

Appendix B

Chapter 4 Overview

The purpose of this review has been to identify those sections of Chapter 4, Internal Controls and specifically Section 4.02A, Financial Management Policy, which are not in compliance with the POAA and the new requirements of the Common Interest Community Board (CICB) or may be subject to review by the Office of the Common Interest Community Ombudsman and require consideration.

In addition to identifying those areas that require revision, consideration has been given to changes in LMOA policy, which would assist in clearly defining intent and understanding.

Among other things, the POAA Chapter 26 “Property Owners’ Association Act” addresses three general areas of association activity:

1. Provisions addressing the formation of the Association and responsibilities of the developer, as well as general matters such as applicability of provisions and definitions.

2. Disclosure requirements authorized fees and related financial management matters. There are requirements under §55-509.5 regarding the contents of Disclosure Packets. §Section 55-509.5 (1) through (16) specify categories of information that must be included in disclosure packets going to those purchasing a lot or lots, including information about “all assessments and any other mandatory fees or charges,” both current and planned, the current Reserve Study or a summary thereof, the current budget, a statement of the status and amount of any reserve or replacement fund [including any amount allocated by the BOD for a specified project], a copy of the current budget and statement of income and expenses or statement of financial position for the last fiscal year for which such statement is available, details of any pending suits or unpaid judgments that could or would have a material impact on the Association or its members or that relates to the lot being purchased, a statement setting forth what insurance coverage is provided for all lot owners by the Association [including the fidelity bond that Association is required to maintain] and what additional insurance each individual lot owner would normally secure.

3. Operation and Management of Association: contains five sections: §55-510 & § 55-513 – 55-516 with a number of subsections.

Section 55-510 requires that the association keep “detailed records of receipts and expenditures” in accordance with general accepted accounting practices and make such records and other books and records kept by or on behalf of an association available to members in good standing for examination and copying subject to reasonable charges for actual costs of providing the information, restrictions as to use of such information and

restrictions on disclosure of certain kinds of information, e.g., personnel matters relating to specific, identified persons. The section goes on to require that draft minutes of meetings of a board of directors be made available to the members.

Section 55-510.1 requires that minutes of the meetings of the board of directors are to be recorded and made available, and it provides procedural rules relating to calling and conducting such meetings. It also requires that the board of directors provide members a reasonable opportunity to comment during a meeting on “any matter relating to the association,” but authorizes limiting the comments of members to specific topics or at a special meeting.

Section 55-510.2 requires the Association to provide a reasonable, effective and free method for lot owners to communicate among themselves and with the board of directors regarding any matter concerning the association.

Section 55-513 Adoption and Enforcement of Rules: This section authorizes boards of directors to adopt rules and regulations relating to use of common areas and “other areas of responsibility assigned to the association by the declaration,” including charges levied against members for violations of such rules and regulations, and rights of members to an opportunity to be heard before such charges may be imposed. The Common Interest Community Board will publish rules regarding sections 55-515 & 55-516.

Section 55-514 authorizes boards of directors to levy special assessments for certain generally described purposes. This section is highlighted here because: (1) it authorizes a majority of the votes cast at a membership meeting to rescind or reduce any such special assessment; and (2) it requires that a director be immunized by the association from liability for failure to fulfill his or her fiduciary duties if a special assessment for the funds necessary to do so is rescinded or reduced by the membership. It probably is fair to read these provisions as implying boards of directors to maintain the common components of the association. It should be understood that under LMOA’s By-laws, permission must be sought to impose a special assessment although authorized under Section 55-514.

Section 55-514.1 requires that generally the BOD shall conduct at least once every five years a study to determine the necessity and amount of reserves required to repair, replace and restore capital components. It also requires that the BOD annually review the sufficiency of reserves called for in the study. If the reserve study indicates a need to budget for reserves, this section requires the budget to include “the current estimated replacement cost, estimated remaining life and estimated useful life of the capital components and the current amount set aside to repair, replace or restore capital components;” “the amount of the expected contribution to the reserve fund for that year,” and to state “the extent to which the association is funding its reserve obligations consistent with the study currently in effect.” It is up to interpretation whether or not there is a requirement to fund such costs within the budget. Disclosure of the cost risk is not debated.

Chapter 4 of the Policy Manual is where the obligations imposed by these provisions of the POAA most logically would be addressed.

The suggested changes presented by the re-write of Paragraph H provide the greatest degree of transparency and accountability in regard to the handling of reserves. The changes meet the requirements of section 55-514.1 “Reserves for Capital Components” and both the stated and implied duties under section 55-514.2 (B) relating to the safekeeping of the Association’s reserves.

Where the Ad Hoc Committee is proposing rewrites, we first have considered wording that existed prior to 2006 and then considered using the language of the POAA. This was done because the 2006 major re-write of policy significantly diluted conformance with the POAA.

The current description of types of expenditures (as amended in 2006) implies that the "Reserve Plan Funds" are for use in funding either capital initiatives or capital expenditures. This does not conform to AICPA accounting guidelines and raises concerns of commingling of reserve funds with capital funds.

Comments in regard to other sections 4.02B – 4.05C, which outline the various areas of internal controls, were generally limited to the overviews provided in each section.

A new section 4.02R.Reserve Management, has been drafted to address the management of the reserve accounts, and a suggested outline of the duties and responsibilities has been included..

Section 4.02S has been reserved for a description of the Budget process. The policy should ensure that budgets meet the requirements of 55-514.1 “Reserves for capital components”.