



South Coast Homeowners Association

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29th ANNIVERSARY MEETING – ANNUAL LAW AND LEGISLATIVE UPDATE

Please join attorneys James Smith (of counsel – Rogers, Sheffield and Campbell, Santa Barbara) and David Loewenthal (Loewenthal, Hillshafer and Carter) who will provide our annual case law and legislative update. The Legislature was busy this year and new laws were enacted pertaining to –

- board member liability
- solar installations
- mechanics liens
- charges for association documents
- manager disclosure of conflict of interest
- noncommercial solicitations on association grounds

In addition, several court cases of note were decided in 2017 which will impact association law. This program is always popular with our members. Make your reservation now!

Date – Tuesday, February 20, 2018

Time – 6:15 PM for appetizers/refreshments – Program starts promptly at 7:00

Place – Frog Bar & Grill at the Glen Annie Golf Course – 405 N. Glen Annie Rd, Goleta

Reservations are Required! There is no charge to attend. Reservations must be made by calling Sandie Foehl at **805-968-3435** or by email at sfoehl@msn.com. Space is limited – no walk-ins. A waiting list will be created should cancellations be received. Vendor members can also contact Sandie for sponsorship information by February 5.

TURNOVER OF RECORDS FROM OLD BOARD TO NEW BOARD AND/OR FORMER MANAGEMENT COMPANY TO NEW MANAGEMENT COMPANY – WHOSE RECORDS ARE THEY?

By: Michael J. Gartzke, CPA

I recently received a call from a board member in exasperation. After several weeks, the new management company (and the board) had only received two checks from the former management company with no documentation as to how the amounts were computed. Further, the former management company had not provided the 4th quarter interim financial statements to the board or the new management company to start for 2018 nor any of the historical records. This situation may occur more frequently than it should, and it raises a number of important questions.

1) Whose records are they? All records generated in the discharge of managing and operating the association belong to the association. Correspondence, bids, contracts, vendor invoices, bank statements and reconciliations, check images, financial statements, general ledgers, etc. belong to the association. Sections 5200 – 5210 detail the different kinds of records that any member of the association can inspect. In the *2018 Condominium Bluebook*, you will find this information starting on page 138. Civil Code Section 5210 dictates that a member can inspect records for the current fiscal year and the preceding two fiscal years.

So, for example, if the association is a calendar year association and we are in 2018, the current fiscal year would be 2018 and the previous two fiscal years would be 2016 and 2017. This would mean at a minimum, detailed records would have to be available from January 2016. Civil Code Section 5200 specifies many records subject to inspection. Some of these records include paid invoices, check registers, bank statements, income tax returns, board and committee meeting minutes and periodic financial statements. Refer to the code for all records required. So, if the management company or bookkeeper maintained these records, they must be turned over to their successors. If board members maintained these records, those records must be transferred to the successor board members as well.

2) Income Tax Return Statute of Limitations – Although uncommon, both the Internal Revenue Service and the Franchise Tax Board reserve the right to audit association tax returns. In an audit situation, the auditor may request any financial documents from the association that he/she needs to determine whether the returns have been prepared correctly and whether the correct amount of income tax has been paid. The IRS statute of limitations is three years. So, at this writing in early 2018, the open years for the IRS to audit are 2014, 2015 and 2016. If the 2017 tax return is filed by April 15, then the open years will be 2015-2017. California has a four-year statute so 2013 is still open until the 2017 returns are filed. The extra year allows the state to act should IRS make a taxable income adjustment and assess tax. If the taxpayer does not inform the state of the Federal audit adjustment, the extra year remains open indefinitely. So detailed records would need to be available from 2013.

3) What records are needed to prepare a tax return – If the association has revenue less than \$75,000 per year, the tax preparer doesn't need as much information as if the

association is having financial statements reviewed or audited (revenue greater than \$75,000 per year). When I prepare a tax return only, I request the end of year bank statements and reconciliations, a year-end balance sheet and income statement (or 12-month trial balance) and a general ledger for the 12-month period. The change in net assets for the year must reconcile with the net income for the year. So, for this association, the tax preparer must have these documents from the former management company in order to prepare the 2017 Federal and California income tax returns.

4) Other issues – In this instance, the property manager used a real estate trust account, comingling the association's cash with other properties it managed. While comingling is permitted under Civil Code Section 5380(d), (*2018 Condominium Bluebook*, page 155) the restrictions and disclosures by the management company to the association are substantial. For one, the management company had to be doing this since 1990, 28 years ago. It sounds like the association doesn't have its own checking account but may have its own reserve funds account. As a result, the association would not have a checking account statement to review but would have to rely on the detailed trust accounting of its segment of the master trust account. It is imperative for the association board to do the quarterly financial review to determine that the correct amount of assessments is being received and that the expenses being charged to them actually belong to them. A sample quarterly financial review checklist follows this article.

5) Can records be scanned? – Yes, in recent years, some management companies with high speed scanners are converting records to digital, pdf files. It is imperative that these scanned records can be accessed easily and maintained where they can be located in the future. Scanning is a relatively recent process. Most older records remain on paper.

At the end of 2017, I was succeeded for the bookkeeping and accounting function for an association that I had been doing this work for over 25 years. Fortunately, I had a couple months' notice that the change was going to occur. I have been working with my successor on transition issues such as providing the year-end financial statements, trial balance, general ledger, member assessment balances at year-end so that they can move forward for 2018. More time consuming was sorting and purging all those old records. After all, the association didn't need trash bills from 2008. I turned over permanent records to the association such as budget files and annual financial statements back to my start with them. The association had even provided me with records from the 1970s that I returned. I had all their historical insurance policies which I gave to the association. I also extracted all the reserve expense invoices and placed them in files. In the future, someone may need to know the history of major repairs in the association. Board members and residents do change and turnover although there are some owners there who predate my service to the association. I also provided them with the four years' detailed records. What a job! Fortunately, I didn't manage the association. The manager had his own set of records to review, sort and give to the new management company and/or association.

Record retention is important and questions about what to keep and for how long come regularly. My colleague, Walt Grady, CPA, wrote an excellent article which we first ran in the newsletter about 10 years ago. He updated it for us and it appears in the January 2017 issue. You can access that article from the website – www.southcoasthoa.org and click on newsletters, then click on 2017 and then you will be able to download the January issue, if you need it.

QUARTERLY FINANCIAL REVIEW CHECKLIST

TO: BOARD OF DIRECTORS - _____

FROM - _____

Please find attached the financial reports and account statements for the operating and reserve accounts for the quarter ended _____.

California Civil Code (CC) Section 5500 requires the board of directors to review the following financial information at least quarterly:

OPERATING ACCOUNTS:

The bank statements and account reconciliations for the operating accounts –

| <u>BANK</u> | <u>BALANCE</u> |
|-------------|----------------|
| _____ | \$ _____ |
| _____ | \$ _____ |

Income and Expense Statement for the period ended _____ (attached)

Budget vs Actual Income and Expense Statement – same period (attached)

Balance sheet and Assessment Receivable Report (recommended but not included in CC 5500)

RESERVE ACCOUNTS:

The bank statements and account reconciliations for the reserve accounts –

| <u>BANK</u> | <u>STATEMENT DATE</u> | <u>TYPE</u> | <u>INTEREST RATE</u> | <u>BALANCE</u> |
|-------------|-----------------------|-------------|----------------------|----------------|
| _____ | _____ | _____ | _____ | \$ _____ |
| _____ | _____ | _____ | _____ | \$ _____ |
| _____ | _____ | _____ | _____ | \$ _____ |
| _____ | _____ | _____ | _____ | \$ _____ |
| _____ | _____ | _____ | _____ | \$ _____ |
| _____ | _____ | _____ | _____ | \$ _____ |

Income and Expense Statement for the period ended _____ (attached)

Budget vs Actual Income and Expense Statement – same period (attached)

The board of directors reviewed the attached financial information at its board meeting on

_____.

By _____ Title _____ Date _____

CAN/SHOULD AN ASSOCIATION PUBLISH A MEMBERSHIP DIRECTORY OF ITS OWNERS AND DISTRIBUTE IT?

By: Michael J. Gartzke, CPA

An owner recently called to say that an association had published a membership directory with his name, address, phone number and unit number without his permission and distributed it to all members. He questioned whether this was permissible given that he had previously informed the association that he did not want all the other members to have his contact information. In the past, he had received unsolicited correspondence directly from another owner and he just didn't want to deal with being contacted by another owner when the matter was not relevant to him. He also mentioned privacy concerns in today's environment. Some years ago, he had completed a form from the management company to opt-out of any membership list that might be requested by another member for business directly related to the association. The change here was that the association has a different management company now and the new company published his information without his consent.

Back in the day, it was common for associations to publish membership information. Several years ago, California enacted what is now Civil Code Section 5220 to allow association members to not include their personal information in a membership list. The code states "A member of the association may opt out of the sharing of that member's name, property address and mailing address by notifying the association in writing that the member prefers to be contacted by the alternative process described in subdivision (c) of Section 8330 of the Corporation Code. This opt out shall remain in effect until changed by the member."

I've seen some management companies distribute a form to members, sometimes with the annual policy and budget disclosure packets, to opt out of any membership list. Corporations Code Section 8330 allows any member to obtain a membership list for those who did not opt out. For those that opt out, the corporation can provide an alternative means to contact the member such as a direct mailing by the association to the member to preserve his privacy. Any use of the membership list must be for purposes reasonably related to the operation of the association.

Some years ago, I was told about a board member who took the association's membership list and used it to solicit customers for his business. The use of the list was not for association purposes but for his own personal use. After unsuccessful attempts to get the board member to stop, the association called for a recall election to remove the director. The recall was successful. Apparently, the members weren't happy about being solicited either.

In conclusion, think twice about publishing a membership list or directory. Be sure to honor opt out requests and consider offering the opt out on an occasional basis to your members.

RESOURCES AVAILABLE ON THE SOUTHCOASTHOA.ORG WEBSITE

There are a number of resources available to you on the www.southcoasthoa.org website. These are available at no charge (and no password) to you.

Meetings – You will find information about our upcoming meeting, including topics, dates, times and location. We work to schedule 3-4 meetings per year for member association board members and interested professional/vendor members. Generally, there is no cost to attend our meetings.

Membership – A membership application is on the site that can be downloaded and printed to send in with payment. The modest dues cover our out-of-pocket costs. Much of South Coast HOA's work is done by volunteers.

Newsletters – Current newsletters are a member benefit. We have archived previous newsletters since 2000 by year. An article index is also available to locate topics that are relevant to you. You can download any prior newsletter. The 2017 newsletters have just been added.

Resources – Over the past several years, our meeting speakers have provided presentation outlines and materials to attendees. These include our popular annual Law and Legislative updates as well as other operational topics. These outlines have been posted under the "Resources" tab for your access.

Sponsors – Many of our professional and vendor members are listed under the "Sponsors" tab. The sponsors also appear at the end of each newsletter. We thank them for their added support. Sponsors are also members.

Links – On the home page, you will find links to several other organizations providing educational opportunities to board members. There is also a link to the California Legislature website where you can find information on state laws (codes), pending legislation and its status within the legislative process. In 2018, for example, there are some bills which were introduced in 2017 that were not acted upon. They must be passed this year or they will have to be re-introduced next year.

A Note about Email – Each association or vendor member is entitled to place one email address with us to send newsletters, meeting reminders and other occasional items of interest. We ask that only one email per association be provided. Maintaining the email list takes time and if all board member and vendor email addresses were included, there could be 1,000 names. If you are the email contact for your association, you may send it to your fellow board members. I know there are services that handle this list for organizations. There are several organizations that I receive email from these types of services and they always land in my spam filter, no matter how many times I approve the sender.

ASSORTED FINANCIAL “TIDBITS” FOR 2018

1099-MISC Filing Date is Now January 31 for certain forms – All 1099-Misc forms which contain amounts in Box 7 – Nonemployee Compensation (independent contractors) must now be mailed or e-filed with IRS no later than January 31, 2018.

New Tax Law Changes Federal Tax Rate for some Associations – In recent years, fewer associations have had to pay income taxes as taxable income from nonmember income (e.g. interest) has declined. More associations file the 1120-H now than the Form 1120. However, some associations with substantial income from rents or investments find it advantageous to file Form 1120 after making the appropriate elections.

In a brief search of the text of the “Tax Cuts and Jobs Act of 2017”, I could not find that the 30% rate on taxable income on Form 1120-H was reduced. (If someone knows different, please tell me!) On Form 1120, rates were graduated, starting at 15% of the first \$50,000 of taxable income and increasing to as much as 39% on taxable incomes above \$100,000. The new tax law reduced the corporate tax rate to a flat 21% on all taxable income for 2018. For associations filing Form 1120 and having taxable income of less than \$50,000, their tax rate increased from 15% to 21%. For example, if an association had \$5,000 in taxable income, its tax would increase from \$750 to \$1,050, an increase of 40%.

Due Date for HOA Income Tax Returns – For calendar year associations, it’s April 17, 2018. A six-month automatic extension of time to file can be applied for. Any tax paid after that date is subject to interest and late payment penalties.

California Employment Development Department (EDD) now Requires Electronic Payments – Effective January 1, 2018, now requires employer tax payments to be made via EFT. This change affects primarily small HOAs with employees who do not use a payroll service such as Paychex or ADP who have been paying their state employment taxes by check.

2017 Federal Unemployment Tax (FUTA) Surcharge Increases Again – For 2017 FUTA tax, California employers are being surcharged 2.1% of FUTA wages towards repayment of loans made by the Federal government to the state to pay unemployment benefits during the financial crisis of several years ago. All other states have repaid their loans.

Trash Rates for the City of Goleta – They did increase 17.76% on November 1, 2017. Will other cities and jurisdictions be far behind?

Insurance Rates – What will insurance rates do after the fire of December 2017 and the mudslides and storm damage of January 2018? What losses will be covered?

California Minimum Wage Increase – For employers with 20 or more employees, it’s now \$11.00 per hour; for those with less than 20 employees - \$10.50.

IRS Mileage Rate for 2018 – 54.5 cents per mile. California doesn’t get an adjustment for gas prices 70 cents per gallon higher than the national average.

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