests <u>How To Compute</u> ½ (or .5) vote x 40 units = 20 voting interests 1 vote x 60 units = 60 voting interests $20 + 60 = 80$ $80 / 2 = 40$ -therefore- majority = 40.5	30 Percent (or .3) of Total Voting Interests <u>How To Compute</u> 1 vote x 150 units = 150 voting interests $.3 \times 150 = 45$ 30% of 150 = 45 -therefore- 45 voting interests are required
Voting Interests Required By Statute To Waive or Reduce Reserve Funding	At Least a Majority of the Voting Interests Present At Meeting <u>How To Compute</u> Must first establish quorum of 26. If 45 voting interests are present in person or by limited proxy, must get approval of “just over half” of those present. $45 / 2 = 22.50$ -therefore- majority = 23	At Least a Majority of the Voting Interests Present At Meeting <u>How To Compute</u> Must first establish quorum of 40.5. If 66 voting interests are present in person or by limited proxy, must get approval of “just over half” of those present. $66 / 2 = 33$ -therefore- majority = 33.5	At Least a Majority of the Voting Interests Present At Meeting <u>How To Compute</u> Must first establish quorum of 45. If 76 voting interests are present in person or by limited proxy, must get approval of “just over half” of those present. $= 76 / 2 = 38$ -therefore- majority = 39

What happens if a meeting is called and the owners don't approve the proposal or a quorum isn't established? If either of these occur, the reserves must be fully funded as outlined in the budget. If the vote to waive or reduce reserves is presented to the owners, it's important to remember that this vote is only to waive or reduce the *funding* of reserves. The vote does not mean that the disclosures in the budget can be waived or reduced. Reserve disclosures, as discussed in Chapter 4, must be included in the proposed budget regardless of whether a vote to waive or reduce reserves will be taken.

Also, remember that general proxies cannot be used to waive or reduce reserve funding, and a vote in person or by limited proxy must be used. The limited proxy used by the association must substantially conform to the Division's Sample Limited Proxy Form. This form can be obtained by contacting the Customer Contact Center at: (850) 488-1122 or email at: callcenter@dbpr.state.fl.us.

NOTE: Subsection 718.112(2)(f)2., F.S., provides that, prior to turnover, the developer may cast votes to waive or reduce reserve funding during the first two fiscal years after the declaration is recorded. After that time, the approval of a majority of non-developer voting interests present at a unit owner meeting must be obtained. After turnover, the developer may again cast votes to waive or reduce reserve funding.

NOTE: Multicondominium associations should refer to Rule 61B-22.005(8), F.A.C., for procedures on voting to waive or reduce reserve funding.

PRACTICE EXERCISE

Your association has 130 units. The bylaws assign one vote to each unit and provide that a quorum is a majority of the total voting interests. The board wants to obtain approval to reduce reserves for this year. Seventy-eight (78) voting interests are represented at the meeting. How many unit owner votes must be obtained, at a minimum, to allow the reserve to be waived for the upcoming fiscal year? (*Circle one.*)

- a) 40
- b) 65
- c) 87

Types of Reserves to Establish

Section 718.112(2)(f)2., F.S., provides that associations must establish reserves for the following capital expenditures and deferred maintenance items:

- Roof Replacement
- Building Painting
- Pavement Resurfacing
- Items Having a Deferred Maintenance Expense or Replacement Cost More Than \$10,000

The proposed budget must include a reserve for each of these items, a pooled account for all of these items or some combination of individual and pooled reserves. As mentioned earlier, associations may establish other reserves in addition to those required by law. To determine whether additional reserves have been established, you should review prior board meeting minutes, prior budgets, and year-end financial reports.

Estimating Reserves

Identifying all of the items for which reserve accounts must be established and obtaining cost and life expectancy estimates can be daunting. For example, you need to determine which items cost more than \$10,000, estimate the total expected lives, the remaining lives, and how much money the association has already set aside to replace these items. Accurate estimates are essential to proper reserve planning. Special assessments often result from poor estimates or failure to establish reserves for expensive items. Keep in mind that estimates will change from time to time based upon factors such as weather, damage, original construction, routine maintenance, location of the property (i.e., inland or on the coast), and inflation. The board must annually re-evaluate these estimates to ensure the reserves will be properly funded for the next budget year. The following steps should be performed each year:

- Take an inventory of the condominium property and evaluate the condition of each item.
- Examine original plans and specifications.
- Review reports from unit owners about repairs that need to be made.
- Talk to other board members and owners who may have special knowledge about the condominium.
- Consult professionals such as architects, engineers, contractors, vendors and suppliers. The board should consider hiring a professional engineer to perform an analysis of the condition of the facilities at least every three to five years.

Summary of Chapter 3

The following table summarizes this chapter on reserves.

Table 3.2 Summary of Chapter 3

Reserves are monies set aside for specific purposes.	Reserves other than deferred maintenance and capital expenditures can be established.
Carefully consider the use of reserve funds and title reserves accordingly in the proposed budget.	Reserves are established to protect the association and prevent financial hardships by spreading the cost of large expenditures over a number of years.
Deferred maintenance is performed less frequently than yearly and will result in maintaining the asset's useful life.	Reserves must be fully funded unless unit owner approval is first obtained to waive or reduce.
Capital expenditures include purchasing or replacing assets having a useful life over one year, or extending the useful life over one year.	Reserves required by statute must be included in the proposed budget.
Reserve funds can only be used for purposes intended, unless approval to use them for other purposes is first obtained by a unit owner vote.	The association may establish a reserve pool including two or more items.
	Good business judgment should be used when estimating reserves.

ANSWER KEY

- 1) Repairs or maintenance that will be performed less frequently than yearly and will result in maintaining an asset's useful life is called **DEFERRED MAINTENANCE**.
- 2) Spending reserve funds to purchase or replace an asset with a useful life of more than one year or to extend the useful life of an asset more than one year is a **CAPITAL EXPENDITURE**.
- 3) 'B' is the correct answer. In this example, the board established a reserve only for capital expenditures related to the swimming pool. The definition of capital expenditure is any expenditure of funds for the purchase or replacement of an asset

whose useful life is greater than one year, or the addition to an asset that extends the useful life of the previously existing asset for a period greater than one year. Answer A should not be circled because purchasing chlorine supplies is an operating expense and should be paid for with operating funds. Answer C should not be circled because paying to have the pool cleaned is considered to be a routine maintenance expense. As stated earlier, these types of expenses should come out of the operating section of the budget.

- 4) 'A' is the correct answer. This reserve account is restricted to replacement of the golf cart. Responses B. and D. are examples of capital expenditures, but are not correct answers because they are not expenditures for the replacement of the golf cart. Responses C and E are not correct because these events are considered routine maintenance. Expenses for routine or frequent maintenance should come from the operating section of the budget.
- 5) 'A' is the correct answer. The vote required to waive or reduce the funding of reserves is the approval of a majority of those present, in person or by limited proxy, at a unit owner meeting. A majority of the 78 voting interests at the meeting is 40.

4 Reserve Schedule

This chapter addresses the preparation of the reserve schedule. Topics that will be discussed include the schedule's purpose, required reserve disclosures, and the computations involved in completing the schedule. The manual presents the segregated method first, followed by the pooled method. However, associations may decide to use the segregated method for some reserve items and the pooled method for others, in which case the proposed budget should contain both schedules.

What is a Reserve Schedule?

The reserve schedule constitutes the reserve section of the budget, and its purpose is to disclose reserve information to the unit owners and board members. The estimates that were discussed in Chapter 3 (how long assets will last, their remaining useful life, and the cost for deferred maintenance or a capital expenditure) appear in the reserve schedule.

Regardless of what reserve schedules look like they must all contain the minimum disclosures required by the Condominium Act and administrative rules.

These disclosures are an important component of the budget. Not just because they are required, but also because they provide critical information for unit owners and board members. Among other things, they help everyone know how much future expenses will cost, when these expenses are going to take place, and how much money has been set aside for these expenses so far. The reserve schedule also provides unit owners with information on which to base a decision whether to vote to waive the reserves.

Reserve Schedule Disclosures

The schedule of deferred maintenance and capital expenditure reserves includes:

- 1) All required deferred maintenance and capital expenditure reserve items.
- 2) Estimated total useful life of each of the required items.
- 3) Estimated remaining useful life of each of the required items.
- 4) Estimated deferred maintenance or cost of capital expenditure of each of the required items.
- 5) Estimated fund balance for each item as of the beginning of the proposed budget year (end of the current year).
- 6) The required funding amount for the budget year for each item.

The funding amounts are important because they let everyone know how much money must be deposited in each reserve account each month or quarter, depending on whether your association collects assessments monthly or quarterly. The steps to prepare the reserve schedule are:

STEP ONE List All Reserve Items on the Schedule

The first thing to do when preparing the deferred maintenance and capital expenditure reserve schedule is to list *all* of the required reserve items. Not only must you list reserves required by the Condominium Act, but also any other deferred maintenance and capital expenditure reserve items or any other reserves that the association would like to fund. For purposes of this manual, we are going to create a reserve schedule that lists the following reserve items:

- Roof Replacement
- Elevator Repair & Modernization
- Pavement Resurfacing
- Clubhouse Roof Replacement
- Building Painting
- Walkway Improvements

In our example, Roof Replacement, Pavement Resurfacing, Building Painting, and Clubhouse Roof Replacement are required by the Condominium Act to be listed on the budget. Additionally, Walkway Improvements and Elevator Repair and Modernization must also be established because, in our example, it is estimated that the cost of the deferred maintenance or capital expenditure will be more than \$10,000. If in our example, the association had a swimming pool where the replacement cost was under \$10,000, a reserve for this item would not have to be listed on the schedule unless there was already an account established by the association. While this manual does not cover reserves not required by the Condominium Act, if your association wants to establish reserves for items other than capital expenditures and deferred maintenance the following information will need to be disclosed in a separate reserve schedule:

- The name of each item (disclosing the intended use of the funds);
- The estimated balance of each of these reserve items at the beginning of the proposed budget period; and
- The amount of funds to be set-aside for each of these items in the current budget.
-

STEP TWO Write the Estimated Total Useful Life on the Schedule

Once you’ve listed the appropriate reserve items on the schedule, the next step you take is to determine the estimated total useful life for each reserve item and to write the amounts on the schedule.

DEFINITION ALERT

The estimated total useful life of a reserve asset is the total life of a newly purchased asset before deferred maintenance or a replacement of the item is needed.

The estimate you obtain for each reserve item’s total useful life will be placed in the first column of the schedule.

STEP THREE Write the Estimated Remaining Useful Life on the Schedule

Once you have listed the estimated total useful life for each reserve item, the next step is to determine each item's estimated *remaining* useful life and to write the amounts on the schedule. The estimate for each reserve item's remaining useful life will be placed in the second column of the schedule.

DEFINITION ALERT

The estimated remaining useful life of a reserve asset is the length of time a particular asset *has left* before deferred maintenance or a capital expenditure is needed.

Example

The 1992 engineer's report given to the association stated that the estimated total useful life of the roof was 10 years. All subsequent re-evaluations supported the 1992 findings. It is now 2001. Based on this information, the estimated remaining useful life of the roof is one year. In 2002, a capital expenditure to replace the roof will probably be needed.

STEP FOUR Write the Costs for Estimated Deferred Maintenance or a Capital Expenditure on the Schedule

The fourth step you need to take in preparing your schedule is to determine each item's estimated cost of deferred maintenance or capital expenditure and to write the amounts on the schedule. Once the amounts are listed, a total should be provided at the bottom of the column. Remember that Chapter 3 defined these two terms and provided guidance on how to obtain these estimates.

STEP FIVE Write the Estimated Fund Balances on the Schedule

The fifth step in preparing the reserve schedule is to identify the estimated fund balance, as of the beginning of the period for which the budget is being prepared, for each reserve item and to write these amounts on the schedule.

DEFINITION ALERT

The estimated fund balance is the amount of money that *should* be in the reserve account.

Note that the information and examples provided for this topic are very basic in nature. The methods used for determining estimated fund balances may vary based on the complexity and sophistication of the association's accounting system. As you read through this section, assume that there have been no unauthorized transfers or unauthorized expenditures from the reserves. In addition, keep in mind that the reserves must be identified separately in the accounting records even if all reserves are maintained in one bank account. In other words, the accounting records must be maintained according to good accounting practices.

Example

Assume that you are working on next year's budget in October. In order to determine what the roof reserve's fund balance will be at the close of business December 31, you can start by checking the amount of money that was in the roof reserve at the end of September. Then, add all of the estimated interest and assessments that *should* be deposited in the roof reserve based on the current budget for the months of October, November, and December. Finally, subtract any expenditures that are anticipated for those three months. This total should give you the estimated fund balance for the roof reserve as of December 31.

As you identify each reserve's estimated fund balance, write the amounts in the "Estimated Fund Balance" column on the schedule and total them.

STEP SIX Compute the Current year funding requirements and Write the requirements on the Schedule

The sixth step in preparing a reserve schedule is computing the current year funding requirements. When the proposed budget is given to the unit owners the reserve schedule must provide for full funding of the reserves.

DEFINITION ALERT

The current year funding requirement is the amount of money that must be deposited in the reserves during the year. This amount should ensure sufficient funds are available when it's time to do the deferred maintenance or a capital expenditure.

Keep in mind that the current year funding requirement is different than the fund balance. The funding requirement is what must be deposited during the year, and the fund balance is the amount that should be in the reserve account at any given time.

The formula for computing the current year funding requirement must take into account the estimated deferred maintenance or capital expenditure amount, estimated fund balance, and number of years remaining until deferred maintenance or a capital expenditure is needed. Since these estimates are part of the formula, you can see that the current year funding requirement will change from year to year. So keep in mind that you shouldn't simply copy the current year funding requirement from the current budget to the next year's proposed schedule. The formula is addressed by rule 61B-22.005(3), F.A.C.

Example, Segregated Method:

Assume that you are preparing next year's budget (January to December) in October, the remaining useful life of the roof is 4 years, the estimated cost to replace the roof is \$86,000, and \$50,000 should be in the roof reserve when the budget becomes effective on January 1. To determine the amount that must be deposited during the proposed budget year, subtract \$50,000 from \$86,000. The result is \$36,000. Then, you divide this amount by the remaining useful life of 4 years. The final answer is that \$9,000 is the current year funding requirement.

$$(\$86,000 - \$50,000) / 4 = \$9,000$$

As the current year funding requirements are computed for each reserve, place them in the "Current Year Funding Requirement" column on the schedule and total them.

Figure 4.1 Completed Sample Reserve Schedule Using the Segregated Method

SCHEDULE OF DEFERRED MAINTENANCE & CAPITAL EXPENDITURE RESERVES (for the fiscal year of January 1, 2002 through December 31, 2002)					
Reserve Items	Estimated Total Useful Life (in years)	Estimated Remaining Useful Life (in years)	Estimated Cost for Deferred Maintenance/ Capital Expenditure (\$)	Estimated Fund Balance as of 12-31-01 (\$)	Funding Required for Proposed Budget Period (\$)
Roof Replacement	12	1	\$95,000	\$87,000	\$8,000
Pavement Resurfacing	18	7	55,000	30,472	3,504
Building Painting	5	4	92,000	19,968	18,008
Elevator Repair & Modernization	25	14	20,000	8,800	800
Clubhouse Roof Replacement	12	1	60,000	57,000	3,000
Walkway Improvements	10	9	30,000	3,000	3,000
T O T A L S			<u>\$352,000</u>	<u>\$206,240</u>	<u>\$36,312</u>

NOTE: This schedule is for illustrative purposes only.

NOTE: Multicondominium associations have additional disclosure requirements for the proposed budget and reserve schedule. Refer to Rule 61B-22.003, F.A.C., for more information.

In computing the Funding Required for the Proposed Budget Period, you might come across a situation, usually indicative of a statutory violation, where a reserve has a negative (less than zero) balance. Negative balances can occur when the association spent more money than was available for one or more reserve items. To

compute the current year funding requirement in this type of situation, the administrative rules require that you make up the deficit in the upcoming year in addition to funding the replacement cost over the life of the item being replaced or purchased (the formula discussed above). The negative amount cannot be made up over the remaining useful life of the roof that was just replaced. The money that is being deposited during the life of the new roof is to pay for the *next* time it needs to be repaired or replaced.

Adjusting the Schedule

Changes will probably occur that will affect the formula you use from year to year. For example, the board may be given different estimates for life expectancies, deferred maintenance, capital expenditures, interest and inflation estimates, all of which will affect the reserve analysis. It is important to remember that when you compute the current year funding requirement for the proposed budget, you are only computing it for the year for which the reserve analysis is being prepared.

Preparing the Pooling Schedule

Rule 61B-22.005(3)(b), F.A.C., addresses the method of calculating reserves using the pooling method. The rule provides that the amount of the current year contribution should not be less than that required to ensure that the balance on hand at the beginning of the period when the budget will go into effect plus the projected annual cash inflows over the estimated remaining lives of the items in the pool are greater than the estimated cash outflows over the estimated remaining lives of the items in the pool. The rule prohibits using any type of balloon funding. This method also requires associations to identify each item to be included in the pool, along with the estimated cost of replacement or deferred maintenance, and the remaining lives of each of the items within the pool. The following table 4.2 demonstrates how the same reserve information shown in the segregated method may be used to create a pooled reserve account schedule. In order to present the entire pooling analysis on one page this manual shows the first four columns of the schedule separately, when you prepare a pooling schedule insert this information into the table.

NOTE: This schedule is for illustrative purposes only and does not represent the Division's position regarding the life expectancies or costs of reserve assets.

NOTE: Multicondominium associations have additional disclosure requirements for the proposed budget and reserve schedule. Refer to Rule 61B-22.003, F.A.C., for more information.

Figure 4.2 Reserve Schedule Using the Pooling Method

Replacement Item	Total Estimated Life (Yrs)	Remaining Life (Yrs)	Cost
Roof Replacement	12	1	\$95,000
Pavement Resurfacing	18	7	\$55,000
Building Painting	5	4	\$92,000
Elevator Repair & Modernization	25	14	\$20,000
Clubhouse Roof Replacement	12	1	\$60,000
Walkway Improvements	10	9	\$30,000

Figure 4.2 - Continued Reserve Schedule Using the Pooling Method

Projected Annual Cash Outflows														
Replacement Item	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14
Roof Replacement	95,000	0	0	0	0	0	0	0	0	0	0	0	95,000	0
Pavement Resurfacing	0	0	0	0	0	0	55,000	0	0	0	0	0	0	0
Building Painting	0	0	0	92,000	0	0	0	0	92,000	0	0	0	0	92,000
Elevator Repair & Modernization	0	0	0	0	0	0	0	0	0	0	0	0	0	20,000
Clubhouse Roof Replacement	60,000	0	0	0	0	0	0	0	0	0	0	0	60,000	0
Walkway Improvements	0	0	0	0	0	0	0	0	30,000	0	0	0	0	0
Total Projected Cash Outflows:	(155,000)	0	0	(92,000)	0	0	(55,000)	0	(122,000)	0	0	0	(155,000)	(112,000)
Beginning Cash Balance:	\$206,240	\$85,866	\$120,492	\$155,118	\$97,744	\$132,370	\$166,996	\$146,622	\$181,248	\$93,874	\$128,500	\$163,126	\$197,752	\$77,378
Annual Reserve Requirement:	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626	\$34,626
Ending Cash Balance:	\$85,866	\$120,492	\$155,118	\$97,744	\$132,370	\$166,996	\$146,622	\$181,248	\$93,874	\$128,500	\$163,126	\$197,752	\$77,378	\$4

Pooling Method Reserve Schedule Disclosures

The schedule of deferred maintenance and capital expenditure reserve items for the pooling method includes the same items that are required for the segregated method as follows:

- All Required Deferred Maintenance and Capital Expenditure Reserve Items.
- Estimated Total Useful Life of Each of the Required Items.
- Estimated Remaining Useful Life of Each of the Required items.
- Estimated Deferred Maintenance or Cost of Capital Expenditure of Each of the Required Items.
- Estimated Total Fund Balance for the Pooled Reserves as of the beginning of the proposed budget year (end of the current year).
- The Required Funding for Proposed Budget Period for the Pooled Reserves.

The required funding for proposed budget period for the pooled reserves is the annual deposit that will be required, based on the current reserve analysis, in order to ensure that sufficient funds will be available when the anticipated expenditures take place.

Hint: Formula driven spreadsheets make it a lot easier to prepare the pooling method reserve schedule.

The steps to prepare the pooling method reserve schedule are:

STEP ONE List All Reserve Items on the Schedule

The first thing to do when preparing the deferred maintenance and capital expenditure reserve schedule is to list *all* of the required reserve items. For purposes of this manual, we are going to create a reserve schedule that lists the following reserve items:

- Roof Replacement
- Elevator Repair & Modernization
- Pavement Resurfacing
- Clubhouse Roof Replacement
- Building Painting
- Walkway Improvements

In our example, Roof Replacement, Pavement Resurfacing, Building Painting, and Clubhouse Roof Replacement are required by the Condominium Act to be listed on the budget. Additionally, Walkway Improvements and Elevator Repair and Modernization must also be established because, in our example, it is estimated that the cost of the deferred maintenance or capital expenditure will be more than \$10,000.

STEP TWO Determine the Estimated Total Useful Life of Each Item in the Pool

Once you've listed the appropriate reserve items on the schedule, the next step is to determine the estimated total useful life for each reserve item and disclose the information on the schedule.

STEP THREE Determine the Estimated Remaining Useful Life of Each Item in the Pool

Once you have listed the estimated total useful life for each reserve item, the next step is to determine each item's estimated *remaining* useful life and disclose the information on the schedule.

STEP FOUR Determine the Number of Columns in the Projected Annual Cash Outflows Section of the Table

Each column in the projected annual cash outflows section of the table represents one year to be included in the analysis. The analysis must include at least the number of years (columns) equal to the longest remaining life of any item in the pool. In this example the longest remaining life is 14 years for the Elevator Modernization. Therefore, the minimum number of columns required for analysis is 14.

STEP FIVE Enter Costs for Estimated Deferred Maintenance or Capital Expenditure of Each Item in the Pool

Once you have created sufficient columns in the table determine each item's estimated replacement or deferred maintenance cost and write the amounts in the column reflecting its remaining life. Note that some items may be replaced more than once during the entire period under analysis. For example, Figure 4.2 shows that Building Painting will be done at the end of the remaining painting life of 4 years and will reoccur every 5 years from that date. After the amounts are listed for each item a total should be provided at the bottom of each column. This total represents the total projected annual cash outflows from the reserve pool.

STEP SIX Enter the Estimated Beginning Cash Balance for Year 1

The sixth step in preparing the reserve schedule is to determine the estimated fund balance of the reserve pool, as of the beginning of the period for which the budget is being prepared. Since the budget is usually prepared in advance of the new year, this requires an estimate of the amount that will be on hand at the end of the year. This can be done by determining the reserve pool balance on the date the estimate is being prepared, adding the monthly or quarterly funding requirement for the remainder of the year, and subtracting any estimated expenses that will be incurred during the remainder of the year. Enter this amount in the "Beginning Cash Balance" cell under Year 1.

Hint: Spreadsheet users create a formula making the Beginning Cash Balance for each year after year 1 equal to the Ending Cash Balance from the prior year. The formula for calculating the Ending Cash Balance each year is:

Beginning Cash Balance less the Total Projected Cash Outflows plus the Annual Reserve Requirement. Copy this formula to the Ending Cash Balance cell for each year in the analysis.

STEP SEVEN Compute the Annual Reserve Requirement

The last step in preparing a the pooling reserve schedule is to calculate the Annual Reserve Requirement. The Annual Reserve Requirement is the minimum annual deposit that, based on the reserve analysis, will ensure that the reserve pool will not have a negative Ending Cash Balance.

Note: Figure 4.3 shows a level funding requirement each year during the analysis. While the rules do not specifically require a level funding requirement, this method cannot be used to simply fund the amount of reserves equal to the amount of cash outflows each year. The rules prohibit ballooning the payments, so the cost of capital expenditures and deferred maintenance projects must be spread over the life of the reserve items.

How To Fund Reserves

Rule 61B-22.005(6), F.A.C., requires that reserves be funded in a timely manner, at least as frequently as assessments are due from the owners, such as monthly and quarterly. This means that if assessments are collected monthly then 1/12 of the Annual Reserve Requirement must be funded (deposited to the reserve account) each month.

In addition, rule 61B-22.005(2), F.A.C., states that if operating and reserve assessments are collected as a single payment, the reserve portion of the payment must be transferred to the appropriate reserves within 30 calendar days from the date the payment was deposited in the operating account. The following situations are intended to illustrate the funding requirements and handling of operating and reserve funds:

Example:

Assume that the condominium documents require that assessments be collected on a calendar quarterly basis and reserves have not been waived, and assessments from unit owners are deposited on January 5, 2004. The association must transfer the reserve portion of that deposit to the appropriate reserve bank account(s) no later than February 4, 2004, and one fourth of the annual funding requirement must be set aside in the reserve account(s) not later than March 31, 2004, even if not all of the unit owners have made their quarterly payments. In other words reserves are required to be funded even if some unit owners are delinquent in their payments. Should your association experience chronic delinquencies it is a good idea to build a line item into the operating budget in order to ensure adequate cash flow to pay for all of the operating expenses and fund the reserves.

PRACTICE EXERCISES

- 1) In the space below, explain why a reserve schedule must be included in the proposed budget that is sent to the unit owners.

- 2) List the six (6) disclosures that are included on a schedule of deferred maintenance or capital expenditure reserve items.
 - a)
 - b)
 - c)
 - d)
 - e)
 - f)

- 3) Which of the following must be listed on a deferred maintenance and capital expenditure reserve schedule? *(Circle all that apply.)*
 - a) Building painting.
 - b) Roof replacement.
 - c) A reserve for an insurance premium due in three years.
 - d) Pavement resurfacing.
 - e) A deferred maintenance item that will cost less than \$10,000.

- 4) Which of the following disclosures are required to be included on the reserve schedule? *(Circle all that apply.)*
 - a) The item's estimated total deferred maintenance or replacement cost.
 - b) The appearance of the reserve item.
 - c) The estimated fund balance.
 - d) The estimated remaining useful life.

ANSWER KEY

- 1) Your experiences may allow you to respond to this question in ways other than that provided in this manual. The paragraph below provides one response.

Not only are reserve disclosures required by the statute and administrative rules, they also provide important information to unit owners and board members. The disclosures assist in making decisions about the funding of reserves, and they identify how long assets should last before needing deferred maintenance or a capital expenditure. It is easier for people to make long-term plans when reserve disclosures are provided.

- 2) Six disclosures that should be on a deferred maintenance and capital expenditure reserve schedule include:
 - a) All deferred maintenance and capital expenditure reserve items.
 - b) The estimated total useful life.
 - c) The estimated remaining useful life.
 - d) The estimated cost for deferred maintenance or a capital expenditure.
 - e) The estimated fund balance.
 - f) The current year funding requirement.
- 3) Items 'A,' 'B,' and 'D' must be listed. Rule 61B-22.003(1)(e), F.A.C., requires that the budget include a schedule of *each* deferred maintenance and capital expenditure reserve item.
- 4) Items 'A,' 'C,' and 'D' must be included. The formula for computing the current year funding requirement for deferred maintenance and capital expenditure reserve items must include these components regardless of whether you use the Segregated Method or the Pooling Method.

5 Operating Expenses

This chapter provides information about the operating section of the budget. First, general budgeting techniques will be discussed, and then, statutory and administrative rule requirements will be addressed.

The Budget

Think of the budget as being a formal written plan of the association's projected expenditures for a given period of time. It's a very important item that communicates the board's plans for the association and significantly affects the operation of the association. Therefore, it's vital that the board takes the time to review the requirements in the statutes and the association's documents and to apply appropriate budgeting techniques.

It's also important that the board understands the importance of establishing an operating budget that reflects, as closely as possible, the association's projected expenses. The board is responsible for administering the affairs of the association and, by law, has a fiduciary relationship to the unit owners. By definition, a fiduciary is a person who stands in a special relation of trust, confidence, and responsibility in his or her obligations to others. If prepared properly, the budget can assist the board members in fulfilling this obligation. However, it takes careful planning to establish a budget that will ensure sufficient money is collected from the unit owners to cover all of the association's expenses.

The Association's Accounting Information System

Keep in mind that the accounting system needs to be designed in accordance with the association's size and budget. The accounting information system for a very small association may consist of index cards and a check register. As the size of an association increases, the level of sophistication of its accounting information system increases. It's important that the system be organized and maintained in such a way so that anyone can look at the records and determine what the revenues and expenses are for both the operating and reserve funds. You should consult with an accountant who is knowledgeable about condominium associations to ensure the system is organized properly and is able to produce the accounting records required by the Condominium Act and the related administrative rules.

Consider purchasing a *general ledger* software program that's user-friendly and easy to update. It should be designed for condominium associations or easy to adapt to fund accounting. (Fund accounting will be explained below) The program should make the process of updating the books faster, easier, and more accurate by having specific codes assigned to all revenue and expense accounts. Purchasing this type of software is generally more feasible for medium to large associations that have numerous monetary transactions. It's usually more expensive than other software packages, such as spreadsheet programs, that may be useful for smaller associations.

Updating the books can be quite tedious, especially for medium and large associations that have numerous general ledger accounts. The software program, if organized properly, can be a great help in ensuring the records are maintained and kept up-to-date as they should be.

If the association chooses to keep the books by hand instead of using a computer, ledger books can be purchased to accomplish this. You can find these at retail or office supply stores. They come in a variety of formats so you will just need to examine the ones that are available to see what will work for you.

Example

The Condominium Act requires the association to maintain a current account and a monthly, bi-monthly, or quarterly statement of the account for each unit designating the name of the unit owner, the amount of each assessment, the due dates, the amounts paid upon the account, and the balance due. Assume that the unit owners are billed for assessments on a quarterly basis. The Subsidiary Accounts Receivable Ledger for assessments has a separate ledger page for each unit. The Accounts Receivable Subsidiary Ledger for unit owner Joseph Miller is as follows:

Figure 5.1 Sample Accounts Receivable Subsidiary Ledger

Joseph Miller Unit 210				
Date	Amount Due	Description	Payment Made	Balance
1/1/02	\$100	First Quarter's Assessment	-	\$100
1/5/02	-	Paid Check Number 2319	\$100	\$0
3/1/02	\$100	Second Quarter's Assessment	-	\$100
3/3/02	-	Paid Check Number 2342	\$100	\$0
6/1/02	\$100	Third Quarter's Assessment	-	\$100
6/5/02	-	Paid Check Number 2360	\$100	\$0
7/10/02	\$200	Special Assessment for Pool Repair	-	\$200
8/8/02	-	Paid Check Number 2385	\$200	\$0
9/1/02	\$100	Fourth Quarter's Assessment	-	\$100

Consider maintaining a Chart of Accounts. This chart is simply a listing of the titles and the numbers, or codes, that have been assigned to the ledger accounts. It's like an index that helps facilitate the process of entering revenue and expense amounts.

A short explanation next to each of the accounts should be included.

Example

The bookkeeper is in the process of posting assessments paid by the owners, and the amounts paid by the association for utilities and cable. Instead of having to memorize the different numbers assigned to each ledger account, the bookkeeper can refer to the Chart of Accounts, locate the ledger account number that corresponds to each account title (Assessments, Utilities, and Cable), access that account number in the accounting records, and post the amounts.

Accrual Basis of Accounting and Cash Basis of Accounting

Accrual and cash basis of accounting are discussed in this manual to familiarize you with the concepts because it's important that you know what method is being used in your association.

DEFINITION ALERT

The accrual basis of accounting means revenues are recognized when they are earned and expenses are recognized when they are incurred, regardless of when cash is received or disbursed.

Example

Assume that your association receives a bill for pool work performed in June with a due date for payment in July. Using accrual basis accounting the transaction is recorded on the books in June even though the payment of cash will not occur until July.

DEFINITION ALERT

The cash basis of accounting recognizes revenues when received and expenses when paid.

Example

Using the above example, under the cash basis the bill for pool work is recorded on the books in July instead of June. This is because the actual flow of cash will occur in July when the bill is paid. The main advantage of the cash basis of accounting is that it's a relatively simple method to apply. In very small associations, it may be the most practical method to use due to its simplicity.

Under the cash basis the results of operations can be manipulated by timing the payment of bills. The accrual basis is less susceptible to manipulation, but is little use without a balance sheet to indicate which of the revenues are still outstanding or which expenses have yet to be paid. Also, the accrual basis is not as straight forward or intuitive as the cash basis.

Estimating the Association's Operating Expenses

As discussed in Chapter 2, the main purpose of the operating section of the budget is to show the categories of expenses (usually called line items) that relate to the

day-to-day operation of the association. In addition, it identifies how much money the board estimates will be spent for each item. This is not a simple process, but it can be made easier if accurate and complete accounting records are maintained. Something that must be kept in mind when preparing the budget is that the association's main source of income is the maintenance fees or assessments received from unit owners.

The Condominium Act requires that sufficient funds be collected in advance to pay all of the anticipated expenses. In other words, the board should not carry out the day-to-day operations of the association at a deficit or on the basis of special assessments. *(Please refer to the Glossary for the definitions of assessment and special assessment.)*

Associations that budget properly for common expenses can reduce the financial hardships that special assessments can cause. Not only do special assessments occur due to insufficient reserve funding, they also occur when the estimated operating expenses are insufficient. If estimated properly, the budget will help the association fulfill its obligations, help the board monitor the association's financial progress, and help the unit owners understand what is planned for the upcoming year.

One of the goals in preparing this manual was to identify the basic procedures and minimum statutory and administrative rule requirements for preparing a proposed budget. The following ideas are presented to assist you with preparing accurate estimates for the budget.

Historical Data

The best information about future budgeting estimates can be obtained by comparing budget versus actual performance from prior years. Start with two to three years' worth of historical information. Identify problem-funding areas and determine why the association was not able to meet its projected budget limits. Identify trends in income and expenses so these trends can be incorporated into the proposed budget. For example, if utility costs have been going up approximately two percent each year, increase the anticipated utility expenditure by two percent. Also, consider historical inflation rates. Even if past estimates were accurate, new estimates should be adjusted for inflation.

Look to the future. Ask, "What is anticipated this year that should be incorporated into the proposed budget?" For example: Is the association involved in litigation in which expenses are anticipated? Does the association need to hire additional employees this year? Are increases in taxes or payrolls anticipated? Does additional insurance need to be purchased for new employees? Is there any additional day-to-day maintenance that needs to be performed? Does the board have new plans for the association? Will the cost of any association contracts or insurance policies be increasing? What is the expected rate of inflation, and what aspects of the association's operations will it affect?

Involve the community. Remember that communication and unit owner involvement are important aspects of community living. Give owners the opportunity to be involved in the budget preparation process. To accomplish this, many associations establish budget committees that gather information about needed improvements or maintenance, new state or federal requirements, or enhancements desired by the community. Pull upon the knowledge and resources of the unit owners, and let them know their input is valued. If owners are involved in the preparation process, they will more likely accept and understand the budget and the expenditures required by the association.

Contents of the Operating Section of the Budget

The minimum requirements for the operating section of the budget are listed on the following checklist:

PROPOSED BUDGET CHECKLIST - Operating Section

All estimated common expenses or expenditures of the association including but not limited to the following items:

- Administration of the association;
- Management fees;
- Maintenance;
- Rent for recreational and other commonly used facilities;
- Taxes upon association property;
- Taxes upon leased areas;
- Insurance;
- Security provisions;
- Other expenses;
- Operating capital
- Rent for a unit, if subject to a lease;
- Rent payable by the unit owner directly to the lessor or agent under any recreational lease or lease for the use of commonly used facilities, which use and payment is a mandatory condition of ownership and is not included in the common expenses or assessments for common maintenance paid by the unit owners to the association;
- Fees payable to the division;
- Expenses for a unit owner;
- All estimated common expenses or expenditures stated on an annual basis;
- All estimated expenses shown on a monthly basis;
- Beginning and ending dates of the period covered by the budget; and
- The total assessment for each unit type according to the proportion of ownership on a monthly basis, or for any other period for which assessments will be due.

NOTE: If the association maintains limited common elements with the cost shared by only those entitled to use them, a separate schedule or schedules must be attached that

contains the same disclosures as in the budget. The schedule(s) must show all estimated expenses specific to each limited common element including reserves for deferred maintenance and capital expenditures if applicable.

Tips on Preparing the Budget

One of the most common errors made in preparing the budget is failing to state the time period covered by the budget. Many associations fail to identify the year to which the budget applies. This can be a problem for future boards who are trying to piece together historical data. Also, while the budget estimates are required to be presented on an annualized basis, there will be times that a budget will need to be amended for the remaining portion of a fiscal year, and putting the period covered by that budget is important in order to ensure that each unit owner was charged and paid the proper amount of assessments throughout the year. The time period covered must be a statement of the *range of time* that the estimated budget will cover.

You should consider using the same line items in the budget and the year-end financial report. Using the same line items will make it easier to compare the budget versus actual performance.

Look in the left-hand column on the sample budget, and locate the line item entitled, "Reserves." You will see the main category of Reserves and a listing of the individual reserve accounts beneath it. In our sample budget, these amounts are simply transferred from the reserves section of the budget to the operating section. Please note that the statutes and administrative rules do not require that the individual reserves be itemized under the main category of Reserves.

Although not required by the statutes and administrative rules, many budgets contain a revenue section. If the association expects to earn non-assessment revenues then maintenance fees may be reduced. In our sample budget the owners' assessments would have been \$195 per month instead of \$180 if the non-assessment revenues had not been included. This is because the full amount of \$372,626 (next to Total Operating Expenses in the bottom right-hand corner) would have been used to compute the assessments. This is determined by taking the amount of \$372,626 (next to Total Operating Expenses in the bottom right-hand corner) and subtracting the anticipated non-assessment revenues of \$6,120 and \$20,906 for Interest Income and Other Income, respectively (in the upper left-hand column). The result is \$345,600. This amount is the assessment income that is anticipated for the budget year and can be found next to the line item entitled Regular Assessments in the upper left-hand column. So, instead of using the larger amount of \$372,626 from Total Operating Expenses to compute assessments, we are using the lower amount of \$345,600. This results in the lower assessment of \$180 per unit.

The budget must identify the total assessment for each unit type, according to the proportion of ownership, on a monthly basis or for any other period for which assessments will be due. As you can see in the bottom right-hand corner, the assessments for each unit are stated on an annual and monthly basis. The reason a

monthly basis is stated is that, in our sample association, the documents require assessments to be paid on a monthly basis. If our sample association's documents required assessments on a quarterly basis, then the budget would identify the assessment amount on a quarterly basis. The documents for your association must be reviewed to determine on what basis assessments are paid.

Budget Line Items Explained

Unit owners and board members are often confused about the meaning of the required budget line items Operating Capital, Additional Expenses for a Unit Owner, and Rent for Recreational and Other Commonly Used Facilities. (These line items can be found in the right-hand column of the sample budget.) Operating capital is simply a built in surplus for the association. Additional Expenses for a Unit Owner are not common expenses to be included in the budget. Instead these expense disclosures notify unit owners of expenses they may incur. These expenses are *not* counted as expenses collectible through assessments, and are generally related to disclosures during developer control of the association. An example of this category might be maid service that is available on a pay as you want basis, but not a common expense of the association.

Rent for Recreational and Other Commonly Used Facilities refers to any facility the association uses but does not own. An example of this could be where a condominium is part of a large recreation association that operates recreational facilities serving the condominium unit owners. Since the unit owner pays assessments directly to the recreation association this expense will not be part of the condominium assessment, and is included for disclosure purposes.

Summary of Chapter 5

The following list summarizes the main points of this chapter. Please review this before proceeding to the practice questions.

- The budget is a formal written plan of the association's projected expenditures for a given period of time.
- The association's accounting system must be organized and maintained in a manner that will allow anyone to look at the records and determine what the revenues and expenses are for the operating and reserve funds.
- The accrual basis of accounting means revenues are recognized when they are earned and expenses are recognized when they are incurred, regardless of when cash is received or disbursed.
- The cash basis of accounting recognizes revenues when they are received and expenses when they are paid.
- The main purpose of the operating section of the budget is to show the categories of expenses (usually called line items) that relate to the day-to-day operation of the association. In addition, it identifies how much money the board estimates will be spent for each item.
- The statutes and administrative rules require the operating section of the budget to contain certain items. See the Budget Checklist - *Operating Section*, for a list of these required items.

6 Assessments

This chapter addresses how to determine each unit's share of the assessments, the budget adoption process, what happens when a budget exceeds 115 percent of the prior year's assessments, and collection of assessments.

How Do I Compute the Assessments?

Before you can compute the assessments, you must know three things:

- 1) How assessments are allocated among the units.
- 2) The number of units in the condominium or cooperative.
- 3) How often the assessments are to be collected.

The first step is to identify how the assessments are allocated among the units. This information can be found by referring to the documents. Keep in mind that the law regarding sharing assessments may change, and your condominium documents may differ. Since the percentage that you share assessments cannot change without your approval, this is one of those items in the declaration that cannot be changed when the law is changed. For *condominiums* created after April 1, 1992, the allocation must be based on either an equal fractional basis or the units' square footage of the unit relative to the total square footage of all of the units.

The second step identifies the number of units in the condominium. Again, the documents will provide this information. The number of units is important because you must have this information for the formula that will be used to compute the assessments.

The last step before computing the assessments is to determine how often the assessments are to be collected. The Condominium Act states that assessments must be made against units not less frequently than quarterly. This just means that owners must be assessed at least four times a year - not one, two, or three times a year. The documents, usually the bylaws, should identify the frequency of the assessments. Look at the sample document language on the next page that sets forth these three critical pieces of information. *(The pertinent language is underlined and italicized.)* Remember that documents are unique. The language you will see here will likely be different than that of your documents.

Sample Language from the Declaration of Condominium

Percentage of Ownership of Common Elements: The undivided share in the Common Elements and Common Surplus, which are appurtenant to each Unit, shall be computed upon the following basis:

Upon recordation in the county records, each unit shall have an undivided share in the ownership of the common elements and the common surplus established on an equal fractional basis. This shall be equal to one/three-hundredths (1/300th). The interest in the ownership of the Common Elements and the Common Surplus for each unit shall be ascertained by dividing one (numerator) by the total number of Units (denominator); the resulting number being the undivided interest expressed in decimals of ownership of the common elements and the common surplus attributable to each unit.

Common Expenses and Common Surplus:

Common expenses of the association, as defined hereinabove, shall be shared by all unit owners in accordance with an undivided share in the ownership of the Common Elements and the Common Surplus attributable to each Unit, as set forth in the paragraph above.

Number of Units:

Upon recordation in the county records, there shall be three-hundred (300) units.

Assessments: The assessments shall be collected from the unit owners on a monthly basis due and payable by the fifth of every month.

In this association, the assessments are allocated on an equal fractional basis of 1/300ths which, in this case, means everyone will pay the same amount in assessments. You can find this information under the headings “Percentage of Ownership of Common Elements”, and “Common Expenses and Common Surplus.” The number of units (300) is very clear in this case. The documents also indicate that assessments will be collected monthly.

Once you’ve obtained these three bits of information, you’re ready to compute the assessments. Chapter 5 indicated that the operating section of the budget must identify the assessments for each type of unit (units with different ownership shares). Remember that the assessments must be shown on an annual basis as well as for the time period for which they are due. The formula for calculating the per unit assessment is as follows:

Total Operating Expenses - Anticipated Revenues = Total Amount to be Assessed.

The Total Amount to be Assessed x Ownership Share = Total Assessment Per Unit.

Total Assessment Per Unit / Frequency of the Assessment = Periodic Assessment (Monthly, Quarterly, Etc.).

Once you have computed the annual and periodic assessments for each unit, you must place them on the operating section of the budget. When this is done, you've fulfilled all of the requirements for preparing the budget! You've prepared the reserve schedule with all necessary disclosures, and included all of the line items and other disclosures on the operating section of the budget.

Before we begin the discussion of the budget adoption process, please answer the following questions. The answer key is provided at the end of this chapter.

PRACTICE EXERCISES

- 1) List the three items that must be identified before assessments can be computed.
 - a)
 - b)
 - c)

- 2) In the space below, write the formula that can be used to compute the total assessment per unit.

- 3) In the space below, write the formula that can be used to compute the periodic assessment amount.

- 4) Compute the total assessment per unit and the periodic assessment using the data below. Write your responses in the spaces provided.
 - Assessments are allocated on an equal fractional basis.
 - Assessments are collected on a monthly basis.
 - Total Operating Expenses are \$321,546.
 - Anticipated revenues are \$23,498.
 - There are 180 units.

Total Assessment Per Unit: \$ _____

Periodic Assessment: \$ _____

The Budget Adoption Process

You've completed the process of preparing the proposed budget package, and now you're ready to adopt it! The association's documents should provide for how this is to be done since it's not specifically addressed by the Condominium Act. Most condominium documents provide that the board has the authority to adopt the budget, but some reserve this responsibility to the unit owners.

Regardless of who ultimately adopts the budget, the Condominium Act contains specific requirements for presenting the proposed budget to the unit owners. Before the proposed budget goes out, the board should review it for accuracy one last time to ensure it contains all of the required disclosures.

Board Approved Budget

The board meeting notice, agenda, and a copy of the proposed budget must be mailed or hand-delivered to each unit owner at least 14 days prior to the meeting. The notice must include a statement that assessments will be considered and the nature of the assessments. In addition, the notice and agenda are to be posted in the designated location on the property not less than 48 hours prior to the meeting. To show that the association complied with the 14-day notice, an affidavit must be executed by the person who provided notice of the meeting, and it must be filed with the association's official records.

Unit Owner-approved Budget

The unit owner meeting notice, agenda, and a copy of the proposed budget package must be mailed or hand-delivered to each unit owner at least 14 days prior to the meeting. In addition, the notice and agenda are to be posted in the designated location on the property. If there is no property to post the notice on, the posting requirement does not apply. To show that the association complied with the 14-day notice, an affidavit must be executed by the person who provided notice of the meeting, and it must be filed with the association's official records.

Communication is a very important aspect of community living. Since the budget is such a vital part of the operation of the association, the board should use this opportunity to communicate with the unit owners. Here are some examples of information that may be included with the proposed budget. They are not required, but they help unit owners better understand what they are receiving.

- Explain any major projects that are planned for the year and why they need to be done. In addition, explain large variances from the prior year's budget, especially if the association has a column that lists the prior year's budgeted amounts next to the proposed amounts.
- Explain hard-to-understand line items.
- If the decision is made to present a vote to the owners to waive or reduce the funding of reserves, explain what happens when reserves are not fully funded. Unit owners need to know that, when reserves *are* funded, they are funding for future

expenses. If the funding of reserves is waived or reduced, owners may not realize that it could result in large special assessments.

- If the decision is made to present the vote to waive or reduce reserve funding, include a disclosure of what assessments will be with and without reserve funding.

IMPORTANT!!

After the board has given the proposed budget to the unit owners, held a meeting to adopt the budget, and adopted it, the board must now ensure that the minutes of the meeting at which the budget was adopted reflect the adoption of the budget, and that copies of the proposed *and* adopted budgets are maintained as part of the financial records of the association.

Budget Exceeds 115 Percent of Prior Year's Assessments

If a board adopts a budget which increases assessments more than 15 percent over the prior year's assessments, the Condominium Act provides that 10 percent of the voting interests are entitled to petition the board to call a special unit owner meeting to reconsider and enact a new budget. However, the law states that certain items should be excluded from the current year *and* the prior year budgets. These are as follows:

- 1) Reserves.
- 2) Anticipated expenses not expected to be incurred on an annual basis.
- 3) Assessments for betterments to the property.

After subtracting these three items from both budgets, divide the current year total assessment by the prior year total assessment. The resulting percentage will tell you whether the current year budget is more than 115 percent of the prior year budget (15 percent increase). The following examples illustrate this calculation:

Figure 6.1 Budget Increase Does Not Exceed 115% of Prior Year's Assessments

	2002 Assessments	2003 Budgeted Assessments
	\$140,646	\$158,482
SUBTRACT: Reserves	\$5,000	\$7,008
SUBTRACT: Anticipated expenses not expected to be incurred on an annual basis	0	500 ¹
SUBTRACT: Assessments for betterments to the property	750 ²	1,500 ²
TOTALS	<u>\$134,896</u>	<u>\$149,474</u>

149,474 / 134,896 = 111%

NOTES

¹The city notified the association that a local ordinance was passed requiring a sidewalk to be installed on a portion of the property. The association will be charged \$500 for this installation. This will not be a continuing charge.

²The association approved the installation of two lobby fountains, one that was built in 2002 and another to be built in 2003. The budgeted expenses were \$750 and \$1,500, respectively.

Figure 6.2 Budget Increase Exceeds 115% of Prior Year's Assessments

	2002 Assessments	2003 Budgeted Assessments
	\$150,454	\$182,684
SUBTRACT: Reserves	\$4,500	\$8,000
SUBTRACT: Anticipated expenses not expected to be incurred on an annual basis	500 ¹	800 ¹
SUBTRACT: Assessments for betterments to the property	1,000 ²	1,000 ²
TOTALS	<u>\$144,454</u>	<u>\$172,884</u>

172,884 / 144,454 = 120%

NOTES

¹The city notified the association that local ordinances had been passed. In 2002, a sidewalk was required to be installed on a portion of the property. In 2003, a fence was required to be built around the pool. The owners will be charged \$500 and \$800 respectively for these installations. They will not be continuing charges.

²The association approved the installation of two fountains, one that was built in 2002 and another to be built in 2003. The resulting special assessments are \$1,000 each.

In the first example, since the percentage increase is not more than 15 percent, the unit owners would not be entitled to petition the board for a special budget meeting. In the second example, the percentage increase is greater than 15 percent thus entitling 10 percent of the voting interests to petition the board for a special unit owner meeting.

If the budgeted assessments exceed 115 percent of the prior year assessments (15 percent increase) and the board is petitioned by at least 10 percent of the voting interests within 21 days after the board's adoption of the budget, the board must call a special unit owner meeting within 60 days after the board's adoption of the budget, providing at least 14 days' written notice of the special meeting to each unit owner.

Example

Assume that the board adopted the budget on October 1, and a valid petition requesting a special budget meeting was received on October 10. In this case, the

board must hold the meeting no later than November 30. If the board decides to hold the meeting on October 30, the board must provide notice of the meeting no later than October 16. In order to adopt a new budget at this special unit owner meeting, the approval of a majority of all of the voting interests must be obtained, unless the bylaws require a larger vote. The vote may be in person or by limited proxy. If the new budget is adopted, it will go into effect. If a meeting is called and a quorum is not attained or a substitute budget is not adopted, the budget originally adopted by the board will go into effect.

NOTE: If the developer is still in control of the board, the board may not impose an assessment for any year greater than 115 percent of the prior year's assessment without the approval of a majority of all of the voting interests, including those of the developer.

PRACTICE EXERCISES

- 5) The board of administration has the authority to adopt the annual budget, but they are silent with regard to noticing the budget meeting. The board has scheduled a meeting for November 21 at which the proposed budget is to be adopted. According to the Condominium Act by what date must the proposed budget be mailed or hand-delivered to the unit owners? (*Circle one.*)
- a) November 8
 - b) November 7
 - c) October 22
- 6) (*A calculator may be needed for this question.*) Using the data provided below, your goals are to determine the percentage by which the budgeted assessments for 2003 exceed assessments in 2002, and whether the unit owners are entitled to petition the board for a special unit owner meeting to reconsider the budget. First, use the dollar amounts in the 2002 and 2003 columns to compute the amounts that will be used to determine the percentage, and write the resulting figures in the shaded area. Then, answer the two questions at the bottom of the page.

	2002 Assessments	2003 Budgeted Assessments
	\$132,478	\$155,689
Reserves	\$6,376	\$10,296
Anticipated expenses not expected to be incurred on an annual basis	\$750 ¹	\$500 ¹
Assessments for betterments to the property	\$1,200 ²	\$1,200 ²
TOTALS	\$	\$

NOTES

¹Both years, the city notified the association that local ordinances had been passed. In 2002, a sidewalk was required to be installed on a portion of the property. In 2003, a fence was required to be built around the pool. The owners will be charged \$750 and \$500 respectively for these installations. They will not be continuing charges.

²The association approved the installation of two fountains, one that was built in 2002 and another to be built in 2003. The resulting special assessments are \$1,200 each.

a) Resulting Percentage: _____%

b) Are Owners Entitled To Petition the Board (*Circle one.*): Yes No

Collection of Assessments

What happens when some of the owners don't pay their proportionate share of assessments? When unit owners are delinquent in their assessments, it creates a financial hardship on the association. Not only are additional expenses incurred due to legal and processing fees, but the cash flow requirements of the association must be met by the other unit owners.

The board should review the association's documents relating to the collection of assessments. If the delinquent assessments are not likely to be collected any time soon it may be a good idea to create a line item in the budget for bad debt expenses. The authority for collection and the requirement that unit owners pay assessments are clearly stated in the Condominium Act. The owners must pay their

share of assessments and cannot avoid payment by waiving the use or enjoyment of the property or by abandoning their unit. In addition, no owner may be excused from paying his or her share of the assessments unless all unit owners are likewise proportionately excused. For example, the fact that an owner does not feel like the board is maintaining the property does not create excuse the unit owner from paying the assessments. The board should obtain competent legal assistance in developing collection procedures and collection of the assessments. [See section 718.116, F.S.]

Summary of Chapter 6

The information below summarizes the main points covered in Chapter 6.

- Before you can compute the assessments, you must know three things:
 1. How assessments are allocated among the units;
 - The total amount to be assessed; and
 - How often the assessments are to be made.
- The three types of information listed above can be found in the documents.
- The formula that can be used to obtain the total assessment per unit is:

(Total operating expenses - anticipated revenues) X ownership percentage

- The formula that can be used to obtain the periodic assessment amount is:

Total Assessment Per Unit / Frequency of the Assessment

- The Condominium Act requires the association to mail or hand-deliver the proposed budget package to the unit owners at least 14 days prior to the meeting at which the budget will be considered for adoption.
- If the board adopts a budget that exceeds 115 percent of the prior year's assessments, a special meeting of the unit owners to consider an alternate budget must be called if at least 10 percent of the voting interests petition the board.
- In determining whether a budget increases the prior year's assessments by more than 115 percent, you must deduct three items from the total budgeted expenses for the current year *and* the prior year: (1) reserves, (2) anticipated expenses not expected to be incurred on an annual basis, and (3) assessments for betterments to the property.

ANSWER KEY

- 1) The three items that must be identified before the assessments can be computed are the following:
 - a) How assessments are allocated among the units.
 - b) The total amount to be assessed.
 - c) How often the assessments are to be made.

- 2) The formula for calculating the total assessment per unit is:

(Total operating expenses - anticipated revenues) X ownership percentage.

- 3) The formula to calculate the periodic assessment amount is:

Total Assessment Per Unit / Frequency of the Assessment

- 4) Since the documents in our question do not contain a provision that requires more notice than the Condominium and Cooperative Acts, the noticing requirements in the statutes are followed. They state that the proposed budget package must be mailed or hand-delivered not less than 14 days prior to the budget meeting. Therefore, the answer to our question is no later than November 7. To determine the appropriate date, begin counting backwards starting with the day prior to the date of the meeting. In this case, you will start with "one" on November 20, and when you get to "14," that will be the date by which the budget packages must be mailed or hand-delivered.
- 5) Your responses should be as follows:
 - a) The response for Part A is 116 percent.
 - b) The response for Part B is "YES."

7 Review

This chapter provides a complete synopsis of the steps involved in preparing and disseminating the reserve schedule and operating section of the budget. In addition, you are given an opportunity to assess your level of knowledge in this area.

Synopsis

The following summary of the topics covered in this manual addresses the statutory and administrative rule procedures related to *preparing and disseminating* the reserve schedule and operating section of the proposed budget. Other activities incidental to this process such as naming the reserve accounts with specificity, applying general budgeting techniques, and knowing the vote required to waive or reduce reserves are not included.

- 1) Notices of board and committee meetings held to *develop* the proposed budget must be posted in a conspicuous location at least 48 hours prior to the meeting. The notice must include the date, time, and location of the meeting and an agenda. If there is no property to post the notice on, it must be mailed or delivered to the unit owners at least 14 days before the meeting. (*Chapter 1*)
- 2) There are two main sections of the budget - operating and reserve. The operating section identifies the line items that relate to the day-to-day operation of the association. The reserve section contains items that are restricted for specific purposes, unless unit owner approval is first obtained. (*Chapter 2*)
- 3) The association must have, at a minimum, a reserve for roof replacement, building painting, pavement resurfacing, and items having a deferred maintenance expense or replacement cost over \$10,000. (*Chapter 3*)
- 4) A reserve schedule must be prepared that lists each of the deferred maintenance and capital expenditure reserve items required by statute, your condominium documents or your association. The steps for preparing the schedule are listed below. (*Chapter 4*)
 - (a) List all deferred maintenance and capital expenditure reserve items on the schedule.
 - (b) Write the estimated *total* useful life of each reserve item on the schedule in the column "Estimated Total Useful Life."
 - (c) Write each reserve item's estimated *remaining* useful life in the column "estimated Remaining Useful Life."
 - (d) Write each reserve items estimated cost for deferred maintenance or a capital expenditure in the column "Estimated Cost for Deferred Maintenance or a Capital Expenditure." Total the amounts.
 - (e) Determine the estimated fund balance for each reserve, and write the answer in the "Estimated Fund Balance" column. Total the amounts.
 - (f) Compute the current year funding requirement for each reserve item, and place the amount in the "Current Year Funding Requirement" column. Total the amounts.

- 5) The formula for computing the current year funding requirement for each reserve item is as follows: *(Chapter 4)*

(Estimated cost - estimated fund balance) divided by the remaining useful life.

- 6) The operating section of the budget must contain certain disclosures. Please refer to the "Budget Checklist - *Operating Section*" on page 52 for a list of these disclosures. *(Chapter 5)*
- 7) Once all of the expenses for the operating section of the budget have been estimated, the total assessment per unit can be computed. The formula for computing the total assessment per unit is as follows: *(Chapter 6)*

Total Operating Expenses - Anticipated Revenues X Ownership Interest.

- 8) Once the total assessment per unit is determined, the periodic assessment amount can be computed. The formula is as follows: *(Chapter 6)*

Annual Assessment per Unit / Frequency of the Assessment.

- 9) When the proposed budget is finalized and ready to go out to the owners, the board must ensure proper notice is given of the meeting at which the budget will be considered for adoption. *(Chapter 6)*
- 10) The board must ensure that the minutes of the board or unit owner meeting at which the budget was adopted reflect the adoption of the budget. In addition, the board must ensure that copies of the proposed and adopted budgets are maintained as part of the financial records of the association. *(Chapter 6)*

BOARD APPROVED BUDGET: The meeting notice, agenda, and a copy of the proposed budget must be mailed or hand-delivered to each unit owner at least 14 days prior to the meeting. An affidavit attesting that the association complied with the 14-day notice must be executed by the person who provided notice of the meeting. The affidavit must be maintained with the association's official records.

UNIT OWNER APPROVED BUDGET: The meeting notice, agenda, and a copy of the proposed package must be mailed or hand-delivered to each unit owner at least 14 days prior to the meeting. In addition, the notice and agenda are to be posted in the designated location on the property. If there is no property to post the notice on, the posting requirement does not apply. An affidavit attesting that the association complied with the 14-day notice must be executed by the person who provided notice of the meeting. The affidavit must be maintained with the association's official records.

FINAL PRACTICE EXERCISES

- 1) You're responsible for noticing the first of several board meetings that will be held to develop the proposed budget. You proceed to read the bylaws and discover that they don't address the time frame for noticing the meeting. How much time prior to the board meeting does the statute require you to post the notice? *(Circle one.)*
 - a) At least 24 hours prior.
 - b) At least 72 hours prior.
 - c) At least 48 hours prior.
 - d) This isn't addressed anywhere.

- 2) The documents for your association state that board and committee meetings must be noticed at least 24 hours prior to the meeting. As secretary of the association, you are responsible for providing proper notice of the upcoming committee meeting at which the proposed budget is to be developed. The proper time frame for noticing the committee meeting is: *(Circle one.)*
 - a) At least 24 hours prior to the meeting.
 - b) At least 48 hours prior to the meeting.
 - c) At least 14 days prior to the meeting

- 3) *(Complete the sentence.)* The budget is divided into two main sections -

_____ & _____.

- 4) In the space below, describe the main difference between how funds can be used that are identified with the operating section of the budget versus those identified with the reserves section of the budget.

- 5) The board of your association has decided to begin saving money for the insurance premium that will be due in three years. They want to ensure that there will be enough money to make this payment by not accidentally spending it for day-to-day expenses. What could the board do in this case? *(Circle one.)*
 - a) Create a line item entitled, "Insurance Premium" in the operating section of the budget, and put the money with the operating funds.
 - b) Create a line item entitled, "Insurance Premium" in the reserves section of the budget, and put the money with the reserve funds.

- 6) The Condominium Act requires associations to establish, at a minimum, certain deferred maintenance and capital expenditure reserves. In the spaces provided, list the required reserves.
- a)
 - b)
 - c)
 - d)
- 7) Your association has a swimming pool that costs approximately \$8,000 to replace. The board decides to set aside funds as a reserve in the event deferred maintenance or a capital expenditure is needed for the pool. Where must this reserve be disclosed? *(Circle one.)*
- a) It doesn't have to be disclosed anywhere because it's a deferred maintenance and capital expenditure reserve item that's under \$10,000.
 - b) It should be disclosed in the reserves section of the budget on the schedule of required deferred maintenance and capital expenditure items.
 - c) It should be disclosed as an "other" reserve in the reserves section of the budget.
- 8) Assume that it is October, and you're preparing the proposed budget. It has been determined that the estimated cost to replace the roof in five (5) years is \$86,000. You estimate that \$64,325 should be in the roof replacement reserve on December 31. Use the Straight-Line Method to compute the current year funding requirement for the roof replacement reserve.
- 9) Due to a recent storms the clubhouse roof sustained extensive damage. The cost to replace it exceeded the balance of the clubhouse roof replacement reserve by \$6,000. The clubhouse roof has been replaced, and you're responsible for preparing next year's proposed budget. The roof is expected to last 15 years and have a replacement cost of \$91,000. Use this data and the Straight-Line Method to compute the current year funding requirement for the clubhouse roof reserve.
- 10) Assume that assessments are allocated on an equal fractional basis and that there are 135 units. The bylaws state the assessments are collected on a monthly basis. total estimated operating expenses amount to \$361,532. The estimated non-assessment revenues are \$21,269. Compute the total assessment and periodic assessment per unit.

Total Assessment per Unit: \$ _____

Periodic Assessment Amount: \$ _____

11) Your association's documents state that the board of administration has the authority to adopt the annual budget; however, they are silent with regard to noticing the budget meeting. The board has scheduled a meeting for October 31 at which the proposed budget is to be adopted. According to the Condominium Act, by what date must the proposed budget be mailed or hand-delivered to the unit owners? *(Circle one.)*

- a) October 17
- b) October 18
- c) October 1

ANSWER KEY

- 1) C. A budget must be noticed at least 48 continuous hours prior to the meeting. The notice must be posted conspicuously on the property with an agenda.
- 2) B. You will post the notice at least 48 hours prior to the meeting because the statute specifies a longer notice period.
- 3) The sentence should have been completed as follows:

The budget is divided into two main sections - OPERATING and RESERVE.

- 4) Although your response may be worded differently than the paragraph below, it should have essentially indicated the following:

The operating section of the budget identifies the line items that relate to the day-to-day operation of the association. The reserves section contains items that are restricted for specific purposes. Any funds that are a part of the reserve section can only be used for the purpose intended, unless the proper unit owner vote is first obtained.

- 5) B. Since the board wants to ensure that funds will be available in three years to pay for the insurance premium, and reserves must be set aside and used for the purpose intended, the board could create a line item for this in the reserves section.
- 6) Your response should have included the following four items:
 - a) Roof Replacement.
 - b) Building Painting.
 - c) Pavement Resurfacing.
 - d) Items having a deferred maintenance expense or replacement cost over \$10,000.

- 7) C. According to the administrative rules, deferred maintenance and capital expenditure reserve items that are not required by the Condominium Act should be disclosed in the "other reserves" section of the reserve schedule.
- 8) The current year funding requirement for this scenario is \$4,335. This amount was determined as follows: $(\$86,000 - \$64,325) / 5 = \$4,335$.
- 9) The current year funding requirement for this scenario is \$12,067. This amount was determined as follows: $((\$91,000 - \$0) / 15) + \$6,000 = \$12,067$.

- 10) The total assessment per unit is \$2,520, and the periodic assessment amount is \$210 per month. These were determined as follows:

$$(\$361,532 - \$21,269) / 135 = \$2,520.$$

$$\$2,520 / 12 \text{ Months} = \$210 \text{ per Month.}$$

11) Since the documents in our question do not contain a provision that requires more notice than the Condominium Act, the noticing requirements in the statutes are followed. They state that the proposed budget package must be mailed or hand-delivered not less than 14 days prior to the budget meeting. Therefore, the answer is no later than October 17. To determine the appropriate date, begin counting backwards starting with the day prior to the date of the meeting. In this case, you will start with "one" on October 30, and when you get to "14," that will be the date by which the budget must be mailed or hand-delivered.

Conclusion

You have concluded your training on the basic procedures and minimum statutory and administrative rule requirements for preparing a budget and reserve schedule of deferred maintenance and capital expenditure reserve items. You should now be able to prepare your association budget and be able to identify missing components in budgets and reserve schedules.

Appendices

PROPOSED BUDGET CHECKLIST - Operating Section

All estimated common expenses or expenditures of the association including but not limited to the following items:

- Administration of the association.
- Management fees.
- Maintenance.
- Rent for recreational and other commonly used facilities.
- Taxes upon association property.
- Taxes upon leased areas.
- Insurance
- Security provisions.
- Other expenses.
- Operating capital.
- Rent for a unit, If subject to a lease.
- Rent payable by the unit owner directly to the lessor or agent under any recreational lease or lease for the use of commonly used facilities, which use and payment is a mandatory condition of ownership and is not included in the common expenses or assessments for common maintenance paid by the unit owners to the association.
- Fees payable to the division.
- Expenses for a unit owner.
- All estimated common expenses or expenditures stated on an annual basis.
- All estimated expenses shown on a monthly basis.
- Beginning and ending dates of the period covered by the budget.
- The total assessment for each unit type according to the proportion of ownership on a monthly basis, or for any other period for which assessments will be due.

NOTE: After turnover of control of the association to the unit owners, if any of these expenses are not applicable they do not need to be included on the budget. If the association maintains limited common elements with the cost shared by only those entitled to use them, a separate schedule or schedules must be attached that contains the same disclosures as in the budget. The schedule(s) must show all estimated expenses specific to each limited common element, including reserves for deferred maintenance and capital expenditures, if applicable.

Sample Budget For the Fiscal Year January 1, 2002 through December 31, 2002

Sample Operating Section of the Proposed Budget
For the Fiscal Year January 1, 2002 through December 31, 2002

REVENUES	
Assessment Income:	\$345,600
Interest Income:	
Operating Account	\$3,510
Savings Account	<u>2,610</u>
Total:	6,120
Other Income:	
Miscellaneous	\$108
Drinks	4,800
Fax	250
Laundry	9,640
Snacks	600
Games	<u>5,508</u>
Total:	\$20,906
TOTAL REVENUES	<u>\$372,626</u>
Reserves:	
Roof Replacement	\$8,000
Pavement Resurfacing	3,504
Building Painting	18,008
Elevators	800
Clubhouse	3,000
Walkways	3,000
Total	\$36,312
Administration:	
Accounting	\$5,004
Bad Debt	1,054
Annual Condominium Fee	640
Annual Corporate Fee	62
Insurance (D&O, Fidelity, Flood, P&C)	32,004
Legal	804
Licenses and Taxes	
Licenses	504
County	144
State	804
Management Fees	6,000
Office Supplies	2,400
Postage	660
Total	\$50,080

Salaries:	
Casual Labor	\$204
Maintenance Staff	80,012
Payroll Taxes	15,004
Worker's Compensation	17,600
Total	\$112,820
Maintenance and Repair:	
Buildings	\$8,004
Elevators	4,000
Fire Systems	3,000
Grounds	7,008
Supplies and Tools	8,008
Swimming Pool	6,408
Tennis Courts	660
Laundry	5,000
Miscellaneous	504
Total	\$42,592
Utilities:	
Electricity	\$23,004
Pest Control	4,008
Sanitation	14,004
Sewer	28,500
Telephone	1,404
Water	12,504
Total	\$83,424
Vending:	
Drinks	\$2,000
Fax	120
Soap Products	3,000
Snacks	360
Games	120
Total	\$5,600
Other Expenses:	
Security	\$25,008
Rent for Recreational / Other	0
Commonly Used Facilities	0
Taxes on Association Property	0
Taxes on Leased Areas	0
Operating Capital	
Special Enhancements	7,250
Contingency	9,540
Total	\$41,798

ADDITIONAL EXPENSES FOR A UNIT OWNER	
Rent For Unit Subject To Lease	0
Rent Payable by Owner Directly to Lessor	0
Under Recreational Lease / Lease for	0
Commonly Used Facilities	0
Total	\$0

EXPENSES FOR ASSOCIATION & CONDOMINIUM

MONTHLY OPERATING EXPENSES	\$31,052
NET INCOME (LOSS)	\$0
ASSESSMENTS FOR EACH UNIT (160 units)	
Annual	\$2,158
Monthly	\$180
OPERATING EXPENSES (w/o reserves)	\$336,314
TOTAL OPERATING EXPENSES	\$372,626

PROPOSED BUDGET CHECKLIST - Reserves Section

- The following items must be disclosed on the schedule of deferred maintenance and capital expenditure reserves required by the Condominium Act or the association:
-
- All deferred maintenance and capital expenditure reserve items;
- Estimated total useful life of each deferred maintenance and capital expenditure item;
- Estimated remaining useful life of each deferred maintenance and capital expenditure item;
- Estimated costs for each deferred maintenance or capital expenditure item;
- Estimated fund balance as of the beginning of the proposed budgeting period (end of the current year) for each deferred maintenance and capital expenditure item; and
- Funding required for the proposed budget period for each deferred maintenance and capital expenditure item.

Additionally, the following must be disclosed for any non-deferred maintenance and capital expenditure reserve item maintained or proposed by the association:

- The intended use of the restricted funds; and
- Estimated fund balance as of the beginning of the proposed budgeting period (end of the current year).

REFERENCES

The Condominium Act, Chapter 718, Florida Statutes (F.S.)

Subsection 718.103(1)
Subsection 718.104(4)(f)
Subsection 718.111(12),(15)
Subsection 718.112(2)(b),(c),(d),(e),(f),(g)
Subsection 718.115(2)
Subsection 718.116(1)(a)
Subsection 718.116(2),(9)(a)
Subsection 718.504(20)

The Florida Administrative Code Rules (F.A.C.)

Rule 61B-22.001
Rule 61B-22.002
Rule 61B-22.003
Rule 61B-22.005

GLOSSARY

Section 718.111(12)(a)11., and any other records that identify, measure, record, and / or communicate financial information whether the records are maintained electronically or otherwise. [Rule 61B-22.001(1)]

ACCRUAL BASIS This basis of accounting recognizes revenues and expenses are when they are earned and incurred, regardless of when cash is received or disbursed. (*Compare with Cash Basis.*)

ADMINISTRATIVE RULES These implement, interpret, and enforce the provisions of the statutes. The Florida Administrative Code (F.A.C.) that correspond to the Condominium Act include Chapters 61B-15 through 61B-24, F.A.C.

ARTICLES OF INCORPORATION This document creates the corporate entity that operates the condominium or cooperative. It contains information about the corporation such as the number of directors and officers, and their powers and duties.

ASSESSMENT A unit owner's share of money that's paid to the association. One unit owner's share will be combined with other unit owners' shares to pay the common expenses of the association. 718.103(1)

ASSOCIATION This is the entity that operates the condominium. 718.103(2)

ASSOCIATION PROPERTY This is property, real and personal, that's owned or leased by, or is dedicated by a recorded plat to, the condominium association for the use and benefit of its members. [718.103(3)]

BOARD MEETING This means any gathering of the members of the board of directors, at which a quorum of the members is present, for the purpose of conducting association business. [Rule 61B-23.001(1)(a)]

BUDGET This is a formal plan that itemizes the association's projected expenditures for the fiscal year.

BYLAWS A condominium association document that addresses the operational aspects of the association such as meeting notice requirements and budgeting information. [718.103(5)]

CAPITAL EXPENDITURE Any expenditure of funds for the purchase or replacement of an asset whose useful life is greater than one year, or the repair or addition to an asset that extends the useful life of the previously existing asset for a period greater than one year. [Rule 61B-22.001(2)]

CASH BASIS This basis of accounting recognizes revenues when they are received, and expenses when they are paid. (*Compare with Accrual Basis.*)

CHART OF ACCOUNTS This is a listing of the titles and the number codes that have been assigned to the general ledger accounts. It's like an index that helps facilitate the process of entering revenue and expense amounts to the accounting records.

COMMITTEE A group appointed by the board or a member of the board to take action on behalf of the board or to make recommendations to the board regarding association matters. [718.103(6)]

COMMITTEE MEETING Any gathering of a committee at which a quorum of the members of that committee is present. [Rule 61B-23.001(1)(b)]

COMMON ELEMENTS The portions of the condominium property that are not included in the units. [718.103(7)]

COMMON EXPENSES All expenses and assessments that are properly incurred by the association in the performance of its duties. [718.103(8)]

COMMON SURPLUS This means the cumulative excess of revenues over expenses. [718.103(9)]

CONDOMINIUM DOCUMENTS For purposes of this manual, condominium documents include the declaration of condominium, articles of incorporation, bylaws, and attached exhibits.

CONDOMINIUM PARCEL A unit, together with the undivided share in the common elements which is appurtenant to a unit. [718.103(11)]

DECLARATION OF CONDOMINIUM This document creates the condominium when it is recorded in the county where the condominium is located. It contains information such as the unit owners' percentages or proportions of and manner of sharing common expenses and owning common surplus. [718.103(14)]

DEFERRED MAINTENANCE Any maintenance or repair that will be performed less frequently than yearly, and will result in maintaining the useful life of an asset. [Rule 61B-22.001(3)]

ESTIMATED FUND BALANCE This is the amount of money that should be in the reserve account at any given time.

ESTIMATED REMAINING USEFUL LIFE This is the length of time a particular asset has left before deferred maintenance or a capital expenditure is needed.

ESTIMATED TOTAL USEFUL LIFE This is the length of time a particular asset should last before deferred maintenance or a capital expenditure is needed.

FISCAL YEAR An accounting period of 12 months, usually the calendar year.

FULLY FUNDED This means that when the budget is provided to the owners, it will show the amount of money that must be deposited that year for each reserve item to ensure that, when the time comes, sufficient funds will be available for deferred maintenance or a capital expenditure.

FUND ACCOUNTING This is an accounting method appropriate for tracking restricted accounts such as reserves.

GOOD ACCOUNTING PRACTICES This requires that accounting records be maintained in sufficient detail so that when someone inspects them, that person will be able to determine the association's revenues, expenses, assets and liabilities. It also suggests that controls need to be in place to protect the financial assets of the association.

LIMITED COMMON ELEMENTS Common elements that are reserved for the use of a certain condominium unit or units to the exclusion of other units, as specified in the declaration of condominium. [718.103(17)]

LIMITED PROXY (*See Proxy.*)

LINE ITEMS Categories of expenses that are listed on the budget.

MULTICONDOMINIUM This is a condominium that is part of or included within a development which contains more than one condominium operated by a single association. [Rule 61B-15.0001(1)]

MULTICONDOMINIUM ASSOCIATION This is a condominium association that operates more than one condominium.

PROXY A proxy, whether general or limited, is a form unit owners can use if they cannot, or choose not to, personally attend a unit owner meeting. A limited proxy limits the decision-making power of the person to whom the proxy is assigned (a proxy holder). The unit owner uses the limited proxy to direct the proxy holder on how to vote for a particular issue.

QUORUM The minimum number of voting interests that must be present for a meeting to be held. The documents should identify the quorum requirement for board, committee, and unit owner meetings. Members at unit owner meetings can be represented in person or by proxy.

RESERVES Funds, other than operating funds, that are restricted as to use by the statutes, the condominium documents or by the association. [Rule 61B-22.001(5)]

REVENUE Income, or settlement of liabilities, related to the operation of the association.

SPECIAL ASSESSMENT This is any assessment levied against unit owners other than the assessment required by the adopted budget. [718.103(21)]

TURNOVER This is when the developer transfers control to the non-developer unit owners. [Rule 61B-22.001(6)]

UNIT OWNER This is the record owner of legal title to a condominium parcel. [718.103(25)]

VOTING INTEREST The voting rights distributed to the association members as described in the documents. [718.103(27)]