

Tying Up Loose Ends:
End of the Year Checklist for Self-Managed Communities

As we near the end of the year, it's time to take care of loose ends and prepare for the upcoming year. This can often prove a difficult balancing act, especially without the help of professional management. However, just because you're a self-managed community doesn't mean you must do without professional assistance. In fact, under the Washington Nonprofit Corporation Act, a board of directors is allowed to do just that: rely on information, opinions, reports, and statements from professionals in a given field. What follows is a basic primer on what you, as a self-managed community, need to do at year-end.

Balancing the Books -- Financial Statement, Budget, Audit & Tax Return

Whether you're a homeowners association or a condominium owners association, year-end means it's time to balance the books and take stock financially.

Annual Financials & Budgeting

Both the Condominium Act and the HOA Act require every association to prepare, at least annually, a "financial statement." A financial statement consists of a balance sheet and an income-and-expense statement. The Condominium Act provides that the statement must be prepared in accordance with generally accepted accounting principles (GAAP). This means that all figures have to be shown on an accrual basis, which records income when earned and expenses when incurred, as opposed to a cash-basis model, where income and expenses are recorded when cash actually flows in and out. The HOA Act does not mandate compliance with GAAP, but doing so constitutes best practices.

In addition to the financial statement, associations should prepare an annual budget that projects anticipated operating costs and reserve contributions for the coming year. This is required by the bylaws of most associations, although it is not a statutory requirement. However, before a new schedule of assessments may be used, there must be a budget that supports the assessment amounts. If a budget proposed by the board of directors is not ratified by the association, the last budget that was ratified must remain in effect.

What's an audit, and can I waive it?

Audits, which are conducted by certified public accountants (CPAs), verify the accuracy and fairness of an association's financial activity and reports. Condominiums with 50 or more units are required to have their financial statements audited annually by a CPA. Condominiums with fewer than 50 units can waive the annual audit if 60% of the units (not including units owned by the declarant) vote to waive. Homeowner associations with annual assessments of \$50,000 or more are required to have an annual audit, unless waived by a 67% vote at a meeting at which a quorum is present. Waiver must be done one year at a time: multi-year waivers are not allowed under the statute.

Taxes, Taxes, Taxes

An association must file a federal tax return each year, even though it is a nonprofit corporation or association. The return is due March 15, unless an extension is requested. One of two IRS forms is used. Form 1120 is considered the "Corporate Method," and graduated tax rates begin at 15%. Form 1120H is the "Exempt Method" and uses a flat tax rate of 30%. If the association has no taxable income, the tax rate may be irrelevant. Form 1120 can save you money if there is taxable income to report, but it is more complex to fill out and requires advance planning. Form 1120H is easier to complete but the following four criteria must be satisfied: (1) 85% of the units must be for residential use; (2) at least 60% of gross income must be tax exempt income; (3) 90% of expenses must be to acquire, build, manage, maintain, and care for property; and (4) residual income must not be used for members' benefit.

Given the complexities of tax laws, consult with a tax professional to ensure compliance with federal requirements and the most favorable tax treatment for your association.

Preserving Your Investment – Reserve Study and Maintenance Plan

Next on the list are those items which keep your buildings and improvements in good repair over the long term: reserve studies and inspections.

Confused about Reserve Studies?

Under a law passed in 2008, all Washington condominium associations (including old-Act condos) must conduct a reserve study and update it annually. Non-condo homeowner associations are not subject to this requirement. A full reserve study includes a physical assessment of all building components and improvements that are expected to require replacement, and a financial analysis.

The purpose of annual updates is to ensure that reserve funding is on track and, if not, to adjust the funding schedule. This means comparing actual wear of components to anticipated wear, adjusting estimates of remaining service life as needed, and checking actual funding and investment returns against expected revenues and investment returns. The update must include an onsite inspection every third year; interim-year updates do not require onsite inspections. Annual updates are not required for associations with ten or fewer units.

Inspect and Repair Every Year

Annual inspections and regular maintenance and repair are key to the long-term well being of any association. The reserve study may include physical inspection of buildings and improvements, but inspection is not the same as maintenance. As board members, it is your responsibility to make sure that regular maintenance and repairs are carried out to preserve the condition of the buildings and improvements. Since board members change year, having a maintenance plan that specifies the schedule for maintenance of each

component helps provide continuity as members rotate off the board ó particularly in self-managed associations. Most reserve study analysts can also prepare maintenance plans.

Legal Housekeeping – License Renewal

The reserve study and annual inspections help preserve the physical well-being of your buildings, but ensuring the legal life of your association is important as well. Nonprofit corporations must register annually with the Secretary of State. An Annual Report must be filed with the Secretary of State. This can be done online and includes verifying the names and addresses of all officers and directors, the principal place of business, your corporation activities, a signature from an authorized board member, and paying a fee. (See <http://www.sos.wa.gov/corps/>). Failure to renew your registration will trigger an administrative dissolution of the corporation. The corporate license can be reinstated for three years after dissolution, but there is an extra fee for reinstatement. A corporation must be in good standing with the Secretary of State to maintain any court action ó such as a collection action ó so annual renewal is important.

Fostering a Sense of Community – the Annual Meeting

The above items are needed to keep your association in good order, but remember what creates a sense of community: the people. While the law (and probably your bylaws) requires every condominium and homeowner association to have an annual meeting, the annual meeting is also a great opportunity to strengthen your community. Adding a social element to the meeting, by having food and beverages, brings people in and creates a positive atmosphere for participation. If alcoholic beverages are involved, it is prudent to complete the annual meeting business before opening the bar! Putting photos from the annual meeting on the association website reinforces the sense of community and fun.

Conclusion

Managing your own association can be a daunting task. Knowing the things you have to do at year-end to satisfy legal requirements is critical. By getting started early in the fall on financial matters, annual inspections and reserve study updates, and license renewal, you will keep your association on track and be ready for a productive and fun annual meeting.

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