

## Security Deposits and Unclaimed Property

**The Basics**—Many associations maintain refundable security deposits by their members; for keys, architectural applications, temporary rentals of facilities, recreational activities, and so on. The vast majority of these refundable deposits work out exactly as planned; the member makes a deposit, returns the key or performs other actions required, and is then refunded their deposit. The purpose of the deposit is to guarantee the performance by the member. However, occasionally, a deposit “slips through the cracks.” Either the member fails to request the refund, or the association fails to properly account for the deposit refund. This is where things get tricky, because you have now entered the world of “unclaimed property.” Unclaimed property may be defined as a liability that a company owes to an individual or entity when a debt or obligation remains outstanding after a specified period of time.

While that doesn’t sound too onerous, the problem is that, no matter what state in which your association is located, your state has a legal “claim” on all “unclaimed property.” Just check your state’s “escheat laws.” Your association may be violating state law if you fail to turn over unclaimed property to the state as prescribed by statute. Many states also have stringent monetary penalties for failure to comply with the law. Each state is different, so check your state’s law.

To add to this problem, many associations have inadequate controls over their accounting for security deposits received. We have encountered many associations that have amounts recorded in their general ledger that are not supported by detail listings, or where they have the detail, but have lost track of the member (who may have moved out years ago).

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### New Cases Added:

**Baumann v. Long Cove Club Owners Association**

**Bay Crest Association Inc. v. Paar**

**Beck v. Holly Tree Homeowners Association**

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# Security Deposits and Unclaimed Property

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2

Many people take the position that these old deposits should be “cleaned up,” the only question is “what is the appropriate action” to take to “clean them up?” Most advocate simply writing the deposits off by recording them as miscellaneous income to the association. The assumption is that if the member ever shows up to claim the deposit, the association will still maintain the list, and can refund the deposit if requested to do so. Obviously, this should be preceded by efforts to contact the member to return the refundable deposit. This is difficult where the member has moved out of the association. The member often either forgets about the deposit, assumes that the new owner of their property will “take over” their deposit, or has simply determined it is not worth the effort to go after the refund because it is too small.

California (where I operate) law is embodied in the Code of Civil Procedure sections 1500 – 1582, and the state has indicated that this section applies to homeowner association deposits (although some lawyers have attempted to take the position that a homeowners association does not meet the definition of a “business association” as defined in section 1501 of the code). Section 1516 of the code states that certain amounts received that have not been returned within three years after the amount was due to be returned to the depositor automatically escheat to the state, and must be turned over to the state treasurer. Section 1518 defines “property” for purposes of determining if unclaimed property exists.

**Missing Records and Estimates**—It takes more than just a list of who made the deposit. It requires sufficient information to be able to identify the amount and nature of the deposit and identification of the depositor and address and other contact information so the depositor may be located.

It also requires documentation of deposits that have been refunded. Too many times I have been confronted with this situation when auditing an association. The deposits have been made, but the deposit is still carried as a liability in the general ledger because it was not properly accounted for. This can result in a double whammy if you’re required to turn over unclaimed deposits to the state, since you have already refunded the money to the member but just can’t prove it. Good records are a must.

State unclaimed property auditors (yes, they do exist) are allowed to estimate your unclaimed property if you do not have sufficient records to support our position. Section 30(e) of the 1981 Uniform Unclaimed Property Act permits the use of estimates where sufficient records are not available to identify unclaimed property.

Unfortunately, there are substantial penalties for failure to comply. It may actually cost the association more money in penalties for failure to comply than if they had simply turned the funds over to the state as required under the law.

Let’s look at an example of an association that levies a \$100 key deposit for its members, but has failed to properly track the deposits since inception.



## Security Deposits and Unclaimed Property– Cont.

The state auditor, by reviewing records, estimates that unclaimed deposits in the test year total \$5,000, or 50 unclaimed deposits. Given a 15-year statute and look back period, the auditor estimates the total liability at \$75,000 (15 X \$5,000). To that, he adds a (statutory) failure to file penalty of 25% (\$18,750), plus compound interest averaging 7% over the 15-year period (\$59,440). The association is handed a bill for \$153,190. This is not a fairy tale, it CAN happen



**The Association’s Options**—So, what is an association to do? First, tighten up the controls on security deposits to reduce the possibility that unclaimed deposits will exist by establishing clear policies and procedures. Second, investigate your state laws to determine what obligations you have to locate the member and refund the money. Third, investigate state law to determine who is now the legal owner of this unclaimed deposit (the statute of limitations may be as long as 15 years). The answer may surprise you, because it is probably not the association. Fourth, undertake periodic reviews (at least annually) to make sure that policies and procedures are being followed.

While the temptation to write off deposits to income is great, it runs the risk of actually creating a larger liability to the state, if such actions are discovered. I routinely advise associations via the annual audit management letter to strengthen their accounting procedures on deposits, make every attempt possible to locate members and former members and refund the money, or, if possible, make a finding (and document it) that the deposit has been forfeited to the association, thereby no longer qualifying as “unclaimed property” that will escheat to the state. With the association’s attorney, I have also advised that the association rewrite their deposit policies so that deposits amounts do not become unclaimed property to begin with. In other words, the rules are revised to state that deposits automatically become forfeit to the association if certain administrative procedures are not completed by the member (may be weak, but at least one lawyer advised this should work).

**The Auditor’s Perspective**—Auditors need to review their clients’ activities with respect to accounting for deposits, as failure to adequately account for deposits or turn over unclaimed deposits to the state may result in a material unrecorded liability. The example above calculating a liability of \$153,190 would probably be material to even the largest association. SFAS No. 5, “Accounting for Contingencies” requires the auditor to record the liability if it is reasonably possible that the event (discovery by the state) will occur (it is reasonably probable, meaning the probability is more than remote but less than likely) and the amount can be reasonably estimated (it can). Auditors need to be more aggressive in evaluating this issue.

**Other Issues**—Certain associations, particularly those in resort areas, must take special care with deposits in understanding unclaimed property law. The U. S. Supreme Court case “Texas v. New Jersey” resulted in the opinion that the state of the creditor’s last known address (rather than the location where the association is located) is the appropriate owner of the unclaimed property. If that state does not have an unclaimed property law, then it reverts to the state in which the association is incorporated. Information to help associations is available from the Unclaimed Property Holders Liaison Council at [www.uppo.org](http://www.uppo.org). Information to help individuals or companies discover if they have any unclaimed property held by the government is available from the National Association of Unclaimed Property Administrators at [www.unclaimed.org](http://www.unclaimed.org).

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Article Title	Article Summary	State
<a href="#">Homeowners against proposed crematorium in Spring Hill</a>	Opposition to a proposed crematorium in Spring Hill appears to be growing. The Spring Hill Memorial Park and Funeral Home wants to build it on property in Maury County.	Tennessee
<a href="#">HOA threatens to sue Possum Kingdom wildfire survivor</a>	When raging wildfires destroyed 54 homes in the Possum Kingdom Lake residential area known as Sportsman's World last month, one of those houses belonged to Jim Brumbelow.	Texas
<a href="#">Deputies investigate feud over pot bel-lied pig</a>	A woman was accused of threatening her neighborhood's homeowners association after an ongoing argument over her owning a pot bellied pig took off on Facebook, York County deputies said.	North Carolina
<a href="#">Steven Seagal's driveway under siege by Homeowners Association</a>	Action star — and occasional reserve deputy sheriff — Steven Seagal is locked in deadly battle of e-mails and lawyers with his Scottsdale, AZ, HOA after, according to the actor, the association decided to decorate the road in front of his home with boulders.	Arizona
<a href="#">City agrees to step in, assist in duckweed dilemma</a>	Duckweed is taking over Coleman/Kell-Aire Lake, and residents along the lake want the city to help eradicate the aquatic plant, which typically floats on or just beneath the surface of still or slow-moving fresh water body	Florida
<a href="#">Northhampton: Contractor bilked homeowners' group, bought Harley, officials say</a>	A North Carolina contractor who accepted money to build a bulkhead at a waterfront community here but bought a Harley-Davidson motorcycle and other items instead of finishing the work has pleaded guilty.	North Carolina
<a href="#">Know the liabilities of buying distressed property</a>	Watch out for unknown liens when buying a home that's been foreclosed on.	California
<a href="#">In Sahalee, beauty is in the eyes of the committee</a>	In a Hillside subdivision called Sahalee, there is a war going on at the end of a cul-de-sac among the flawless lawns and three-car garages. It is the kind of war that, no matter what happens, no one will really win.	Alaska
<a href="#">Homeowners Associations: On the way out?</a>	Studies show that about 20% of U.S. homeowners are members of a homeowners association, but more and more of them may find the doors locked when they go to their next meeting.	New York
<a href="#">'Alief resident sued over parked ambulances</a>	Villages of Pheasant Run Homeowners Association filed a lawsuit on June 13 in the Harris County District Court against Maria Hernandez, alleging breach of contract.	Texas
<a href="#">Advance notice, seasonal review best for policing violations</a>	For many homeowner's associations, the most time-consuming, contentious and difficult issue for board members and homeowners is that of policing violations of the covenants, conditions and restrictions of the community.	Florida
<a href="#">Foreclosure fees haunt homeowner associations</a>	Three years into the foreclosure epidemic, desperate condominium and homeowner associations are now beginning to employ aggressive law firms and collection agencies in a new tactic aimed at recovering delinquent fees.	Florida
<a href="#">Joe Adams: Condolt may be best to 'grandfather' baby into condo</a>	Q: I live in a "55 and over" condominium. Presently, we have a couple who is expecting a baby. This couple was grandfathered when we became a "55 and over" community. What is the law governing this situation?	Florida

Article Title	Article Summary	State
<a href="#">No more potholes - Residents 'happy' about fixed roads after 40 years of disrepair</a>	For the last seven years, whenever Jack Smothers has backed out of his home at Havasu Garden Estates, he's had to avoid dozens of deep potholes that have wreaked havoc on any vehicles driving through the area.	Arizona
<a href="#">Gates Four annexation fight likely over because of new law</a>	Walter Quick, a Gates Four homeowner, says new legislation that effectively blocks the annexation of his community is great news.	North Carolina
<a href="#">Disabled vet battles HOA over handicap parking space</a>	The state civil rights division has been asked to weigh in on a dispute between a disabled veteran who says he needs a handicap parking space and the Jewell Lake Condominium Association which says he hasn't demonstrated a need.	Colorado
<a href="#">Paradise Spa residents may lose homes</a>	There is confusion and fear at the Paradise Spa as homeowner there get notice the community is shutting down. The complex on Las Vegas Boulevard near Silverado Ranch has been the subject of FBI raids targeting the California owner of many of the units.	Nevada
<a href="#">Outcry comes from angry Johnston condo owners</a>	A group of 16 condominium owners at Providence Pointe Apartments in Johnston is circling the wagons against the effects of the renters who surround them.	Iowa
<a href="#">Raytheon neighbors settle pollution suit for \$2,500 each</a>	Three years after filing a lawsuit against the Raytheon Co. for polluting a St. Petersburg neighborhood, attorneys have agreed to a settlement in which most homeowners will get \$2,500 each.	Florida
<a href="#">Making condominiums last another 50 years: Part 1</a>	Many visitors visualize living in Napa in a vine-covered cottage surrounded by vineyards with a picket fence on a cul-de-sac. And what if that vision is a home within a Common Interest Community (CIC), or a condominium? The resident may be renting or owning, but the home meets their needs, short- or long-term.	California
<a href="#">Who pays to trim neighbor's trees?</a>	If your neighbor refuses to trim trees, can your homeowners association board intervene and send in a professional? If so, can the board bill him for the work? When will the new bill lawmakers passed modifying condo and HOA laws take effect?	Florida
<a href="#">Condo group upset over plan to make members pay for stoplight</a>	Members of a Far West Side condominium association are questioning the city's policy regarding who would pay for installation of a traffic signal in their neighborhood, according to a letter association officials sent to city staff last week.	Wisconsin