

# SOUTH COAST HOMEOWNERS ASSOCIATION

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Volume 18, Number 1

January 2005

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## UPCOMING SOUTH COAST MEETINGS

### ANNUAL LAW AND LEGISLATIVE UPDATE

It's the new year and time to be brought up to date on the 2004 Legislative law changes for associations and what they mean to you. The update programs allow you to gain a better understanding (hopefully!) about what the changes mean. This year **James Smith**, of Grokenberger & Smith, and **David Loewenthal**, of Loewenthal, Hillshafer & Rosen, will provide the updates. After the updates, our popular, moderated, question and answer session will follow to take your questions on the legal topics of interest to you. There is no charge for board members to attend.

#### **Santa Barbara/Goleta:**

**DATE – Thursday, January 27, 2005**

**TIME – 7 PM**

**PLACE – Holiday Inn, 5650 Calle Real, Goleta**

#### **Santa Maria:**

**DATE – Monday, February 28, 2005**

**TIME – 7 PM**

**PLACE – Quail Meadows West HOA Clubhouse – 866 Whippoorwill, Santa Maria  
(Santa Maria Way exit towards Santa Maria – right on College Dr (1<sup>st</sup> light)  
then left onto Whippoorwill – clubhouse just inside the gate)**

## 2005 CONDOMINIUM BLUEBOOKS NOW IN STOCK

The 2005 edition of the *Condominium Bluebook* arrived the first of the year. All associations and professional members that renewed for 2005 by December 31 should have received their copy by now. Those that ordered additional copies should have received their extra copies, too. We have approximately 50 additional copies available for those who would like an additional copy. Due to a price increase from the publisher, we have had to adjust our price slightly, to \$17/each, postpaid. Simply send your check to our P. O. Box address shown on page 1 to order additional copies, if you need them.

## TAX REPORTING AND FILING DEADLINES

The start of the new year and its tax time again. Here is a brief summary of the tax reporting and filing requirements for your association. For further information, contact your association's CPA or accounting professional.

**1099s:** Associations, like all other businesses, are required to file 1099 forms by January 31 for payments made during the previous calendar year. This is true even if the association has a fiscal year end other than December 31. If you pay \$600 or more during the calendar year to a "noncorporate service provider", then you are required to issue a 1099-MISC to that service provider. Common service providers to associations include attorneys, managers, accountants, contractors, gardeners, pool service, handymen, etc. Corporate service providers are exempted from receiving 1099s. How can you tell? If the business has the words "inc." or "corp." in its name, then it is a corporation. The word "co" (for company) does not specify a corporation. The 1099 form must show the service provider's name, address, and tax identification number (either social security or employer ID number) along with the amount paid during the calendar year. Copies are submitted to the service provider by January 31 and are due to the IRS by February 28 (the delay is to allow for corrections that may arise).

**Independent Contractor Reporting:** Four years ago, California law was changed to require businesses that use individual independent contractors to report "within 20 days of the earlier of first making payments that in the aggregate equal or exceed \$600 in any year to a service-provider, or entering into a contract or contracts with a service provider providing for payments that in the aggregate equal or exceed \$600 in any year". (California Unemployment Insurance Code) to the California Employment Development Department.

This law is intended to locate "deadbeat parents" who are receiving payments other than wages to be able to garnish them quickly to meet child support obligations. You use many of your contractors on a continuous basis so January is a good time to report them to the California EDD. Reporting is done on form DE-542 and can be mailed or faxed to the EDD. What is troublesome about this law (yes, there are penalties for failure to file) is that reporting can be required at any time during the year, not just once a year or quarterly. For example, you hire a painter on May 15 and sign a contract for a \$5,000 job. Reporting would be required by June 4, even if no payments had yet been made. The reporting deadline is 20 days after signing the contract.

**Employment Tax Returns:** For those associations that hire employees, Federal form 941 and California form De-6 are due 30 days after the end of each calendar quarter. Tax payments are due semi-weekly, monthly or at the filing date, depending upon the amount owed. Annual tax reports (Federal W2, 940; California DE-7) are due January 31.

**Federal Income Tax Returns:** All associations, no matter how small, must file a Federal Income Tax Return 2 ½ months after the end of its fiscal year. For calendar year associations, the due date is March 15 although it can be extended for 6 months by filing an extension form. Associations may elect to file Form 1120H or the standard corporate form 1120.

**California Income Tax Returns:** California Form 100 is also due the same time as the Federal returns. While most associations have “tax-exempt” status with the State of California, nonmembership income such as interest is taxable. If the association has more than \$100 in nonmembership income, then a return is required. Failure to file Form 100 when required can result in significant penalties and interest if tax is owed and can also result in the suspension of the corporation by the State.

**California Exempt Organization Return:** Form 199 is required of all tax-exempt associations that receive \$25,000 or more in revenue from any source (assessments, etc.) It is due 4 ½ months after year-end but can also be extended. A \$10 filing fee is required annually. Failure to file this form when required can result in an additional \$55 in penalties plus interest. Corporate powers can also be suspended for failure to file this form as well.

**Estimated Tax Payments:** If the association pays income taxes on its nonmember income, then it may be required to pay estimated taxes quarterly to avoid an estimated tax penalty. For Federal, estimates are required if taxes are \$500 or more. The state has no minimum. Federal tax deposits are made to your bank using a Federal Tax Deposit coupon while state taxes are paid by check and mailed using form 100-ES. Payments for calendar year associations are due April 15, June 15, September 15 and December 15.

**Secretary of State Biennial Filings:** The Nonprofit Corporation Statement of Information (SI-100) and the Statement of Common Interest Development (SI-CID) are required to be filed with the Secretary of State every two years. These are not tax forms, however, failure to file them with the Secretary of State can result in the suspension of corporate status. Filing fees are \$20 for the SI-100 and \$15 for the SI-CID. Since the forms are required only every two years, the due date is tied to the association’s incorporation month, and since they are not tax forms, it is common for this filing to be overlooked if the association’s mailing address has changed. While seldom done, the state allows for updated forms to be filed without the payment of an additional filing fee. See article following for interim filing of these forms. Fill-in forms are available on line at [www.ss.ca.gov](http://www.ss.ca.gov).

## **INTERIM REPORTING TO THE SECRETARY OF STATE**

As noted in the preceding article, associations are required to file two statements with the California Secretary of State every two years (SI-100 & SI-CID). During this two-year period, you may change directors or your managing agent and/or your association’s mailing address may change. (Sometimes more than once!) If your association’s mailing address changes,

there is a strong possibility that the forms that the Secretary of State mails to the association will not be forwarded to the new director or managing agent and could simply be thrown away by the former officer/managing agent or returned by the Post Office to the Secretary of State as undeliverable.

These Secretary of State filings are not part of your CPA's or tax professional's annual income tax filings for your association. For example, a calendar year association that incorporated in July 1977 would have annual income tax returns due to the IRS and Franchise Tax Board due March 15 each year (subject to extension). However, the Secretary of State filings are due on July 31<sup>st</sup> of each odd number year in this example. based on incorporation month and whether incorporated in an odd or even year. These biennial filings can be made any time in the preceeding five months prior to the incorporation month (the "six-month window") (February – June) with the Secretary of State upon payment of the \$20 filing fee.

At this time of the year, many associations have annual meetings where new directors are elected. Also, some associations have changed managers. This is a good time to review the last filing to see if an amended filing is needed. If the filing is being done outside the "six-month window" referenced above, **then no filing fee is required.** Forms and instructions are available online at the Secretary of State's web site – [www.ss.ca.gov/business/business.htm](http://www.ss.ca.gov/business/business.htm).

Our recommendation would be to review this filing annually after the annual meeting or when new signature cards are made when officers change.

## **WHAT SHOULD A BOARD BE LOOKING FOR WHEN THEY READ THE ASSOCIATION'S FINANCIAL STATEMENTS?**

**By: Gayle Cagianut, CPA**

**Editor's Note:** This article and the one following on records retention address common questions and concerns of board members when presented with financial information from their manager or accountant. Mrs. Cagianut is a long-time South Coast member and supporter whose practice is located in Oak View, near Ojai. Her firm works with over 200 homeowners associations in Southern California and Gayle has written many articles and professional publications on accounting issues for homeowners associations. She can be reached at 805-649-4630 or at P. O. Box 1047, Oak View, CA 93022

### **Operating cash:**

- Is there sufficient cash to meet your monthly cash requirements? If not, what should you do?
- Is there excess cash sitting in a checking account earning little or no Interest? Should you open an operating savings or money market account? Or should you transfer the excess to reserves?

- Does the cash balance on the balance sheet agree with the reconciled bank statement? Are there old outstanding checks that need to be researched? Are there unusual transfers?
- Does the board review the bank statements and reconciliations as required by California Civil Code on at least a quarterly basis and document the review in the association minutes?
- Are signature cards updated when board members or property management staff changes?

### **Reserve Cash:**

- Are reserve transfers being made on a regular basis from the operating account?
- Are funds properly invested in accordance with your investment policy? (*What? You don't have an investment policy?*)
- Are funds kept under \$100,000 per banking institution to obtain FDIC insurance?
- Are any investments maturing, requiring action by the board as to reinvestment?
- Will funds be available for planned reserve projects?
- Are reserve expenditures and transfers properly approved and documented in the board meeting minutes? Do they agree with the bank activity?
- Are two board members signing all reserve checks in compliance with California Civil Code?
- Are signature cards updated and current?

### **Assessments Receivable:**

- Are all accounts collectible? If not, has proper action been taken?
- Is the collection policy written and distributed to members on an annual basis in compliance with California Civil Code? Is the collection policy being applied consistently?
- At the end of the year, have you discussed with your accountant which accounts to write off as uncollectable or set up as an allowance for bad debts?

### **Revenues:**

- Does assessment income agree with budgeted amounts?
- Is all interest income posted to the financial statements on a timely basis?

- Are late charges, violation fees, and interest posted to member accounts per your collection policies?
- Is all miscellaneous income explained?

**Expenses:**

- For items that are over or under budget, are explanations given or research done? Are the findings documented?
- Are bills being paid on a timely basis?
- For unusual, non-recurring types of expenses, is board authorization required before the invoice is paid?

These are a few of the questions that should be considered. The financial statements should tell the board a story about the Association's financial stability, liquidity, and profitability. It may take a while to be able to read the balance sheet and income statements, but you owe it to the members who have entrusted you with their funds, With a bit of effort, your Association's financial statements need not be the mystery they once were.

**HOMEOWNERS ASSOCIATION  
Records Retention Schedule  
- Financial/Tax Issues**

**By: Gayle Cagianut, CPA**

**Retain Permanently:**

- Governing Documents
  - CC&Rs
  - Bylaws
  - Articles of Incorporation
  - Rules & Regulations
- Minutes - Board & Annual
- Federal & State Tax Returns
- State Tax Exempt Status Letter
- Year End CPA Reports
- Annual General Ledgers
- Budgets
- Insurance Claims
- Reserve Studies
- Fixed Asset Purchases

**Retain for Seven Years:**

- Monthly Financial Statements
- Bank Statements
- Monthly General Ledgers
- Accounts Receivable Listings
- Assessment Ledgers
- Check Registers
- Employee Records

**Retain for Four Years:**

- Paid Invoices
- Bank Reconciliations
- Payroll Tax Returns
- Deposit Slips
- Canceled Checks
- Collection Action Items

**Retain for Life plus 4 Years:**

- Insurance Policies

## ARE COMMINGLED TRUST ACCOUNTS ALLOWED FOR HOMEOWNER ASSOCIATIONS?

By: Michael J. Gartzke, CPA

A commingled trust account is a single bank account in which the funds from more than one owner are kept and accounted for separately by individual owner. The separation of funds in a commingled trust account is purely an accounting abstraction. These types of accounts are commonly used in rental real estate by licensed property managers. Property management firms are required by the California Department of Real Estate (DRE) to adhere to specific regulations regarding record keeping and accounting for these trust funds and are subject to surprise audit by DRE staff.

California Civil Code Section 1365.2(d) prohibits the use of commingled trust accounts by association property managers **unless** all of the following requirements are met:

- 1) The managing agent commingled the funds of various associations on or before February 26, 1990.
- 2) The managing agent has obtained a written agreement with the board of directors of each association that he or she has commingled funds showing that the managing agent will maintain a fidelity and surety bond in an amount that provides adequate protection to the association as agreed upon by the managing agent and the board of directors of each association.
- 3) The managing agent must disclose in the written agreement whether he or she is deriving benefits from the commingled account or the bank, credit union, or savings institution where the monies will be on deposit.
- 4) The written agreement discloses the name and address of the bonding companies, the amount of the bonds and the expiration dates of the bonds.
- 5) If there are any changes in the bond coverages or companies providing the coverage, the managing agent discloses that fact to the board of directors of each affected association within 10 days of the change.
- 6) The bonds assure the protection of the association and provide the association at least 10 days' notice prior to cancellation.
- 7) Completed payments on the behalf of the association are deposited within 24 hours or the next business day and do not remain commingled for more than 10 calendar days.

Prior to 1990, property managers were not prohibited from maintaining commingled trust accounts for homeowners associations. The law was changed in 1990 to require separate bank accounts for each association except for the accounts meeting all of the exceptions noted above. A property management firm that started after February 1990 is not allowed to use commingled trust accounts. Some commingled bank accounts are used only to collect assessments. The collected assessments are then transferred to a dedicated association

checking account to pay expenses. Other accounts may be commingled for expenses, too. This allows the manager to make one check for multiple associations for a common vendor such as utilities or maintenance. As noted in item 7 above, funds cannot be commingled for more than 10 days. Reserve funds must be maintained in separate accounts to maintain the integrity of the reserve account (Civil Code 1365.5(c)(2)) as they can't be commingled more than 10 days

Most associations have separate bank accounts for operating and reserve funds that are not commingled with funds of other associations or businesses. Maintaining a commingled trust account is only allowed for a licensed real estate broker subject to DRE oversight in business before March 1990. Many associations are managed by companies that are not licensed real estate brokers. The DRE does not regulate association property managers. All managing agents are required under Civil Code Section 1363.1 to disclose the names of the owner(s) of the management company and whether any of the principals hold licenses such as contracting, accounting and real estate. If the principals hold any professional certifications such as CCAM from nongovernmental organizations, then these are also disclosed.

Much of the Civil Code presumes that the association has its own bank accounts. For example, Civil Code 1365.5 requires the association board to review a reconciliation of its operating accounts at least quarterly. If its funds are commingled with others, the association can't do that review. The board is also required to review the latest account statements from its banks at least quarterly. A commingled trust account has only one statement and reconciliation for all its associations, making required reviews by any of the commingled associations quite difficult.

Commingled trust accounts present a challenge for the CPA. As part of the year-end review or audit, the CPA will look to obtain evidence to support balances and activity in a trust account. If the managing agent has had an audit of its trust account done by an outside CPA which documents procedures relating to assessment collection, expense approval and payment and voided check handling, then your CPA can rely on the another CPA's report to document the trust account controls and balance as part of his accounting engagement.

If the CPA is unable to obtain an independent audit report or examine the trust account transactions, he/she may be precluded from performing a review or issuing an unqualified audit report. On a technical level, this is referred to as a "scope limitation." In an audit, a scope limitation would require the CPA to disclaim an opinion in his/her audit report. This means that the CPA would not provide an opinion as to whether the financial statements are presented fairly in conformity with generally accepted accounting principles. For reviews, scope limitations are not allowed and the CPA would not be able to comply with Civil Code Section 1365.5(b) for issuing a review report, either.

So whether your association is part of a commingled trust account or has separate bank accounts, be sure to review expense ledgers from your property manager for accuracy; that the expenses incurred were for your association. Review reserve account statements to determine that funds shown as transferred out of the operating or trust account to reserves have been deposited into the reserve account. Review Gayle Cagianut's article above for procedures that you can do as a board to ensure accurate financial reporting and sound financial management. Consider asking your CPA about the advantages and disadvantages of using a commingled trust account and whether it is appropriate for your association.

## **SOUTH COAST NEWSLETTER SPONSORS**

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Goleta, CA 93117  
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Channel Islands Chapter  
P. O. Box 3575  
Ventura, CA 93006  
805-658-1438  
[www.cai-channelislands.org](http://www.cai-channelislands.org)

Executive Council of Homeowners  
ECHO  
1602 The Alameda #101  
San Jose, CA 95126  
408-297-3246  
[www.echo-ca.org](http://www.echo-ca.org)

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