



Capturing the Pulse of the HOA Industry
HOA Industry News, Articles, and Links

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Does your board need advice on making sound financial decisions? This article offers ten informative ways to successfully manage the financial health of your association.

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Association of the Week
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Association, Inc.



Briarcliffe Towne Homes Association, Inc. is a lovely townhouse development...

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Preventing Fraud and Embezzlement

Check fraud is one of the quickest growing crimes at 25% per year with losses of over \$20 billion per year. You can avoid this happening to your association by putting safeguards in place. Read the full article to find out how to protect your association from a devastating loss.

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Business Spotlight

Butler, Jones & Hansen, PC



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More on Revenue Ruling 70-604 and Association Taxation

Just over a year ago, the IRS issued an "Information Letter" providing an additional interpretation of Revenue Ruling 70-604. The question this time related to the ability to accumulate a working capital reserve without paying taxes on that accumulated income. Guess what the IRS response was. Read more to find out.

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New Features - The HOAPulse.com Community

HOAPulse.com is proud to announce new features that have been added to the site. These features have created a community for residents, managers, and other professionals in the HOA/Condo Industry like no other! We have integrated a full-featured bulletin board with forums dedicated to discussions relating STRICTLY to HOAPulse and our industry and we have added profiles and connections for everyone who registers. Join our community by going to HOAPulse.com.

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Association of the Week

Briarcliffe Towne Homes Association



Briarcliffe Towne Homes Association is a lovely townhouse development of 295 residential units, comprised of 39 separate buildings situated on 14 acres in the beautiful San Fernando Valley. Located 20 miles north of Los Angeles, this association is close to the luxuries the city offers. The development boasts a refurbished pool, two tennis courts and a lot of open green space.

Recently, Briarcliffe adopted a new philosophy. "We Listen to the People, Management that Cares" and has proven to be effective in listening to their community and renewing community spirit. A number of committees have been established starting with the Welcome Committee. This committee meets and greets all new residents where they go to the home and explain the rules of the community in a friendly one on one get together, with the emphasis that this is their home and people in the community really care. Also, a Community Care Committee has been started to assist residents who may have special needs, that can't do simple tasks by themselves, like changing lightbulbs, cleaning a screen door or cleaning cobwebs from the porch light. Community Lawn Picnics, International Days and an Annual Community Potluck have created a great community environment. Briarcliffe Towne Homes Association is truly a community filled with care and pride.

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Business Spotlight

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The firm are members of CAI and AACM. Butler, Jones & Hansen, PC are your Association experts for the Phoenix, Arizona area. The firm provides, compilation, review, and audit services, in addition to income tax preparation and consulting services for its homeowners association clients.

Motivating Boards to Make Sound Financial Decisions

By Karen Bennett, PCAM, CCAM

1. Always plan enough time on the Agenda to review the monthly financial statement.
2. Make sure each board member understands the monthly variables between the budgeted numbers and the actual numbers. Record the information in the minutes.
3. When reviewing the annual Reserve Study, make sure all the members of the board understand and discuss the report. Are all components included? Is the life expectancy realistic?
4. When reviewing the Audit Draft point out any “interesting points” that the Auditor has made. Consider hiring a different Auditor about every 5 years to get a “second opinion” and feel confident that another Auditor is looking at the books.
5. Recommend experts to create specifications for large reserve projects. Then, create a matrix to clearly show the board the differences in the bids. Make sure enough is budgeted so that the expert can supervise to make sure that his specifications are being followed.
6. When comparing bids be thorough and able to determine the quality of each product that is used. What is the life expectancy of the application?
7. Collect assessments fairly. Review cost of living increases, completeness of reserve allocations, adequacy of reserve accounts and community expectations, each year. Homeowners should expect assessments to go up most years. Homeowners that “live” in the community should be setting aside money to pay for their fair share of the replacement of the assets.
8. Asking homeowners to pay for a special assessment shouldn't come as a surprise if the board has been monitoring expenses, planning for the future, setting adequate budgets and making reasonable decisions.
9. Communication with owners is a large part of the board's duty. Share the information. Invite owner participation in solving the problems. Create ad hoc committees to research and advise the board.
10. With the cost of housing increasing every year, it is in everyone's best interest to invest in maintenance, refurbishment and revitalization of homes and community centers. Hiring architects and landscapers to re-design and create newer looking facilities is exciting and rewarding for all the owners that live in the community. Keeping existing communities repaired, clean and well-funded adds to the value for every owner.

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Preventing Fraud and Embezzlement

By: Craig Huntington

Introduction. Dishonesty, untrustworthiness, betrayal.

What is Fraud? Deceit, trickery; intentional perversion of the truth in order to induce another to part with something of value or to surrender a legal right.

What is Embezzlement? To appropriate (as property entrusted to one's care) to one's own use.

How bad is it - stats?

- 1.2 million+ worthless checks enter the banking system each day.
- Check fraud losses over \$20 billion per year
- Check fraud is growing at a rate of approx. 25% per year.
- Average loss for small business was \$127,500. For large business \$97,000.



Key Factors.

- Smaller organizations often lack basic accounting controls.
- Having a single employee who writes and signs checks, reconciles the bank statement and keeps the company books makes it easy to commit and conceal fraud.
- The level of trust that tends to exist between co-workers makes them less alert to the possibility of dishonesty.

What to do?

- Separation of Responsibilities
- Security and Control of Account Documents and Information
- Proper Check Issuing Procedure
- Prudent Personnel
- Computer System Protection
- Check Printing Safeguards

Separation of Responsibilities

- Maintaining adequate checks and balances is essential on protecting you association from dishonest people
- Separate access to and responsibility for issuing checks from that of balancing and reconciling statement.
- Reconcile your bank statement promptly – within two or three days after receipt.
- Authorized signers should NEVER be the same people who reconcile the account.

Security and Control of Account Documents and Information

- Store your reserve supply of blank checks in a secure, locked location that is accessible only to authorized personnel, preferably under dual custody.
- When not in actual use, lock your working supply of blank checks in a secure place separate from your reserve supply.
- Canceled checks and bank statements contain sensitive information and should be stored in a secure place.
- Provide proper protection for all checks that have been issued but not yet mailed or delivered.
- Notify your bank immediately when someone who is authorized to transact business with the bank leaves and remove that person's access to all bank accounts and electronic access.
- Use bank services such as Positive Pay or Check filtering to reduce the chance for fraud.

Proper Check Issuing Procedure

- Never sign a check that has no payee.
- Checks used for transferring money between accounts should be made payable to the name of the account to which they are being deposited.

Prudent Personnel Practice

- Verify references and last place of employment of any new employee.
- Telephone previous employers to confirm all relevant information supplied by the applicant.
- Be alert to major changes in someone's spending patterns or financial circumstances.
- Enforce mandatory vacation policies especially for those with access to financial records or computer access.

Computer System Protection

- Change passwords periodically.
- Never share passwords.
- Computer systems should create an audit trail of all changes to the master file records including who made the changes.
- Immediately delete the computer access of individuals no longer authorized.

Check Printing Safeguards

- Iridescent printing with distinctive colors
- Watermarks
- Erasur-resistant ink
- Void or Copy pantographs
- Microprinting

Summary

In most states, the code that governs check-related fraud assigns significant responsibility to an account holder for preventing and detecting fraud. Prevention and early detection are two of the main factors in reducing exposure.

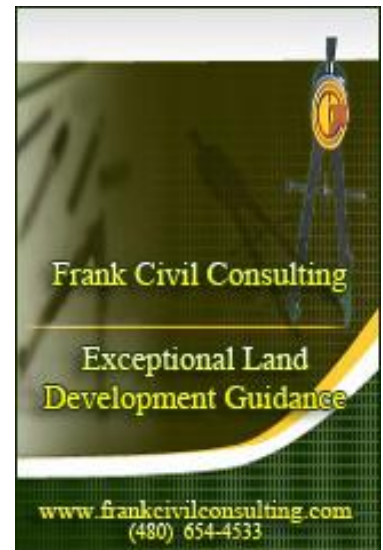
While these suggestions have proven effective, you should consult with your own outside auditors or accountants in developing controls appropriate to your situation.

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More on Revenue Ruling 70-604 and Association Taxation

By: Gary Porter, CPA

The issue of homeowners Association taxation is a difficult one and that difficulty is never going to go away. The basic problem is that a homeowners association is the only taxable entity that gets to choose annually which tax form it wants to file; Form 1120 or Form 1120-H. New guidance issued by the IRS is rare. The new guidance that is issued is usually a clarification of existing law, regulations, and rulings. The IRS did issue a very low-level ruling in late 2009. It did not break any new ground, but is still important enough that associations should be aware of it. In addition, it is an opportunity to again review the basic ground rules with respect to homeowner association taxation.

On December 31, 2009 the IRS issued information letter number 2009-0233. An IRS information letter is considered to be the lowest level of authority released by the IRS and has no precedential authority (may not be cited as a precedent in any other proceeding). However an information letter is significant because it clarifies the IRS thinking on a particular subject, and even though this letter has no authority, it would be difficult for the IRS to later take a position that departed significantly from a position taken in an information letter.

An information letter is issued in response to a specific request by a taxpayer on interpretation of tax law. In this case the taxpayer, a homeowners association, wanted to know if it could transfer excess membership income into a “working capital reserve” and avoid taxation under the provisions of Revenue Ruling 70-604. The IRS responded that such an action was not acceptable. A working capital reserve is simply a set-aside of excess membership income to be used as working capital. In the eyes of the IRS this is still taxable income.

A little background is necessary here. In 1970 the IRS issued Revenue Ruling 70-604 related to the excess membership income of a homeowners association. In 1970 all associations were required to file Form 1120 as non-exempt membership corporations. Form 1120-H was not created and related Internal Revenue Code Section 528 was not enacted until 1976. The importance of Revenue Ruling 70-604 is that it allowed a homeowners association that had excess membership income in a given tax year to either refund it to the members or roll it over to the subsequent tax year, thereby avoiding taxation of that excess membership income. While it is clear that the IRS intent was that this be a one-year only option, the IRS has never issued any specific guidance stating so.

For most homeowners associations the only taxable income is the interest income on reserves. If the association files Form 1120-H, it pays taxes at a rate of 30% on the interest income less any related deductions. Form 1120-H was specifically designed for homeowners associations and contains certain qualifying requirements. It was created by Internal Revenue Code section 528, which also defines the term “homeowners association.” The importance of Form 1120-H is that excess membership income is not subject to taxation, because the homeowners association is considered to be a (partially) tax exempt organization. The other critical factor regarding Form 1120-H is that there is virtually no tax risk associated with this form; it is very safe to file this form. The downside of electing to file Form 1120-H is that your tax rate is 30%.



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This is contrasted to homeowners associations that file Form 1120. A homeowners association that files Form 1120 is indistinguishable from any other type of organization that files Form 1120. It is simply considered to be a nonexempt membership organization. When filing this Form, in the eyes of the IRS, you are no longer considered to be a homeowners association. That is a key point that many fail to understand. The good thing about filing Form 1120 is that the corporate tax rate applied is only 15% for the first \$50,000 of taxable income, which covers almost all homeowners associations. The two downsides to Form 1120 are (1) any excess membership income is considered taxable unless an election is made under Revenue Ruling 70-604, and (2) there is considerable tax risk associated with Form 1120. However many associations are willing to assume the risks associated with Form 1120 in order to get the lower tax rate.

This brief article is not intended to be a complete analysis of homeowners Association tax law. It is simply intended to alert you to the IRS's newest ruling in review the basics of Revenue Ruling 70-604. The Revenue Ruling allows an association to make an election to either refund excess membership income to the members or to roll that excess membership income over to the following tax year.

The Ruling states that the members are to make the election. However I have had several conversations with the national office of IRS and pointed out to them the inherent conflict with state law; that only the Board of Directors has the authority to make decisions regarding disposition of association funds; members do not have that authority. The national office of IRS has acknowledged verbally (meaning no authority) that the ruling may be interpreted as stating that those who have the authority to make a decision regarding disposition of association funds may make the election under this ruling. My advice to associations is that the election under Revenue Ruling 70-604 should be a standard part of the Association's annual meeting agenda and that the members should approve the election. In addition the board should immediately ratify the members' action. That way the association is in compliance with state law and also avoids any conflict with the IRS.

Many times the association would like to transfer excess membership income to reserves. This is not an option under Revenue Ruling 70-604. However the association can achieve the same effect by making an election to roll excess membership income to the subsequent tax year, then make the transfer to reserves in the subsequent tax year after adequate notice to members. Advance notice to members is a requirement of capital contributions (reserves) and is normally taken care of through the budget process. If an additional transfer to reserves is going to be made the members must receive advance notification.

Revenue Ruling 70-604 is only three paragraphs long, yet it is sufficiently vague that much interpretation is required. I had the opportunity to speak with Mr. Ranson, the author of this Revenue Ruling, before he retired from the IRS several years ago. Mr. Ranson stated that he purposely left the wording somewhat vague in this ruling so that there would be some flexibility in interpretation. The unfortunate side effect of this is that there is also some dispute as to the interpretation of the ruling. The IRS is well aware of certain abuses within the homeowners association industry regarding the interpretation of this ruling and has even internally discussed withdrawing this ruling. Obviously that has not occurred, and the IRS officials that discussed this with me have also since retired from the IRS.



Associations are advised to always proceed with caution on homeowners Association tax issues. Consult with your CPA on this matter. I have received more questions as a tax practitioner on Revenue Ruling 70-604 than on all other tax matters combined. Consequently, I have established a website at www.revenueruling70-604.com that is intended to answer the many questions that arise regarding this important ruling. This website contains all information I was able to obtain regarding Revenue Ruling 70-604. The site is also supported by several other CPAs.

Also see free videos at www.hoapulse.com on Revenue Ruling 70-604 that help explain how this ruling works.

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Web Articles

Click on Title to view

<u>Title</u>	<u>Summary</u>	<u>State</u>
Data Security	Applicants' privacy needs to be protected to avoid identity theft	National
Sure, you could sue, but would that be best?	A resident is angry that the board was flexible with the covenants	Florida
Lawmakers to consider abutter notification for condo owners	Legislators will be meeting to endorse or dismiss a proposed law, that would require condo owners to be notified of public hearings that would affect their views	New Hampshire
Rollins Square offers suggestions on "Going Green"	Condominium Association wins a "Green Award" from the Mayor.	MA
Deed detail may sink cell tower plans at Ahwatukee church	A deed restriction that bans radio towers and antennae may force AT&T to seek a new location for a planned cellular tower at a church.	Arizona
Marine sued by HOA over flagpole	A Marine says his HOA is suing him because of a flagpole on his property	Texas
Subdivision's residents may sue over plans for elementary school	HOA not happy about the change in the traffic loop at a new elementary school being constructed.	Florida
Long Beach's Marina Pacifica Bridge Reopens	A 300 foot long bridge has reopened after being renovated by the Marina Pacifica HOA. It was paid for through special assessments of the homeowners in the	California

Lawmaker reacts to Houston Marine's HOA dispute	Congressman Ted Poe made comments on the floor of the House of Representatives, in support of all military, to have the right to fly the American flag, no matter	Texas
Some violations can take years to resolve, correct	Various issues in regards to the management of an HOA are addressed.	Nevada
Legal fees a major drag on homeowners' associations	HOA in North Carolina spent nearly 20 percent of its budget on legal expenses.	North Carolina
New Plan Puts Competition In Crime Fighting	Police and area homeowners come up with a competition to help prevent and increase awareness of crime	North Carolina
Watching For A Rebound	Community associations are seeing the sign of improvement in the real estate crisis. Homeowners who have not been paying fees are decreasing in	Florida
Flood Insurance Not Optional	Issues of flood insurance, property values and rental property are addressed	Florida
Yarmouth residents pay to keep streetlights on	Residents of HOA pay \$80 per streetlight to keep the City from turning them off	MA
Side Streets: Tragedy or drama, it's good theater	HOA Board wants home based bird business gone	Colorado
House Plaques Idea a Sign of Summit Pride	Homeowners organize a plaque program to bring attention to historical district	Minnesota
To sell home this summer, prepare now	The housing market is analyzed for those considering selling their home	California
Hazlet school employees plowed private sidewalks so students could walk safely	Taxpayers pay for cost of Board of Education vehicles to plow private roads so students could walk to school safely	New Jersey
Brooks: Turns out a nuisance can be in the eye of the neighborhood	House, left abandoned, is kept up by neighbors	California
Toro-area homeowners move on new sewer district	A coalition of homeowners move ahead in plans to form their own water district or joining a different one	California
USGS presents lake level study proposal	Funding for a study to analyze groundwater and surface water interactions in White Bear Lake is proposed.	Minnesota
Gates Four again files appeal of annexation	Gates Four HOA continues its fight against annexation	North Carolina
Residents oppose dwellings	Homeowners in two local neighborhoods oppose new development of affordable apartments	Colorado