Kevin Ducotey, CMCA, AMS, PCAM

I originally intended to write about a specific budget success story that I have experienced. The fact is every association is different and has a unique story. As I continued to think about it, I kept coming back to the same point: It's not about individual success stories, it's about applying certain principles and concepts, and adapting to the changing climate of the industry that determines the level of budgeting success.

My success story is consistently incorporating the following principles, steps, or concepts in the preparation of every budget. This list is based on my experience, past mistakes, and the changing economic conditions of the area:

1. DON'T OVERSTATE INCOME TO BALANCE THE BUDGET:

a. Use only predictable income—such as assessments, move-in fees, and parking fees.

b. Don't use unpredictable income to balance the budget—e.g., late charges and house rule violations.

c. Don't use interest earned on the reserves as operating income. This is part of the reserve contribution, as outlined in the reserve study, and cannot be used as operating income.

2. ACCOUNT FOR UNEXPECTED ITEMS:

a. Create a contingency line item for maintenance and administrative expenses such as legal fees and unexpected maintenance.

b. The more mechanical systems a building has, such as HVAC systems and elevators, the higher the contingency number should be to cover any unexpected repairs.

c. Contingency line items are flexible, meaning they can be used for different items every year. One year it might be the elevators, next year it might be used for the HVAC system, etc.

3. ACCOUNT FOR "BAD DEBT":

Prior to 2007, writing off unpaid assessments was not an issue for any association. Writing off debt has become a direct result of the housing-market meltdown and is part of adapting the budget to current economic conditions. As managers, we had to learn how to incorporate the bad debt issue into the budget:

a. The amount of bad debt budgeted for each association is different. No one rule applies to all associations.

b. Each year any unused bad debt should be rolled over to the balance sheet as a future liability.

c. Bad debt in 2015 is becoming less of an issue as housing and employment is on the rebound.

4. COMPLY WITH THE RESERVE STUDY:

As recently as 15 years ago, before reserve studies were a requirement, the way we determined the reserve contribution involved taking the annual assessment income, less the annual operating expenses. The difference between the two became the reserve contribution. The climate and expectations have changed a little since then:

a. Include the recommended reserve contribution in the budget and let the board change it if desired.

b. Include the list of planned reserve projects for the year in the budget after the net income on the budget, including a description of each project.

c. Review the reserve study every year with the board along with the list of projects listed in the study.

5. ADJUST FOR CASH FLOW ISSUES BY ACCOUNTING FOR BUDGET SURPLUSES OR DEFICITS FROM YEAR TO YEAR:

a. Account for a deficit by adding a line item in next year's budget ("Prior Year's Loss").

b. Account for a surplus by adding a line item in next year's budget ("Prior Year's Surplus"), or consider refunding money to the owners, or making an additional reserve contribution before closing out the year. I prefer the last option.

c. Deficits over multiple years will create a cash flow problem.

d. Don't resolve a cash flow problem by not making the budgeted reserve contribution. I do not recommend writing off reserve contributions, which should be done as a last resort.

6. EVALUATE RETAINED EARNINGS:

a. What are "retained earnings"? Simply put, retained earnings are assets less liabilities. For example: If I have $3,000 of accrued income for the year and I have accrued $3,500 of expenses for the year, my retained earnings is -$500.

b. General Rule: The larger the negative number, the more likely the association will have a cash flow problem. This problem magnifies if this scenario happens over multiple years.

The last two items go beyond the normal budgeting process and number crunching, and enter more into financial analysis. These practices identify cash flow and spending issues, and allow for adjustments to be made in the budget each year to correct the problem.

It was a "light bulb over my head" moment when I finally realized and connected the dots that the budgeting process and addressing cash flow issues go hand-in-hand. It made a big difference in the content of the budget as well as the information I was communicating to the Board. It's going beyond the numbers and looking at the association's financial past, present, and future and addressing the financial health of the association.