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Would Your HOA's Accounting Stand Up To a Judge's Scrutiny? Mistakes to Avoid

In a recent case, a Florida court of appeals denied a foreclosure action because of sloppy and unreliable accounting of assessments and collections. Here we explain the details of Jenkins v. Plaza 3000 Inc. and talk about its lesson for associations nationwide.

What Happened in *Jenkins*

Jenkins involved not a homeowners or condo association but a nonprofit corporation that operated a shopping center, Plaza 3000. Shareholders owned lots, and the corporation collected assessments, just like associations do, to maintain common areas. Scherry Jenkins owned three lots in the center.

Jenkins' husband handled the payment of assessments, and he wasn't very good at it. According to the court, he habitually paid late, paying on time only twice in 15 years. The corporation generally accepted his late payments and applied them toward his delinquent assessments. There was always a balance due, the court noted, and that balance was frequently in dispute because Mr. Jenkins several times provided proof that he'd paid but that the corporation hadn't credited the payment to the account.

On July 21, 2008, Plaza sent Jenkins a demand letter for $26,456. Jenkins sent a check for $4,651 marked "paid in full to date" and "paid under protest." Plaza returned the check and after further wrangling, eventually filed a foreclosure action. Jenkins' defenses included allegations that Plaza had wrongfully refused tendered checks, hadn't maintained proper accounting records, and had incorrectly charged interest.

At trial, Plaza's accountant testified about two charts entered into evidence. One had been attached to the original demand letter. The second he prepared to update the information through 2012. The second chart also attempted to correct errors in the first chart by crediting Jenkins with payments the accountant admitted Plaza had credited late and interest Plaza had charged on those payments. The accountant admitted Jenkins had been given inaccurate information regarding the amount of assessments owed as well as the interest accrued. The judge's response: "This case is a mess. The accounting was a mess." Admitting an inability to determine the actual amount due, the judge denied foreclosure but entered judgment in favor of Plaza for $10,037.

Jenkins appealed, and the appellate court reversed the trial court's judgment. The appellate court, in so many words, agreed Plaza's accounting was indeed a mess and that the company's accountant admittedly couldn't explain some of the calculations. But because a judgment must be based on competent evidence, and not conjecture, the court wiped out the amount awarded the plaintiff.

The Lesson of *Jenkins*

"*Jenkins* doesn't involve an association," notes Jed L. Frankel, a partner at Eisinger, Brown, Lewis, Frankel & Chaiet PA in Hollywood, Fla., who advises community associations. "It's a commercial shopping plaza that people own a store in, and its articles of incorporation, bylaws, and covenants give the plaza the ability to file a lien and seek to foreclose. To me it's a very different setting than condos.

"Because of this context, and with the relatively small amount of money involved, this appears to have been an attorneys' fees-driven case," adds Frankel. "Nobody goes to trial and goes up on appeal for $26,000 if their attorneys are giving them good advice and the clients are rational. You probably have fees and costs on both sides of $150,000 and that's why this case is where it is. The judge tried to split the baby."

That, of course, didn't work. "One of the problems is the shopping center goes back to its original demand letter and admits the amount they demanded was improper, so the judge denied foreclosure," says Frankel. "Essentially, the judge was saying, 'You didn't start this thing correctly, and you can't foreclose. But it's clear money's owed. Plaintiff, prove how much.' The appellate court said the plaintiff didn't prove it and that the accepted evidence wasn't competent and substantial. It also said you can't split the baby. That's absolutely applicable to condo and HOAs. When you start with a lien, the amount of money you demand had better be right."

Frankel has had cases like this. "They're not that frequent because typically in a condo, you pay or you don't pay your monthly assessments," he says. "But I've had a couple of situations where people have owned multiple units, rented parking spaces, gotten cable through the association, or had an association employee do service in their unit. So there are these ancillary services, and after five years, if they're claiming they made payments or things were discounted, how do you figure it out?

"I try to get my clients to settle," says Frankel. "Forget the late fees. Once you pull those out—because you didn't actually lose that money—the number becomes much more manageable. Let's say the $40,000 comes down to $20,000. How much is it worth to the association to get it to a zero balance? Cut the baby in half and be done with it. We've done that, and moving forward, you don't have that problem anymore. You have specific assessments and they're either paid or not paid.

"This also happens a lot when there are changes in accountants," adds Frankel. "Here they changed management companies, and the current company couldn't tell the judge what the first company had done. In that case, it's helpful to have an association president who says, 'I oversaw the transition from one to another, and I saw those numbers.' Still, I think you're better off resolving this by settlement and moving forward."

Accounting Problems Still Arise

Jenkins shows that now's the time to look at your accounting system to be sure it's up to the job.

"I'm sorry to say I've heard about when there are problems, not when things have gone well," says Beth Grimm, an attorney in Pleasant Hill, Calif., who's practiced HOA law for more than 25 years, representing both associations and homeowners. "It's been more common that boards did have good accounting records, especially when they were managed by a professional management company."

"Problems come out most commonly in situations where somebody's doing the accounting who has a poor system set up, or it's a smaller association—there are more smaller than large that do this—that's operated more on the honor system than on actual records," says Grimm. "And sometimes they'd don't have formal HOA accounting systems or good collection policies because they don't get them from the right people."

Robert White has seen similar situations. "I haven't seen this problem as it relates to foreclosure actions," says the managing director of KW Property Management & Consulting in Miami, which oversees about 125 associations totaling 30,000—35,000 units. "I have seen it where amounts receivable are very hard to determine. Usually before an account goes to foreclosure, we'll do a lot of front¬-end work. We'll meet with the owner, get the documentation, and we'll try to resolve it before it gets to that point.

"But I've taken over many self-managed communities where the accounting leaves a little something to be desired," adds White. "There are two components to an accounts receivable system. The first is posting all assessments. The other big component involves posting properly. A lot of times, checks will come in and be misposted. Let's say unit X's owner sends in a check, and the accountant accidentally posted it to unit Y. Time will go by, and X will be getting late notices, while Y will get notices he's prepaid or that he paid, even though he didn't. If enough time goes by, there's no easy way to show X paid this.

"The only way to gain control of accounting is to have any unit owner who has a question come into our office with copies of cancelled checks to show payments have been posted to the wrong account," says White. "That's literally the level of detail we have to go through."

That's also the practice for Steven Parker, president of FirstService Residential Nevada in Las Vegas, which manages hundreds of community associations. "If you have arrears when you take over management of an association, it occasionally happens that a homeowner will call and say, 'The statement is wrong; I paid that,'" he explains. "We'll say, 'Can you provide a copy of your check?' If they do, we correct it. The homeowner can't expect the management company to take their word the balance is wrong. In this day and age, it's not hard to get the information to prove it's been paid."

That's a good practice for any billing dispute, adds Parker. "This is an interesting case, and a little common sense and reasonableness would have solved this," he contends. "There are times when mistakes are made. Maybe the homeowner sends a check to the wrong lockbox, puts in the wrong account number, or somebody puts it in the wrong account. But once the matter goes to collection and the homeowner says, 'I thought I paid,' that's a sign you need to do digging. Now, it would be a lie to for me to say there's never been a paid account that's gone to collections. But when owners say, 'I paid,' we get it resolved. To get all the way down that road, someone has thrown commonsense to the wind."

Also be sure your accounting system separates fines from assessments because your right to collect them will likely differ. "A system like QuickBooks doesn't always work if you're trying to account for fines and for assessments," says Grimm. "But if it's set up properly, it would at least show assessments received and payments paid. The other thing is to have a comprehensible system that show assessments coming in and payments going out. With some, I couldn't even decipher what was going on. And, finally, you need somebody who's trained in accounting to do that work."