

# SOUTH COAST HOMEOWNERS ASSOCIATION

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## UPCOMING SOUTH COAST MEETINGS

### ANNUAL LEGAL FORUMS

**Date – Wednesday, January 21**

**Time – 7:00 – 9:00 PM**

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

**Scheduled to Present – James H. Smith, Grokenberger, Smith and Courtney**  
- **David A. Loewenthal, Hillshafer, Loewenthal and Rosen**  
- **Karen A. Mehl, Esq.**

It's time for our annual law forums. Our speakers will provide us an update on California legislative changes (which were numerous) as well as other legal topics of current interest. In addition, we will also have a moderated Question and Answer session where you can submit written questions to the panel for their consideration. There is no cost to attend.

**Date – Wednesday, February 4**

**Time – 7:00 PM -**

**Place – Quail Meadows West HOA**

**866 Whippoorwill, Santa Maria (101 at Santa Maria Way exit)**

**Scheduled to Present – Karen A. Mehl, Esq.**

**PLEASE FEEL FREE TO MAKE COPIES FOR YOUR BOARD MEMBERS  
SHARE THIS NEWSLETTER WITH YOUR ENTIRE BOARD OF DIRECTORS**

## ALTERNATIVE DISPUTE RESOLUTION MEETING

We are pleased to announce that we will have a special meeting on Alternative Dispute Resolution (ADR, mediation, arbitration, etc.). Civil Code encourages disputes between members, residents and/or the association to be handled via ADR prior to going to court. **James Lingl**, an experienced HOA attorney from Camarillo and President of the Ventura Center for Dispute Settlement will present a comprehensive explanation of ADR, how it works, how to implement it, etc. Mr. Lingl drafted the first version of the Davis-Stirling ADR Statute (Civil Code 1354) in 1991. He serves on mediation panels for Ventura County courts and the State Department of Insurance.

**DATE – Wednesday, March 24, 2004**

**TIME – 7 PM**

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

## 2004 CONDOMINIUM BLUEBOOKS

The Condominium Bluebooks arrived the first week on January and all members who have renewed their memberships for 2004 received a copy. Additional copies of the Bluebook are available for \$16 per copy, postpaid.

## SOUTH COAST MEMBER SURVEY RESULTS – PART II

In September, all South Coast association members received a 2-page survey to ask for our members' input regarding current association financial and management information and in some cases, to be able to compare data from our previous surveys.

**Sample Size:** We received 95 responses, approximately 70% of our associations took the time to respond. This compares to the 74 responses that we received three years ago. 20 responses came from North Santa Barbara and San Luis Obispo Counties. 74 came from South Santa Barbara County while a single response came from outside this area.

**Type/Age of Associations:** 55% of the responses were from condominium associations, the same percentage as in 2000. However, 61% of the South County responses were from condominiums while only 35% of the North County responses were from condos. Overall, the median association (half older and half newer) was built in 1979 – 24 years ago. Again, geographic differences occur. The median North County association was built in 1984 while in the South County – 1975, 9 years difference.

**Note:** In many cases, I have used medians instead of averages in making comparisons. A median is defined as where half of the values are larger than the median and half are smaller. In some cases, averages can distort the data. For example, if you had a sample of 5, 10, 15, 20 and 100, the average would be 25 which is larger than 4 of the 5 numbers in the sample. 15 is the median where 2 items are smaller and 2 are larger.

**Median Size of Associations:** The median size association responding was 38 units, exactly the same as our 2000 survey. For condos, the North County median was 30 units while the South County median was only 20 units. For planned developments, the medians were nearly identical – 48 for the North County and 46 for the South County

**Special Assessments:** Did your association have a special assessment within the last two years? What was it for? How much was it per member? Did members vote on it? Did members have the option to pay it in installments?

22% of the respondents had a special assessment in the past two years. This is down from 29% in 2000 and 33% in 1996. 7.4% of the respondents had special assessments of \$1,000 or more compared to 14.9% in 2000. The following chart shows the tabulation of the special assessments:

	<u>Total</u>	<u>North</u>	<u>South</u>	<u>Condo</u>	<u>PUD</u>
Special Assessment?	21	3	18	11	10
Median Amount		\$600	\$563	\$500	\$612
\$1000 or more	7	1	6	4	3
Range of Assessment		\$108-1000	\$100-\$15,651	\$100-\$15,651	\$105-\$4068
Paid in Installments	8	2	6	3	5
Members Vote	11	2	9	6	5

While many special assessments require a vote of the members, Civil Code allows for exceptions when they are less than 5% of the annual budget (small) or where there is a threat to health and safety.

Reasons for the special assessment were quite varied. Reasons cited by more than one association included – landscape/tree trimming, painting, operating fund shortage, build reserve funds, fences and roof. Single association responses included, underground waterproofing, retaining wall, road repairs, fumigation, fireplace inspections and conversion from well to city water.

**Water Damage/Mold:** In recent years, water damage and mold issues have become more prevalent for associations and owners. Insurance companies are restricting coverage. The California Legislature has directed that research be done and standards established to determine “safe levels” of mold. What molds are toxic and which ones are not? So we asked “Has your association ever had a significant water damage claim? Has the association ever had to deal with a mold problem?” Number in ( ) equals number of responses to the question.

	<u>Total</u>	<u>North</u>	<u>South</u>	<u>Condo</u>	<u>PUD</u>
Water Damage Claim (92)	20	0	20	14	6
Mold Problem (93)	14	4	10	12	2

**Current Issues:** We asked 7 “yes or no” questions dealing with issues that the Legislature passed new laws on during the past 2 years or have been debated in the local media to determine the magnitude of these issues in our area. For example, in some housing

proposals, parking would be restricted to encourage mass transit or other forms of transportation. In the case of flying the American flag, Governor Davis held the signing ceremony at a Southern California HOA. Has your association ever had to deal with any of the following issues (Yes or No):

	<u>Total</u>	<u>North(20)</u>	<u>South(74)</u>	<u>Condo(53)</u>	<u>PUD(42)</u>
Improper Parking	70	14	56	38	32
Pets (Noise/threats)	50	11	39	24	26
Signs by members	23	9	14	10	13
Access to HOA records	15	7	8	7	8
Liens ignored by members	19	6	13	9	10
Flying the American flag	5	1	4	5	0
Smoking in common area	7	0	7	5	2

North/South or Condo/PUD, improper parking was reported to be a problem in over 70% of each category shown above. It would appear that we have plenty of associations with limited parking and it is not encouraging residents to reduce the number of cars they have. Over 50% report some kind of problem with pets. Expanded collection policy and lien disclosure laws were passed in 2002. New laws were passed in 2003 expanding members' ability to post signs, access HOA records and flying the flag. Legislation is pending to impose liability on associations for smoking in the common area.

**Board Service:** The following questions were asked to gain an understanding about the size of your boards, vacancies, elections, volunteers and length of board meetings.

**Number of Members on your Board:**

- Three - 13
- Four - 9
- Five - 56
- Six - 1
- Seven- 10
- More - 3

**Does Your Board currently have any vacancies?:** Yes = 7

**Was your last board election “contested” (more candidates running than spaces up for election)?** Yes = 17

**Do you have problems getting volunteers to serve on the board?** Yes = 65

**Length of Average Board Meeting** – 1 hour 42 minutes

**Length of Average Board Meeting (Problems getting volunteers)** – 1 hour 42 minutes

**Length of Average Board Meeting (no problems getting volunteers)** – 1 hour 42 minutes

**Range of Length of Average Board Meeting** – 45 minutes to 4 hours

It is popular in the media to point out problems with association governance and dictatorial boards. Members have the right to vote for boards and run for the positions themselves.

Over 82% of the association's surveyed did not have more members running than spaces up for election in the last association election. Over 68% reported that they have trouble getting volunteers to serve on the board. Note there was no difference in the length of board meeting between those associations having trouble getting volunteers and those that don't.

Thanks to all that participated in submitting surveys. If you are like me, some of the results confirm your thinking while some things were a surprise. If you have an idea for questions for a future survey, email or let me know. Time permitting, we may do another survey next fall.

## TAX FILING DEADLINES

The start of the new year and its tax time again. (Oh, boy!). Here is a brief summary of the tax filing requirements. 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:** Three 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).

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. Many of your contractors are continuous and 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 one 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. It 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. Fill-in forms are available on line at [www.ss.ca.gov](http://www.ss.ca.gov).

## **WHY CPAs SHOULD PROVIDE MANAGEMENT LETTERS TO THEIR ASSOCIATION CLIENTS AND WHAT THEY SHOULD CONTAIN**

### **GUIDANCE FOR BOARD OF DIRECTORS**

Each year, most homeowner associations will engage a CPA to review or audit their annual financial statements and/or prepare their annual income tax returns. These compliance services meet the requirements of the association’s governing documents, the California Civil

Code and tax law. For many, this annual ordeal ranks somewhere between standing in line at the DMV and a root canal. Yes, it's necessary but what does the association get from these services? In my years of providing accounting services to homeowner associations, I have noted that association boards of directors as well as their managing agents are receptive to observations and suggestions that I make that arise as a result of my providing the income tax and financial statement services.

Accounting standards require CPAs to communicate "matters coming to the auditor's attention that, in his judgment, should be communicated to the audit committee because they represent significant deficiencies in the design or operation of the internal control structure, which could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertion of management in the financial statements." In addition, "the auditor may also identify matters that in his judgment, are not reportable conditions as defined above, however, the auditor may choose to communicate such matters for the benefit of management". (AICPA Auditing Standards Section 325.02-.03)

I have found that the "management letter" can be the most discussed portion of the documents that I provide an association at the conclusion of an accounting engagement. CPAs who have provided services to associations for years have become knowledgeable of the wide range of disciplines that affect association operations. While we can't (or won't) take the place of your manager, lawyer, insurance agent or maintenance experts, we can offer recommendations on a wide variety of issues for the association to consider in future operations. What follows is a sampling of financial and other issues that I have encountered that should be considered in improving association operations.

**CASH AND INVESTMENTS:** Cash and investments are typically the largest assets that an association has. Many times, these assets will be underinvested either in noninterest or low interest checking and saving accounts. Sometimes, checks will be held for days or weeks without being deposited timely, reducing the average balance on deposit which means less interest or paying bank charges because of low balances. Bank investments such as higher interest money market accounts and certificates of deposit are available to associations. Many associations have opted for US Treasury bills and notes for a portion of their reserve investments. Principal is guaranteed if held to maturity and in most cases, the interest income is California tax-free.

Some associations will have over \$100,000 in cash in the same bank. FDIC insurance does not cover balances over \$100,000 so there is the possibility of loss for balances over \$100,000. Some associations have placed funds in mutual funds to take advantage of the rising stock market. These funds are subject to market fluctuations and also early withdrawal penalties if redeemed within 5 years of the investment. Capital losses on securities sales are only deductible against capital gains received by the association for income tax purposes.

Signature cards are frequent not updated when officers change. Reserve accounts require the signature of two officers or an officer and director of the association. No one else is allowed to withdraw or expend funds from an association reserve account. Some managing agents will use a commingled cash account where funds from multiple associations are deposited in the same bank account. California law restricts this practice to managing agents that provided this service in February 1990 or earlier. CPAs are concerned about the controls that the managing agent uses to safeguard your association assets and that they are

accounted for properly. Some managers will leave reserve funds in the operating account to make it easier to withdraw funds to pay reserve expenses when they are incurred.

Are bank statements being reconciled monthly? Are copies of bank statements and reconciliations being provided to the board at least quarterly in compliance with Civil Code requirements? Is the association able to segregate (use two different people) the issuance of payments for bills and the mailing of the checks? Does the board approve maintenance and nonrecurring invoices for payment?

**ASSESSMENTS:** The prompt and efficient collection of assessments is the lifeblood of association operations. When the economy is strong, collections are generally easier. Increases in members' equity in their property will convince most people to not risk the loss of that equity by not paying assessments. The economy is cyclical and some members who purchase at the "top of the market" will find their equity eroded or gone in a down real estate market. It is important to establish a diligent collection policy that is consistent and equal to all members. Late notices and late payment penalties should be sent on the 16<sup>th</sup> of the month (or later if your governing documents specify a later date). Follow-up should be made and further collection activity should be pursued (pre-lien letters, lien filings, small claim judgements and/or foreclosure as necessary). Lenders are wary of providing financing to unit owners in associations where large amounts of delinquent assessments exist.

I have noted, fortunately on infrequent occasions, that board members will fall behind in paying their assessments. If the delinquency is large enough, a disclosure will be made on the financial statement indicating the amount due from the officers and directors. Some associations will have an inadequate monthly assessment. Political pressures not to raise assessments or not increase them enough conflict with the reality of increased costs. Many times, reserve funds will not be funded at the level specified in the budget or reserve study. Over time, this underfunding of reserves will result in a major special assessment. Most special assessments require a membership vote. Special assessments are never popular.

Speaking of reserve funding, California law has mandated disclosures about reserve information for 18 years now. Many more associations are obtaining the required reserve information either through a reserve study professional or on their own. As with high delinquent assessments, lenders are reluctant to lend on association units with low reserve fund balances.

## **OTHER OPERATIONAL ISSUES**

**Employee vs. Independent Contractor** – Is the association using independent contractor workers who should be classified as employees? The IRS has a checklist of 20 factors to review when making this determination. Areas such as who controls the worker, licensure, how the worker is paid go into making this determination. Are workers covered by insurance, especially workers comp?

**Insurance** – Is the association carrying the proper kinds of insurance in accordance with its governing documents and the Civil Code? Does the board meet with its insurance agent annually to discuss necessary coverages and policy limits?

**Minutes** – Are minutes complete? Are they signed? Are executive session minutes included with regular minutes and improperly disclosed? Are relevant accounting issues such as major expenditures, assessment changes, open/close bank accounts, tax elections and budget approval included?

**Taxes** – Has the association filed 1099 forms for independent contractor services? Is the association paying property tax assessments that are only chargeable against residential parcels? Does the association have tax-exempt status with California? Are income tax filings up to date? (This is another area that can cause a corporation to be suspended)

**Professional Organizations** – Is the association a member of South Coast Homeowners or another trade organization? Can the board members benefit from the seminars and newsletters published by these organizations?

Other topics such as record retention, accounting system recommendations and comparative financial information are worthy of discussion with your CPA. Ask your CPA about any of these issues. We welcome the opportunity to provide guidance in these areas and to provide a service that you really want! We can attend board meetings and/or annual meetings to present relevant information. Your CPA is part of your professional team.

## **AN ACKNOWLEDGEMENT**

South Coast would like to acknowledge and thank all those who made presentations for us at our meetings this past year and/or wrote an article for our newsletter.

- Beth A. Grimm, Esq.
- David A. Loewenthal, Esq.
- Karen A. Mehl, Esq.
- James H. Smith, Esq.
- Jennifer Tice, Esq.
- William Dunlevy, Esq.
- Glenn Youngling, Esq.
- Jan Hickenbottom, PCAM
- Chris Andrews – Stone Mountain Corporation
- Michael J. Gartzke, CPA
- Sarah Kitson, Kitson Landscape Management
- Karen Christman, Certified Arborist
- Chuck Swankosky, Green's Entomological Service
- Tony Vassalo, Las Canchas Owners Association
- All who attended our meetings
- All who completed our membership survey

**HAPPY NEW YEAR!**

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