

# ***SOUTH COAST HOMEOWNERS ASSOCIATION***

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**Michael J. Gartzke, CPA, Editor**

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## **UPCOMING SOUTH COAST HOA MEETING – FEBRUARY 3**

It's time for our annual law and legislative update for the New Year. Our attorney panelists, James H. Smith (Grokenberger & Smith – Santa Barbara) and David A. Loewenthal (Loewenthal, Hillshafer & Rosen – main office Sherman Oaks) are planning to discuss numerous topics including:

- Assembly Bill (AB) 2016 – Deed Requests
- AB 1427 – Default Notices
- Vetoed Legislation
- Numerous New California Court Cases affecting HOA Operations such as Architectural Guidelines, Maintenance Responsibilities, etc.
- New FHA Lending Guidelines
- Basic Rental Restrictions

**Date – Thursday, February 3, 2010**

**Time - 7-9 PM (Refreshments 6:45!)**

**Place - Encina Royale Clubhouse - 250 Moreton Bay Lane, Goleta**

(Fairview exit off 101 - north 2 blocks to Encina Road, right one block to Moreton Bay Lane - left into Encina Royale - clubhouse on the right just inside the entrance)

Refreshments provided by Fresco North Café of Goleta and generously donated by **Santa Barbara Painting** (Gustavo Dabos) and **First Bank Association Services** (Judy Remley)

### **Spring Meetings Scheduled!**

**April 30** – Spring Legal Forum with Beth Grimm, Attorney (Saturday morning)

**June 16** – Patrick Hohman, Association Board President, Louisville, Kentucky, Author of New Book – “Condos, How to Make your Investment Safer (Financially, is your Association Running on Empty?)”

## **IS VOLUNTEER LABOR A GOOD THING FOR YOUR COMMUNITY ASSOCIATION?**

**By: Timothy Cline, CIRMS  
Timothy Cline Insurance Agency, Santa Monica**

**Editor’s Note:** Tim is considered one of the leading California experts on homeowner association insurance and has spoken to South Coast members several times over the years and contributed numerous articles for the newsletter. He is a South Coast member and his contract information appears in Sponsor section of the newsletter.

Mounting delinquencies, the result of resetting sub-prime loan interest rates, and escalating foreclosures have caused community associations to find more creative ways to live within their budgets. If your Association is attempting to stay solvent by relying on volunteer labor to substitute for the more conventional, subcontracted (and insured) kind, you’re not alone.

Volunteerism continues to enjoy popularity. The American Association of Retired Persons (AARP) conducted a study in 2003 which reported that 80% of Americans aged 45 and older are involved with “helping others without pay.” Granted, while most volunteerism involves churches, hospitals, schools, and coaching pursuits, such as soccer and little league-the poll indicated that “neighborhood volunteerism” accounted for nearly 47% of the total.

For a community association, volunteer labor has potential for being a thorny issue. Condominium attorneys, risk managers and insurance professionals routinely recommend against volunteer labor arguing that the “risk transfer” achieved by using licensed and insured contractors far outweighs any potential savings the HOA may reap using volunteers.

When a person volunteers their services, who is responsible for their actions? More specifically, if a volunteer is injured while performing a task they voluntarily offered to complete, who is responsible for their injuries? And, if the decision is made to purchase a policy to cover volunteers under the HOA’s workers’ compensation policy, does it immediately solve issues of responsibility? And, quite frankly, is covering the volunteer under a workers’ compensation policy really a good idea?

While it is mandatory for all employers to maintain workers’ compensation coverage, it is not mandatory for a community association to purchase a workers’ compensation policy that

covers volunteer laborers. When coverage for volunteers is available, does it really make good business sense to have the policy so amended to cover them?

Workers' compensation is often described as an "exclusive remedy." This means that, in most circumstances, a person who is covered by workers' compensation is barred from suing their employer in civil court if they sustain a work-related injury. Under workers' compensation law, recoveries are limited to specified benefits to remedy such issues as disability, medical costs and, if necessary, the cost to retrain the injured worker for another occupation. In exchange for those benefits, the injured worker cannot receive compensation for pain and suffering. Generally, the awards paid under a workers' compensation policy are smaller than if the individual sued the entity directly.

The trade-off is that workers' compensation is a "no-fault" system. Under a commercial general liability policy, the injured party must show that the community association was negligent. No such requirement exists under workers' compensation law. The injured person need only prove that it happened in the course of their "duties." As a result, it's easier to recover benefits under a workers' compensation policy. Some Board of Directors consider a workers' compensation claim one where they have "no control of the outcome" but even when a general liability claim is tendered, the Association has little control over what will happen in the end.

So, should every Board of Directors immediately adopt a resolution to cover volunteers under their workers' compensation policy? Not so fast. It's important to first consider the following:

1). Not all carriers offer coverage for "volunteers." A specific resolution must be passed by the Board in order to extend coverage to voluntary workers. But that's only part of the equation. Not all workers' compensation policies allow for coverage of volunteers. Furthermore, even some that do still exclude volunteers other than those specifically appointed by the Board.

2) May all that show up for a "work day" participate? If a volunteer "shows up" on a community clean up day, (and has not been formally appointed by the Board), would there be coverage? It may depend on the carrier and their approach to "volunteers." What exposure exists for the Community Manager and the board for allowing this person to work?

3) Carriers who do provide coverage for volunteers typically require a three-step process. In order to qualify for coverage:

- a) The Board must pass a resolution;
- b) The Association must purchase coverage from a carrier that is willing to extend coverage to volunteers; and
- c) the volunteer must be specifically appointed by the Board to a committee. The carrier recommends this last step be documented in writing within the Board's meeting minutes.

4) Potential Conflicts Abound. What if the volunteer is a great worker, but has poor financial habits. What potential conflict exists if the Association's formally appointed "volunteer" is also past due on their monthly homeowners dues? What if they haven't paid their homeowners dues but volunteered 345 hours of their time in one month?

5) Good help is hard to find – a “Slippery Slope.”-Volunteers may be great at changing light bulbs, but what if the work involves a greater skill set? Where will the Board of Directors “draw the lines” between which projects can be reasonably performed by volunteers and which cannot? Certain projects like lawn mowing, hedge trimming, and pool maintenance seem easy enough but can be great sources of injuries. How will your Board decide which projects are okay to use volunteers for?

6) Does volunteer labor really result in a “savings?” Or could it just mean more liability for the Board and the Community Manager? Is the association liable to the public if the volunteer allows for a hazardous condition to exist? What, if any, additional exposure does the Association have because the homeowner volunteer is now a recognized “employee” for the purposes of the workers’ compensation policy?

Exactly what long-term costs result from replacing subcontracted workers (complete with contractor’s license, liability and workers’ compensation coverage) for volunteer labor are hard to calculate. And it does seem almost un-American to reject volunteerism. There are, however, some very important issues for the Board and Community Manager to consider first and, as always, caution should be exercised to determine precisely when (and if) volunteers can be utilized.

## **LANDSCAPE REBATES AVAILABLE FROM SOME CITIES AND WATER DISTRICTS**

By: Madeline Ward, Water Conservation Intern, City of Santa Barbara Public Works  
Department – 805-897-2672 [www.SaveWaterSB.org](http://www.SaveWaterSB.org)

### Cash for Making Your Garden More Water Wise!

The Smart Landscape Rebate Program offers rebates on approved irrigation equipment and landscape materials including:

- Irrigation Equipment: 50% of the cost of drip irrigation parts, sprinkler system efficiency retrofits, MP Rotator sprinkler nozzles, and equipment for a laundry to landscape graywater system.
- Water-wise Plants and Mulch: 50% of the cost of water-wise plants and mulch. Planted areas must be covered with a 3-inch layer of mulch.
- Smart Irrigation Controller: 50% of cost of the smart irrigation controller. Smart irrigation controllers work on a simple principle: provide the appropriate watering schedule; automatically adjust for weather changes; irrigate based on the needs of your plants.

Any combination of irrigation equipment and planting costs may qualify for a one-time rebate; maximum amount varies by water provider and customer type.

The City of Santa Barbara and the Goleta Water District are offering rebates up to \$1,000 for single family homes and up to \$2,000 per account serving irrigated area (\$4,000 per site) for commercial, multi-family, and HOAs.

Projects must be approved in advance and landscapes for new construction are not eligible. Sales receipts and/or contractor invoices are required for all rebates.

Many other water providers county-wide offer this rebate program; contact your local water provider for more information or go to <http://www.sbwater.org/LandscapeRebates.htm>"

## **TAX AND FINANCE CHANGES FOR 2011**

**By: Michael J. Gartzke, CPA**

**Get Balances on Certificates of Deposit Now!:** Approximately 70-75% of associations have a calendar year-end (December 31) for income tax purposes. As part of the tax preparation and/or financial statement development for the year end, bank balances need to be verified and interest (such as it is) posted. Many banks have stopped issuing monthly or quarterly statements for their CDs. Some will allow you to access information online, if you are set up for it. Your accountant will need this information. January is a good time to contact the banks and have them fax or email account balance and interest information to you. Your financial statements and/or tax returns cannot be completed without it. 1099s issued by banks usually do not show account balance information, only interest earnings during the year.

**Updating Signature Cards:** Every bank account (checking, money market and certificate of deposit) has a signature card with the names of all the signers on the accounts. Over time, members of the board turn over and frequently, signature cards are not updated. In some cases (especially on CDs which may simply roll over at maturity) there are no signers on the account who remain on the board. This is a good time to update signature cards. Many associations hold annual meetings at this time of year and there may be changes in your boards.

**FDIC Limit of \$250,000 is now Permanent –** The increased FDIC limit of \$250,000 per “depositor” (not account) has been made permanent. You will have FDIC insurance on all bank accounts which aggregate \$250,000 or less at one financial institution. Please note that some brokerage money markets (e.g. Fidelity, Schwab) are not insured by the FDIC. Also, some of these money market accounts have been paying minimal interest (0.01%). While banks aren’t paying much, they usually are paying more than 0.01%.

**Federal Tax Deposit Coupons Discontinued –** Many of you received a notification from the IRS to enroll in the Electronic Federal Tax Deposit Payment System (EFTPS). This is due to corporations and other business no longer being able to send income tax payments to your bank or Federal Reserve Bank starting January 1, 2011. While there is a small balance exemption for payroll taxes, it does not appear that this exemption will apply to small Federal income tax balances. Therefore, associations will have to enroll in the IRS EFTPS program. Estimated tax payments are subject to this new system. Follow the instructions on the form

to enroll. Customer service is available at 1-888-434-7338. You will need a personal ID # (PIN), your tax ID #, bank account information and a primary contact phone number to enroll. **1099 Filing Requirement** – Homeowner Associations continue to have a filing requirement with the IRS for payments made to service providers during calendar 2010. Requirements for filing 1099s for these payments are:

Total Paid - \$600 or more during the year  
The service provider was not a corporation  
Paid for services such as landscaping, maintenance, repairs, professional services, etc.

You will need the provider's name, address, tax ID # or social security number. If a social security number is used, then the 1099 is issued in the person's name, not the name of the business. If you have financial management or bookkeeping services, then your professional should prepare the 1099. In some cases, your tax preparer can prepare them but only if you ask them to. This is not part of tax preparation services. Forms are due to the service providers by January 31. If you are responsible for preparing the forms, forms can be ordered (not downloaded) from the IRS at [www.irs.gov](http://www.irs.gov) or available for pick up at a local IRS office. Some tax preparers will stock the forms.

The new health care law passed in 2010 greatly expands 1099 filing requirements starting with 2012 payments. While it is hoped that Congress will recognize the folly of such expansion, prior experience suggests that is not the case.

**New California Nonprofit Corporation Reporting Requirement** – The Franchise Tax Board has established a new reporting requirement for small nonprofit corporations with revenues less than \$25,000 per year. This new requirement can affect small homeowner associations with assessments and other income below \$25,000. It does not change anything for associations with more than \$25,000 in revenue. Previously, if an association had nonmembership income of less than \$100 and revenues of less than \$25,000, it did not have a tax filing requirement with the Franchise Tax Board. Now, these small nonprofits must complete an online form 199N with the FTB ([www.ftb.ca.gov](http://www.ftb.ca.gov)) or submit Exempt Organization form 199 as a paper return like exempt organizations with receipts greater than \$25,000. Information needed to file 199N starting January 2011 for organizations with a December 31, 2010 year-end.

- California Corporation Number
- Entity name of the organization
- Federal employer identification number
- Account period beginning and ending (also known as your tax period / tax year)
- Entity's mailing address
- Any other names the organization uses
- Name and address of a principal officer
- Entity's amount of total receipts (the gross receipts must be \$25,000 or less)

- If the organization terminated or went out of business, if applicable
- If the entity started business within the current account period
- Contact person's name and telephone number

**REVIEWED VS. AUDITED FINANCIAL STATEMENTS**  
**What Does State Law Require?**  
**What do your CC&Rs or Bylaws Require?**  
**What is the difference?**

**By: Michael J. Gartzke, CPA**

California Civil Code (CC) Section 1365(c) requires all homeowners associations to have a **review** of their annual financial statements prepared in accordance with generally accepted accounting principles by a California CPA for any fiscal year which the gross income of the association exceeds \$75,000. An **audit** of an association's financial statements is not required by California Civil Code, no matter how large the association is.

A reviewed financial statement entered accounting literature in 1978. Prior to that time, financial statements were either audited or unaudited. There can be a huge difference between the two levels of statements depending upon the amount of work done by the CPA is preparing the statements. In addition to audited financial statements, we now have reviewed or compiled financial statements. There is no unaudited financial statement in current accounting literature. There are different standards that CPAs must adhere to in performing a compilation, review or audit and the differences involve the amount of inquiry, testing, investigation, documentation and analysis that the CPA and his staff performs in completing the engagement. These standards are issued by our trade organization, the American Institute of Certified Public Accountants (AICPA). These standards change regularly and CPAs in California who issue financial statements must complete 24 hours of accounting and auditing continuing education every two years to keep up with the changes.

For a compilation, the CPA just needs to be familiar with the accounting practices of the client's industry and have an understanding of how the client's financial transactions were recorded. The CPA then compiles the statements in an appropriate form and that it appears that there are no obvious, material errors. Compilation standards allow for financial statements to be prepared relatively quickly if records are good, however, the amount of inquiry can be minimal or nonexistent. I sometimes compile very basic financial statements for associations with less than \$75,000 in annual revenue at their request. The statements may not be in accordance with generally accepted accounting principles (see paragraph following) but tell owners that someone other than the Treasurer or manager's staff was involved in the compilation of the financial statements.

As noted earlier, California law requires a reviewed financial statement in accordance with generally accepted accounting principles when revenues exceed \$75,000. What are financial statements that are prepared using generally accepted accounting principles?

- 1) Uses the accrual basis of fund accounting – cash basis or hybrid accrual basis statements are not “generally accepted accounting principles”. Accruals for HOAs may include prepaid and delinquent assessments, accounts payable, prepaid insurance and income taxes and amounts due between the reserve and operating fund.
- 2) Financial statements include:
  - a. Balance Sheet
  - b. Statement of Revenues and Expenses
  - c. Statement of Changes in Fund Balances
  - d. Statement of Cash Flows
  - e. Notes to the Financial Statements
  - f. Supplementary Information on Reserves
  - g. Accountant’s Report

Statements that are not prepared using generally accepted accounting principles may be prepared using a basis of accounting other than accrual and/or may not include all of the statements listed above.

In addition to the compilation procedures, a review requires the CPA to be independent of the entity and that all necessary disclosures be made in the financial statements. The CPA makes inquiries concerning accounting principles practices and policies, board of directors actions (minutes), and any expected events which might impact the financial status of the association. The CPA applies analytical procedures to identify unusual items in the financial statements that may require additional explanation (e.g. why are receivables up 100%?). A review is designed to see whether the financial statements make sense without applying audit-level testing. Upon completion of the engagement, the CPA issues a review report that provides limited assurance that material changes to the financial statements are not necessary.

When I perform a review, I provide a checklist of all the documentation I need from the association. In addition to the accounting records, I receive the board minutes, insurance declaration pages, operating budget and the reserve study. As part of the analytical review, I obtain an income statement compared to the budget, if one is available, to look for unusual variances. I then create a file with the review documentation and evidence to support the cash balances, member receivables, accounts payable and all items shown on the balance sheet. After drafting the financial statements, I complete a 34-page checklist which documents which review procedures were performed during the engagement.

For an audit, the CPA will perform all the compilation and review procedures. In addition, the CPA will perform “search and verification” procedures with third parties. For example, they may communicate directly with your bank to verify bank balances at year-end and not rely on the bank statements alone. If material, the CPA may communicate directly with owners to verify amounts owed to the association at year-end. The CPA will test certain transactions by examining supporting documentation such as invoices corresponding to checks issued. The CPA will interview responsible parties to establish whether internal controls are proper and will design the transaction testing based upon the answers provided, An audit requires the CPA to establish a materiality level to which any adjustment that falls below that level may

not be made. For example, if a \$200 payable is omitted on the association's books, it will probably not make a material difference on the financial statements and the CPA will not make the adjustment. The CPA may also communicate with the association's attorney to see whether there is any legal action which could impact the financial statements.

By accumulating documentation from third parties as well as from the association, the CPA tries to reduce the risk that the financial statements are materially misstated. The auditor then issues a report stating that the financial statements are presented fairly, in all material respects, to conform with generally accepted accounting principles at the conclusion of the audit.

An audit or review is not necessarily designed to catch all fraud and forgeries. The audit or review procedures may detect these irregularities but there is no guarantee that the CPA will detect them.

Your governing documents may require something different than what California law requires. Documents written after the passage of the Davis-Stirling Act (California Civil Code Sections 1350-1378) in 1985 usually reflect the language of CC 1365(c). Older documents may refer to audited financial statements only. Many associations are updating their governing documents to reflect California law for financial statements. Although Davis-Stirling has been amended many times, this provision has remained unchanged since the original enactment 25 years ago.

In my opinion, I believe that a review financial statement is sufficient for the vast majority of associations. Evolving audit standards have increased the work and documentation necessary by the CPA to issue audited financial reports which has driven up costs. Even when getting an HOA loan, banks are accepting reviewed financial statements with no reservations.

## **SOUTH COAST HOA WEBSITE**

We maintain an archive of newsletters on our website [www.southcoasthoa.org](http://www.southcoasthoa.org). In addition to the newsletters, we post information about our upcoming meetings and have a professional member sponsor page if you are looking for professional services for your association. We also have links to other HOA organizations and resources.

If no one on your association board is receiving the newsletter electronically, we will be happy to add one email address from your association to our email blast to receive newsletters, meeting reminders and other information electronically. The only qualifications are that your association is a South Coast member and that there isn't another board member already receiving the email. You may then distribute the email to your other board members.

## **SOUTH COAST NEWSLETTER SPONSORS**

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