

Community Association Management *Insider*[®]

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The Year-End Audit: How to Prepare, What to Expect

Associations produce audited financial statements so that members, prospective buyers, and lenders can assess an association's financial condition. If an association's finances are mismanaged, prospective buyers may have a difficult time getting loans and may look elsewhere for a home. This ultimately may reduce home values in the community in an already difficult economic climate.

Increasing news reports of fraud within associations and the effects of the economic downturn have highlighted the need for associations to produce audited financial statements. Community associations may be required to produce audited year-end financial statements by state law. Some states require audits to be performed if an association is a certain size, generates a certain amount in assessments, or if the association is transitioning from developer control.

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TECHNOLOGY

How Digital TV Transition May Affect Condo Associations

Big changes are coming to broadcast television, and some of your members may have been contacting your management office with questions about the upcoming change. Currently, broadcast stations are broadcasting in both analog and digital. But on Feb. 17, 2009, all full-power broadcast television stations are required to stop broadcasting in analog and continue broadcasting in digital only. This is known as the digital television (DTV) transition.

Why the Switch?

Efficiency and quality are the major reasons for the switch. By switching to all-digital broadcasting, more technologies will be able to use the broadcast spectrum, the range of wireless frequencies in which information is communicated. The switch will free up parts of the valuable broadcast spectrum for public safety communications such as police, fire departments, and rescue squads. Also, the majority of the rest of the spectrum has been auctioned off to companies that will take advantage of new wireless technologies. For example, more companies will be able to provide consumers with more advanced wireless services

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Year-End Audit (continued from p. 1)

Regardless of whether your association is required to conduct an audit by state law, it is advisable to do so, says Gary Rosen, a certified public accountant and certified fraud examiner. An audit is the highest level of service a certified public accountant can provide to an association to ensure that the management company as well as its board members are acting in the best interests of the association.

To help you better understand the audit process, we'll discuss two important letters from the auditor and the association and provide a pre-audit checklist to help you organize the documents you need for an audit (see Model Form: Gather Items Needed for Year-End Audit).

Engagement Letter

The first written communication between an association and its auditor is the engagement letter. This letter puts in writing the auditor's agreements with the association about the scope, terms, and conditions of the audit engagement. The letter is usually addressed to the board of directors, with a copy sent to the audit committee if the association has one. It will state the amount of the audit fee and when it is payable.

The primary purpose of the engagement letter is to minimize any possible misunderstanding concerning the scope and terms of the audit. The letter should clearly outline the objective of the audit of your association's financial statements. Typically, the objective is to express an opinion about whether your financial statements are fairly represented under generally accepted accounting principles.

The letter may state that the tests performed by the auditor will look at your internal control procedures to see if your association has adequate safeguards in place to prevent instances of fraud or embezzlement.

Besides outlining the audit's objectives and the extent to which the auditor is responsible for reporting weaknesses in internal control procedures, the engagement letter should clearly state who has the responsibility for preparing the financial statements. An association's board is ultimately responsible to ensure that the association's books and records are maintained. This means that regardless of the management company's role in financial statement preparation, the association still retains responsibility for the accuracy of its financial statements. The auditor's role in the process is to ensure that the financial statements are free from material misstatement.

Audit Representation Letter

For the auditor to issue an official opinion at the end of an audit attesting to the accuracy of an association's financial statements, an auditor will require the association's board of directors to sign a representation letter. Auditors need this letter from the association to comply with generally accepted auditing standards (GAAS) and the

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MODEL FORM

Gather Items Needed for Year-End Audit

Here is a pre-audit checklist written with the help of Gary Rosen of Wilkin & Guttenplan, P.C. Use this checklist to organize and prepare for the year-end audit of your association’s financial statements.

PRE-AUDIT CHECKLIST

Items Needed for Audit of _____

Management Company _____

Prepared by _____ Date _____

COPIES OF THE FOLLOWING DOCUMENTS FOR AUDITOR TO KEEP

DATE	COMPLETED	N/A	DESCRIPTION
_____	<input type="checkbox"/>	<input type="checkbox"/>	Year-end financial statements
_____	<input type="checkbox"/>	<input type="checkbox"/>	Bank reconciliations, including account #, description and detail of outstanding checks and deposits-in-transit
_____	<input type="checkbox"/>	<input type="checkbox"/>	List of authorized check signers on each account during the year
_____	<input type="checkbox"/>	<input type="checkbox"/>	Trial balances (worksheets listing the balance, at a certain date, of each ledger account in two columns consisting of debit and credit)
_____	<input type="checkbox"/>	<input type="checkbox"/>	Accounts receivable listings
_____	<input type="checkbox"/>	<input type="checkbox"/>	Fixed assets’ schedules, including depreciation
_____	<input type="checkbox"/>	<input type="checkbox"/>	Accounts payable listings
_____	<input type="checkbox"/>	<input type="checkbox"/>	Schedule of replacement fund activity
_____	<input type="checkbox"/>	<input type="checkbox"/>	Most recent engineering study
_____	<input type="checkbox"/>	<input type="checkbox"/>	Operating budgets for the year
_____	<input type="checkbox"/>	<input type="checkbox"/>	Insurance schedules, including period, carrier, policy #, premiums, and payments made

DOCUMENTS TO BE MADE AVAILABLE TO AUDITOR

DATE	COMPLETED	N/A	DESCRIPTION
_____	<input type="checkbox"/>	<input type="checkbox"/>	Bank statements
_____	<input type="checkbox"/>	<input type="checkbox"/>	Investments, CDs, or passbooks during year
_____	<input type="checkbox"/>	<input type="checkbox"/>	Delinquent notices sent to shareholders
_____	<input type="checkbox"/>	<input type="checkbox"/>	General ledger, cash disbursement journals, cash receipts journal, and payroll journal
_____	<input type="checkbox"/>	<input type="checkbox"/>	Description of late fee charges policy and late fees collected
_____	<input type="checkbox"/>	<input type="checkbox"/>	List of personnel included in payroll
_____	<input type="checkbox"/>	<input type="checkbox"/>	Board meeting minutes
_____	<input type="checkbox"/>	<input type="checkbox"/>	Insurance policies in effect during fiscal year
_____	<input type="checkbox"/>	<input type="checkbox"/>	Paid invoices for all cash disbursements
_____	<input type="checkbox"/>	<input type="checkbox"/>	Unpaid vendor invoices
_____	<input type="checkbox"/>	<input type="checkbox"/>	Executed management contract

ADDITIONAL INFORMATION

DATE	COMPLETED	N/A	DESCRIPTION
_____	<input type="checkbox"/>	<input type="checkbox"/>	Monthly maintenance fees in effect for audit period
_____	<input type="checkbox"/>	<input type="checkbox"/>	Board members, phone numbers, and offices held during the year
_____	<input type="checkbox"/>	<input type="checkbox"/>	Name, address, and phone number of association attorney and insurance agent

Year-End Audit

(continued from p. 2)

American Institute of Certified Public Accountants' Statement of Auditing Standard No. 85, which "establishes a requirement that the independent auditor obtain written representations from management as a part of an audit of financial statements performed in accordance with generally accepted auditing standards."

Typically, the letter will state that the association understands the financial statements are its responsibility. Although the auditor prepares the financial statements and related disclosures, this does not transfer responsibility for the integrity of the financial statement from the association to the auditor.

The letter may also confirm that the association has had no communications with regulatory agencies concerning noncompli-

ance with financial reporting practices. It also will affirm that the association has no knowledge of any fraud or suspected fraud that could affect the association's financial statements, and that there are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

The letter also may list any significant information provided to the auditor. An auditor may have relied on this information to render an opinion on the financial statements. For example, the letter may list that the association provided financial records, related financial data, and the minutes of board meetings.

At the end of an audit, the auditor will issue an independent auditor's report. Assuming an association has maintained accurate financial records and has adopted good internal controls,

the auditor should be able to confirm that the association's financial statements fairly reflect the association's financial position. It is important to note that an auditor's report on financial statements is only an opinion on whether the information presented is correct and free of material misstatements. All other determinations as to the financial health and performance of an association are left for the members, prospective buyers, and lenders to decide.

Insider Source

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For More Information...

VISIT US ONLINE:

www.communityassociationinsider.com

Search Our Web Site by Key Words: audit; auditors; financial statements; embezzlement; fraud

Digital TV Transition

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such as wireless broadband. Consumers also benefit because digital broadcasting allows stations to offer improved picture and sound quality.

Who May Be Affected?

Not everyone will be affected by the DTV transition in the same way. If your members receive their local broadcast stations through a paid provider such as cable or satellite TV, they are already prepared for the DTV transition. However, if your members have an analog TV that does not receive local broadcast stations through a paid provider, these members will need a "digital-to-analog converter box" to watch digital broadcasts.

Some members may have a digital TV, a TV with a built-in digital tuner. If so, they do not need a converter box. However, if your condo association has a master antenna that feeds a TV signal through wiring in the building, members with an analog television may or may not be able to watch full-power broadcast stations after Feb. 17, 2009. Their ability to view channels after this date depends on whether members with analog television sets get a "digital-to-analog converter box" and whether the association needs an upgrade to its master antenna.

EDITOR'S NOTE: Community associations can impose restrictions on the placement of antennas or satellite dishes only on common areas. The Federal Communications Commission's Over-the-Air Reception Devices Rule prohibits

restrictions on a person's ability to install, maintain, or use an antenna for television access. According to the FCC, a restriction is not allowed if it: "(1) unreasonably delays or prevents use of; (2) unreasonably increases the cost of; or (3) precludes a person from receiving or transmitting any acceptable quality signal from an antenna covered under the rule." If a member has exclusive use in the area where the antenna is to be located, such as a limited-common-element balcony, then the no-restriction rule applies.

Master Antenna Systems

According to a representative from ERL Electronic Products, an antenna installation service provider, each condominium building should ask: What have we got, how is it wired in, and what are we going to do about it? Some condominium buildings receive local TV stations

through a master antenna system, sometimes called a common antenna or a MATV system. These antenna systems receive TV signals through an antenna on the roof or in a central location and provide the signals through wiring in the building that connects to the TV set in individual members' homes. These systems incur no charge to the members. Many condo associations see this system as a way to reduce antenna clutter and to provide a service to members.

Other condo buildings may use a SMATV, or satellite master antenna system. In these instances, there is a private cable operator involved to whom members or the association pay a fee for local broadcast channels coupled with satellite TV programming. If this is your case, the association should contact this provider and ask what it is doing about the digital TV transition.

Generally, in these master systems it's not a simple matter of wiring directly attached to the antenna. There is some process in which the signals are processed and then delivered to the member's home. Many of these antenna sys-

tems will need adjustment so that the digital signals can be received and delivered through the wiring to your member's home to be able to view broadcast channels with a digital converter box or with a digital television set. If your association has a master antenna not associated with a private cable operator, your association will have to pick up the cost of upgrading if your association wants to continue to provide this service.

Assess the Impact

After determining the costs associated with modifying the master antenna system if your current master antenna system will not process digital transmissions, you will have to decide a number of issues, such as whether to replace or upgrade the system, arrange for cable service for the entire community, or let individual members make their own arrangements, at their own expense.

One important question an association should ask at this point is how many of its members are actually relying on the master antenna. In older condo buildings with master antenna systems, most

likely, many members initially enjoyed the free signals through their building's master antenna. However, over time, those members may have migrated to regular franchise cable. As a result, your association may not deem it worthwhile to choose to upgrade the master antenna system because very few members may be affected.

Some associations may choose to revamp their master antenna system so that the building's wiring can pass the digital signals to members with digital television sets or converter boxes. This decision depends on the membership and an understanding of the ramifications for the members residing in the building.

Insider Source

ERL Electronic Products, LLC: 6550 Austin St., Rego Park, NY; 11374-4628; www.erlelectronics.com.

For More Information...

VISIT US ONLINE:

www.communityassociationinsider.com

Search Our Web Site by Key Words: digital television transition; master antenna; cable; satellite

RECENT COURT RULINGS

► Member Allowed to Keep Her Dog

Facts: An association sued to enforce its governing documents against a member. The member's home is governed by two sets of governing documents: one for a master association and one for a sub-association within the larger community. Both governing documents prevent a member from replacing his permitted dog upon its death. However, the documents differ in that the master association limits ownership to instances where the owner had the dog when he purchased his home.

The association tried to compel the owner to remove her dogs because she did not own a dog at the time of her home's purchase. A trial court ruled for the member on the basis that the two sets of govern-

ing documents were in conflict on the issue of dog ownership within the community.

Ruling: An Ohio appeals court upheld the lower court's ruling.

Reasoning: The court ruled that if the association sought to limit dog ownership to members who had their dog at the time of purchase of their home, it would have included that restriction in its more recent declarations. The court also found that the sub-association's handbook did not place a timing restriction on dog ownership. As a result, the two sets of governing documents should not be read together, but rather, the sub-association's governing documents should

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Recent Court Rulings (continued from p. 5)

be read as easing the timing of the dog ownership restriction of the master association, the court said.

■ Courtyards of Crystal Lake Homeowners Assn. v. Bradescia, November 2008

► Association Entitled to Reasonable Attorney's Fees

Facts: A planned community of several subdivisions consolidated to form a single community association in 1999. As part of the transition process, the association recorded several amended governing documents with the county clerk. When a member purchased a home in 2000, she did not know that her property was subject to the amended governing documents. Later, the member sued to have the amended documents nullified and to have the court state that she did not have to pay assessments. The association won the case and sued the member for reasonable attorney's fees.

Ruling: An Oregon appeals court ruled for the association.

Reasoning: Under Oregon state law, the prevailing party in a lawsuit involving an association trying to enforce its governing documents is entitled to recover reasonable attorney's fees. The court ruled that the trial court erred in not awarding the association reasonable attorney's fees. There is no dispute that the association won the lawsuit. The appeals court sent the case back to have the trial court determine the association's reasonable attorney's fees.

■ Mt. High Homeowners Assn. v. Jewett, November 2008

► Former Management Company Must Follow Settlement Agreement

Facts: A condo association sued its management company and an insurance broker for breach of contract and negligence. After a rainstorm damaged the community and the association made a timely claim with a proof of loss under the insurance policy obtained by the management company, the association discovered that the community was grossly uninsured. Eventually, the association and the management company reached a settlement in which the company was to pay the association \$26,000. At the time, the settlement terms were to include a confidentiality and non-disparagement agreement.

While negotiating the terms, the board of directors asked the association lawyer to explain the settlement terms to its members. The former management company discovered this disclosure and refused to

make a payment to the association. The court granted the association's request to enforce the settlement agreement against the management company.

Ruling: A North Carolina appeals court upheld the lower court's judgment.

Reasoning: The appeals court found enough evidence to support the lower court's finding that the association lawyer communicated only the terms and rationale of the settlement agreement to the members. The meeting was secretly recorded by the daughter-in-law of the principal of the management company who is also a member of the association. The court ruled that the members were entitled to know the information related to the settlement that the attorney communicated at the meeting.

■ Selwyn Vill. Homeowners Assn. v. Cline & Co., November 2008

► Lease Agreement with Wireless Company Ruled Invalid

Facts: A group of members sued their condo association and a cell phone company to prevent them from installing wireless communication antennas on the roof of the condominium building. The members were concerned that the antennas would cause ill health effects.

The lawsuit challenged a 25-year lease agreement between the board and the company. The members argued that the lease agreement violated the governing documents and asked the court to grant a judgment in their favor without a trial.

Ruling: A New York trial court sided with the members and declared the lease agreement void.

Reasoning: The court ruled that the community's governing documents clearly limits the use of all condos in the community to residential uses and limits the use of the common elements to uses that have some residential purpose related to the units' residential use.

The board of directors and the wireless company argued that the antennas had a residential purpose because 17 percent of property owners nationally no longer use landlines and because revenues generated by the lease would be used to reduce future maintenance costs for the members. The court countered by saying that there is no evidence that the members are presently unable to use cell phones from their condos and an activity that produces revenue for an association does not mean that the activity has a residential purpose. The court ruled that this lease agreement is only related to the financial betterment of the members.

■ Kaung v. Board of Mgrs. of the Biltmore Towers Condominium Assn., December 2008

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► TOXIC MOLD

- "Court Rulings: Further Trial Needed for Toxic Mold Injury," April, p. 8.

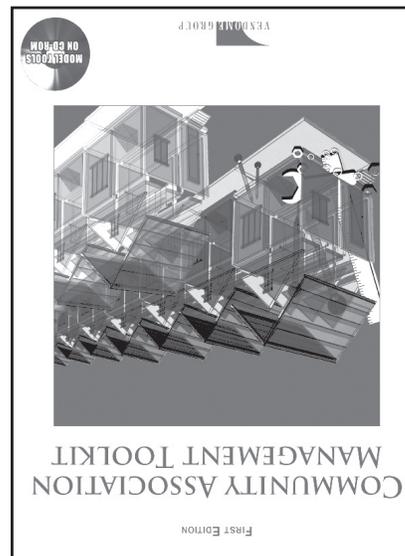
Community Association Management Toolkit

Community Association Management Toolkit contains 14 chapters filled with Model Agreements, Model Checklists, Model Contract Clauses, Model Forms, Model Letters and Memos, Model Questionnaires, Model Rules, and more that will help you handle today's most pressing community association issues.

Community Association Management Toolkit contains Model Tools covering the following topics:

- Board of Directors, Elections, and Meetings
- Common Areas
- Contracts and Contractors
- Crime and Safety
- Employees and Staff
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