

# Budget Sense

Serving Homeowners Associations, Condominiums and Cooperatives Since 1974

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July 2013

## Has your Association received a Notice CP 2030 from the IRS? Will you know how to respond?

Has your Association received a Notice CP 2030 from the IRS with the following wording?

*"We have received additional information from third parties that changes the amount of your tax, deductions, and payments. As a result, you owe \$X,XXX (including interest), which you need to pay by DATE."*

The notice is not a request for payment. It is a proposal of changes the Internal Revenue Service (IRS) feels should be made to the Association's income tax returns and requires a response from the Association. The IRS is now comparing 1099 forms submitted by entities that made payments to the Association to the Association's income tax returns. If the IRS cannot reconcile the 1099 forms submitted to the income tax returns, then your Association may receive this notice.

An entity may issue a 1099 to the Association and file it with the IRS for income such as assessments paid by an entity to the Association, proceeds from a brokerage firm on the maturity of an investment, interest income, laundry income, settlement proceeds from the Declarant or rental income, just to name a few. Not all of this income is considered taxable to the Association.

Common Interest Realty Associations (CIRAs), which include condominiums, homeowners associations and housing cooperatives are membership organizations and file their tax returns under very specific sections of the Internal Revenue Code. Normally, taxable income is income that is received from a non-member. Membership income is not always included on the tax return in a format that would allow the IRS to reconcile it to the 1099 forms.

We have not made any changes in the way the Association's income tax returns have been prepared by our firm that would result in this notice. It is our understanding that the IRS has started to reconcile the 1099 forms filed with the income tax returns for 2011 tax year-ends and this is the reason these notices are now being received.

### **What does the Association need to do?**

The IRS notice requires either payment or a response by a specific date. Our firm is available to research and respond to the IRS on behalf of the Association with a letter explaining how the income is reported on the Association's income tax returns. If you receive one of these notices and would like our firm to prepare the response, please contact us upon receiving the notice. We will bill for our time.

## Does Your Service Organization Have the Proper Internal Controls in Place?

First, what is a service organization? A service organization may also be referred to as a third-party service provider. It is an entity that the Association may use to outsource aspects of its operations, ranging from specific tasks to entire functions. An example of a service organization used by many associations would be a payroll company that pays employees' salaries, withholds and pays payroll taxes and prepares and files payroll returns on behalf of the Association. Other examples are companies that read the utility sub-meters and then bill and collect from the members of the Association and companies that collect laundry income from the Association's laundry machines and then turn over the funds or a portion of the funds to the Association.

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## Service Organizations - *continued*

In the three examples of service organizations listed above, the internal control functions are being performed by an entity other than the Association or the management agent of the Association.

As the auditors for the Association, we are required to obtain an understanding of the Association's internal controls. Additionally, if the function being performed by the service organization is significant to the Association's financial statements, then we are required by auditing standards to obtain an understanding of the service organization's internal controls. This is a requirement of auditing standard AU-C Section 402, which went into effect for periods ending after December 15, 2012.

Most service organizations have a report prepared by their auditors, called a Service Organization Control (SOC) report. If this report is available, then we can use this report to obtain an understanding of the internal controls of the service organization. In our experience, the payroll companies all have SOC reports. If this report is not available, then our options would be to

contact and visit the service organization to obtain information and perform procedures related to the internal controls or have another auditor perform the procedures necessary to obtain an understanding of the internal controls. This additional work would be time consuming and costly to the Association and is outside the scope of our engagement. Therefore, if we determine that the Association uses a service organization that performs a function that is significant to the Association's financial statements and the service organization does not have a SOC report, then we will qualify our audit opinion. The qualification will specifically state that we were unable to obtain an understanding of the internal controls of the service organization.

If your Association uses a service organization, you should ask for the service organization's SOC report. If a SOC report is not available, then consider changing the functions performed by the service organization. For example, if the service organization reads the utility sub-meters and then bills and collects from the

members, have the service organization read the utility sub-meters and then turn over a report to the Association. The Association could then bill and collect from the members. If the service organization collects the laundry income, have an employee of the Association verify the count of the laundry income collected each month. While the auditors are required to obtain an understanding, the Association should also have an understanding of the internal controls in place for each service organization that performs significant functions on behalf of the Association.

*We Welcome  
Our Newest  
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