

**MONTGOMERY COUNTY, STATE OF MARYLAND**

Paul Kelly  
5500 Friendship Boulevard, #1017  
Chevy Chase, MD 20815

Complainant

vs.

The Willoughby of Chevy Chase Condo.  
4515 Willard Avenue  
Chevy Chase, MD 20815

Respondent

Panel Chair Memorandum By: John F. McCabe, Jr. :

:  
: COMMISSION ON COMMON  
: OWNERSHIP COMMUNITIES  
:  
: Case No. 03-677-0  
:  
: Panel Hearing Date: October 27, 2004  
: Decision Issued:

**MEMORANDUM DECISION AND ORDER**

The above entitled case came before a Hearing Panel of the Commission on Common Ownership Communities for Montgomery County, Maryland, for hearing on October 27, 2004, pursuant to Sections 10B-5(i), 10B-9(a), 10B-10, 10B-11(f), 10B-12, and 10B-13 of the Montgomery County Code, 1994, as amended. The duly appointed Hearing Panel considered the testimony and evidence of record, and finds, determines and orders as follows:

**BACKGROUND**

This is a complaint filed on December 2, 2003, by a unit owner in a condominium against the condominium. The Complainant has complained about two aspects of the Condominium's audit procedures. He claims:

1. That the pre-audit meetings pertaining to the annual audits must be open to the unit owners pursuant to the Maryland Condominium Act, Section 11-109.1, Real Property, Md. Code Ann. The annual pre-audit meeting, pursuant to Board Resolution 2004-1 adopted March 23, 2004,

is a meeting among the general manager, the managing agent's personnel and the accountant's audit team.

2. That the "management letter" provided annually to the Condominium by the accountant must be made available to the unit owners, in its entirety, pursuant to the Maryland Condominium Act, Section 11-116, Real Property, Md. Code Ann., and the By-laws of the Condominium, Article III, Section 3(1).

The position of the Condominium is that the pre-audit meeting is not a meeting of the Condominium's Board of Directors or of a committee of the Board, and therefore is not required to be open to the unit owners. With respect to the annual management letter, the Condominium's position is that the letter is protected from inspection by unit owners by the accountant/client privilege (Section 9-110, Courts and Judicial Proceedings, Md. Code Ann.) and also that it may be withheld from inspection by unit owners pursuant to Section 11-116(c)(2), Real Property, Md. Code Ann., in whole or in part.

#### **FINDINGS OF FACT**

1. The Complainant, Paul E. Kelly, is a unit owner in The Willoughby of Chevy Chase Condominium located in Montgomery County, Maryland.

2. The Willoughby of Chevy Chase Condominium is a Maryland condominium within the meaning of the Maryland Condominium Act, Title 11, Real Property, Md. Code Ann.

3. Until recently, the Condominium has been conducting its annual audit in accordance with procedures reduced to writing in Board Resolution No. 2003-01, a copy of which is attached to this Order as Attachment 1. (Record-5) That Resolution provides, among other things, for a "pre-audit meeting" among the general manager, the managing agent's person responsible for keeping the

books, members of the Board of Directors, the chair of the Budget and Finance Committee, and the accountant's audit team. Thereafter the accountant's audit team begins the audit and ultimately sends an auditor's report to The Willoughby's general manager for distribution to the Board of Directors and the Budget and Finance Committee. The chair of the Budget and Finance Committee convenes a meeting of the Committee to review the audit and make recommendations to the Board of Directors. Present at this Committee meeting are the Committee members, the auditors, the general manager and the managing agent's representative, all of whom participate in the meeting. Members of the Board of Directors also may attend this meeting as members of the audience. This Committee meeting, according to the testimony, has been open to the unit owners of the Condominium. Once the Budget and Finance Committee develops its recommendations for the Board, the Board discusses those recommendations as an agenda item at a Board meeting. This Board meeting also has been open to the unit owners of the Condominium.

4. By Board Resolution No. 2004-1 adopted March 23, 2004, the Condominium has modified its budget procedures. Board Resolution No. 2003-1 has been rescinded. The pre-audit meeting is now conducted among the general manager, the managing agent's personnel responsible for keeping the books and the accountant's audit team. The members of the Board of Directors and the chair of the Budget and Finance Committee no longer attend this meeting. The audit is conducted and still sent to the general manager for distribution to the Board of Directors and the Budget and Finance Committee. The Budget and Finance Committee still convenes a meeting to develop recommendations for the Board. This meeting is open to all unit owners of the Condominium. Distribution of the management letter still is restricted to the Board of Directors and management. A copy of Board Resolution No. 2004-1 is attached as Attachment 2. (Record-149)

5. The accountant transmits a "management letter" with the annual audit report. The accountant restricts the distribution of the management letter to the Board of Directors and management. The Board of Directors has honored this restriction.

6. By letter dated March 29, 2004, the accountant for the Condominium has attempted to explain the reasons for the restriction it places on distribution of the management letter. According to the accountant, the restriction has been placed on the management letter because of generally accepted auditing standards that accountants are required to follow. The restriction is also placed on the management letter because there may be certain matters that are communicated in the management letter that the accountant feels should not be disclosed to all of the unit owners, such as personnel issues and delinquencies. A copy of the March 29, 2004, letter is attached to this Decision as Attachment 3. (Record 150) The accountant stated that pursuant to its auditing standards it issues reports called "by-product reports." The management letter is such a by-product report. These reports are "based on the results of procedures designed to enable an auditor to express an opinion on the financial statements taken as a whole, not to provide assurance on the specific subject matter of the report." The accountant further explained that because the issuance of the by-product reports is not the primary objective of the audit engagement, an audit generally includes only limited verification procedures of the subject matter of a by-product report. "Accordingly, because of the potential for misinterpretation or misunderstanding of the limited degree of assurance associated with the by-product report, the use of such report should be restricted." Attachment 3.

7. Ann M. Sheehan, a Certified Public Accountant with the firm of Goldklang, Cavanaugh & Associates, P.C., that does the annual audit for the Respondent Condominium,

testified that the management letter in question is a "by-product report". The accountant is not engaged to produce this letter, but it does so as a service to clients. It contains advice or recommendations that, as stated, the accountant believes, should be reviewed only by a restricted group of people. She testified that when the accountant placed this restriction on the management letter, it had not considered the provisions of Section 11-116, Real Property. She also testified that she was not familiar with the accountant/client privilege in Maryland being asserted by the Board of Directors. The restrictions placed on the management letter by the accountant, according to Ms. Sheehan, also were the result of internal policies of her firm, based upon its understanding of auditing standards that auditors are required to follow.

8. Martha Golden, current President of the Board of Directors of the Respondent testified that the matters contained in the management letter are considered in executive session by the Board because the management letter contains "privileged" matters with respect to such items as personnel. Protecting personnel matters from disclosure seems to be paramount with the Board of Directors in reaching its decision not to disclose the contents of the management letter to unit owners.

9. The Board of Directors has instituted a policy of disclosing to the unit owners much of the information contained in the management letter it does not deem to be of a sensitive or privileged nature. However, the management letter itself still is not subject to inspection by the unit owners.

10. The Respondent Condominium asserted at the hearing that the legal basis for not disclosing or making the management letter available to the unit owners for inspection is the accountant/client privilege contained at Section 9-110, Courts and Judicial Proceedings, Md. Code

Ann. Members of the Panel questioned how this privilege comports with Section 11-116, Real Property, Md. Code Ann., and its provisions for withholding or allowing inspection of records.

11. The representatives of the Respondent at the hearing, namely its president and its accountant, did not seem to be familiar with the legal basis that the Condominium was asserting at the hearing for not disclosing the management letter to the unit owners.

12. Complainant also contends that the Respondent Condominium is required to have an "Audit Committee" in addition to its Budget and Finance Committee. While this may be a helpful practice in some instances, there is no requirement in the Condominium's documents or in applicable law that would compel the Respondent Condominium to form an Audit Committee.

13. It appears that meetings of the Condominium that are committee meetings or Board meetings are open to the members except as otherwise permitted to be closed under Section 11-109.1, Real Property, Md. Code Ann. (Section 11-109.1 does not specifically refer to "committee meetings," only to "board meetings.")

### **CONCLUSIONS OF LAW**

1. The Maryland Condominium Act Section 11-109.1, Real Property, Md. Code Ann., provides that a meeting of the Board of Directors may be held in closed session only for the specific purposes enumerated therein.

2. The Maryland Condominium Act Section 11-116(c), Real Property, Md. Code Ann., provides that "all books and records" kept by the Council of Unit Owners shall be available for examination and copying by any unit owner, except as limited by Section 11-116(c)(2). Article III, Section 3(I) of the Condominium's By-laws provides that the Condominium "shall keep books with detailed accounts in chronological order of the receipts and expenditures affecting the Property and

the administration of the Condominium specifying the expenses of maintenance and repair of the Common Elements and any other expenses incurred," and that such "books and vouchers" shall be available for examination by the unit owners.

3. Section 9-110, Courts and Judicial Proceedings, Md. Code Ann., provides in part that a licensed certified public accountant or firm may not disclose

- "1. The contents of any communication made to the licensed certified public accountant or firm by a client who employs the licensed certified public accountant or firm to audit, examine, or report on any account, book, record, or statement of the client;
2. Any information that the licensed certified public accountant or firm, in rendering professional service, derives from:
  - (i) A client who employs the licensed certified public accountant or firm; or
  - (ii) The material of the client." Section 9-110(b), Courts and Judicial Proceedings, Md. Code Ann.

This restriction, standing alone, would appear to prohibit disclosure to anyone but the client of all information of any kind whatsoever that a condominium communicates to an accountant or provides in the form of materials to an accountant. If this is true, then with respect to the books and records of a Condominium, none of those books and records, to the extent communicated to an accountant, would be subject to inspection by the unit owners unless the accountant/client privilege is waived by the holder of the privilege. For a condominium the holder of the privilege is the Council of Unit Owners. See Section 11-109, Real Property, Md. Code Ann. This would render Section 11-116(c)(1) inapplicable to any communications or records of the Condominium that an accountant obtains from the condominium unless the Council of Unit Owners waives the privilege.

4. Section 9-110(b), Courts and Judicial Proceedings, Md. Code Ann., has been interpreted to prohibit accountants from disclosing information given to them by their clients, but not to provide blanket protection to communications from an accountant to a client. Such communications are privileged only if they contain information that is itself a client communication or is derived from the client's material. Comments of the accountant, such as advice in a management letter, that are severable from client communications or client derived information are not privileged. See generally Office of the Attorney General of Maryland, 81 Op. Att'y Gen. (May 23, 1996). A "by-product report" appears to be such comment or advice.

5. Section 11-116(c)(2), Real Property, Md. Code Ann., specifically protects from disclosure the written advice of legal counsel, but does not mention communications from accountants.

6. At issue is what the condominium, not what the accountant, may or must disclose to unit owners. A reasonable approach would be to find that the account/client privilege as described in Section 9-110, Courts and Judicial Proceedings, Md. Code Ann., does not embrace within its scope the unit owners of a condominium so as to prohibit disclosure to those unit owners of information not otherwise protected or permitted to be withheld from disclosure under Section 11-116(c), Real Property, Md. Code Ann. In this way the two statutes can be read together. The result can be avoided that all matters that the accountant derives from communications or materials from the client/Council of Unit Owners can be disclosed only to the Board of Directors of the Condominium and not to its unit owners. Otherwise the unit owners might have no access at all to any financial information provided to the accountant by their condominium or to the



condominium by the accountant.

7. The Panel does not view this case as an instance of creating an exception to the accountant/client privilege. Rather, the issue is to determine the proper scope of that privilege, in the narrow context of the rights of unit owners vis-a-vis their condominium to obtain financial information. The accountant's self-imposed constraints, whether by virtue of auditing standards, internal firm policies or professional codes of conduct, do not govern the obligations of the Council of Unit Owners with respect to disclosure of information to its members, the unit owners themselves. The Panel sees no basis for interpreting the accountant/client privilege to restrict or override the provisions of Section 11-116(c), Real Property, Md. Code Ann., with respect to required disclosure of financial information to unit owners of a condominium. What the accountant may not disclose is controlled by the statutory accountant/client privilege. What the condominium must disclose to its unit owners is controlled by the Maryland Condominium Act.

#### **ORDER**

Based upon the foregoing Findings of Fact and Conclusions of Law it is this 11<sup>th</sup> day of

January, 2005

#### **ORDERED:**

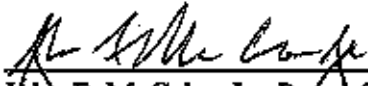
1. The meetings of the Condominium that are not Board meetings or committee meetings do not have to be open to the unit owners. This includes the pre-audit meeting as it is presently constituted under Resolution No. 2004-1 so long as it is not a committee or Board meeting.

2. Communications from the accountant to the Council of Unit Owners are protected from disclosure to the unit owners of the Condominium, if at all, only to the extent provided in

Section 11-116(c), Real Property, Md. Code Ann. The accountant must disclose protected information only to its client, the Council of Unit Owners. The Council of Unit Owners must disclose to its unit owners information not protected by Section 11-116( c), whether contained in a "management letter" or elsewhere.

The foregoing was concurred in by Panel Members Lawrence Stein and Vicki Vergagni.

Any party aggrieved by the action of the Commission may file an administrative appeal to the Circuit Court of Montgomery County, Maryland, within thirty (30) days of this Order, pursuant to the Maryland Rules of Procedures governing administrative appeals.

  
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John F. McCabe, Jr., Panel Chair

**Board Resolution No. 2003-01**

**WHEREAS** certain processes of the Board are required to conform with our Bylaws, as well as the Maryland Condominium Act; and

**WHEREAS** The Willoughby By-laws, in Article III, Section (L), directs the Board of Directors to "Keep books with detailed accounts...and the same shall be audited at least once each year by an independent certified public accountant retained by the Board of Directors who shall not be a resident of the Condominium or a Unit Owner..."

**IT IS THEREFORE RESOLVED THAT** the annual audit shall be conducted in accordance with the following procedure:

The Willoughby retains a qualified firm to perform its audit. The audit is conducted after the close of The Willoughby's fiscal year, which is February 28 (or 29 in a leap year), and typically, during the month of May.

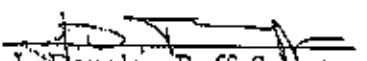
Prior to the audit, the general manager, the managing agent's person responsible for keeping the books, members of the Board of Directors, and the Chair of the Budget & Finance Committee, meet with the audit team to review the previous year's audit recommendations and to discuss any questions/concerns that may arise either during the audit or during the current fiscal year.

The audit begins shortly thereafter and once completed, typically by mid-June, the auditor's report is sent to The Willoughby's general manager for distribution to the Board of Directors and the Budget & Finance Committee.

The Chair of the Budget & Finance Committee convenes a meeting of its members to review the audit and to make a recommendation to the Board of Directors as to whether or not to accept the audit's findings. Present at this meeting, in addition to committee members, are the auditors, the general manager and the managing agent's representative. Members of the Board of Directors typically attend this meeting as members of the audience.

Once the Budget & Finance Committee determines its recommendation to the Board, the topic is placed on the agenda for the next Board meeting.

The auditors typically transmit a "management letter" with their audit report providing comments and recommendations on various subjects. The auditors restrict the distribution of the "management letter" to the Board of Directors and management. The reason for this restriction is that the letter often contains information that is confidential or privileged, and board members and management are under a legal obligation to maintain the confidentiality of such information, whereas committee members (and others) are not.

  
J. Douglass Ruff, Secretary

10/26/03  
Date

(5)

Attachment

1

## Board Resolution No. 2004-1

WHEREAS certain processes of the Board are required to conform with our Bylaws, as well as the Maryland Condominium Act; and

WHEREAS The Willoughby Bylaws, in Article III, Section 3 (l), direct the Board of Directors to "Keep books with detailed accounts...and the same shall be audited at least once each year by an independent certified public accountant retained by the Board of Directors who shall not be a resident of the Condominium or a Unit Owner..."; and

WHEREAS the Board wishes to revise the procedures for the annual audit adopted in Board Resolution No. 2003-1 by rescinding that resolution and adopting a new one;

IT IS THEREFORE RESOLVED THAT Board Resolution No 2003-1 is hereby rescinded and this resolution No. 2004-1 is hereby adopted to stand in its place to set forth the following procedure for conducting the annual audit:

The Willoughby retains a qualified firm to perform its audit. The audit is conducted after the close of The Willoughby's fiscal year, which is February 28 (or 29 in a leap year).

Prior to the audit, the general manager and the managing agent's personnel responsible for keeping the books, meet with the audit team to review the previous year's audit recommendations and to discuss any questions/concerns that may arise either during the audit or during the current fiscal year.

The audit begins shortly thereafter and, once completed, the auditor's report is sent to The Willoughby's general manager for distribution to the Board of Directors and the Budget & Finance Committee.

The Chair of the Budget & Finance Committee convenes a meeting of its members to review the audit and to make a recommendation to the Board of Directors as to whether or not to accept the audit's findings. Advance notice of this meeting is posted on the bulletin boards, and this meeting is open to all owners. Present at this meeting, in addition to committee members, are the auditors, the general manager and the managing agent's representative. Members of the Board of Directors typically attend this meeting as members of the audience.

Once the Budget & Finance Committee determines its recommendation to the Board, the topic is placed on the agenda for the next Board meeting.

The auditors typically transmit a "management letter" with their audit report providing comments and recommendations on various subjects. The auditors restrict the distribution of the "management letter" to the Board of Directors and management. The reason for this restriction is that the letter often contains information that is confidential or privileged, and board members and management are under a legal obligation to maintain the confidentiality of such information, whereas committee members (and others) are not.

**GOLDKLAUF, CAVANAUGH & ASSOCIATES, P.C.**  
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March 29, 2004

Board of Directors  
The Willoughby of Chevy Chase Condominium  
Council of Unit Owners, Inc.  
4515 Willard Avenue  
Chevy Chase, Maryland 20815-3622

Dear Board Members:

The purpose of this letter is to explain the restriction placed on distribution of the management letter, a letter from our firm to the Association that accompanies the annual audit report. The restriction limits the distribution of the management letter to the Board of Directors and management. This restriction has been placed on the letter because of auditing standards that we are required to follow. The restriction is also placed on the letter because there may be certain matters that are communicated in the management letter that should not be disclosed to all of the unit owners. These matters include personnel issues and delinquencies.

The Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) issues Statements on Auditing Standards (SAS). The Auditing Standards Board issued SAS No. 87, which discusses restricting the use of an auditor's report.

The management letter issued by our firm is a by-product of the financial statement audit and is also a communication of internal control related matters noted in the audit. SAS No. 87 states the following:

"An auditor may issue certain reports on matters coming to his or her attention during the course of an audit of financial statements. Such reports include but are not limited to reports issued pursuant to the following:

- SAS No. 60, Communication of Internal Control Related Matters Noted in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325)
- SAS No. 61, Communication With Audit Committees (AICPA, Professional Standards, vol. 1, AU sec. 380)

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Attachment  
3

- Paragraphs 19 through 21 of SAS No. 62, Special Reports (AICPA Professional Standards, vol. 1, AU sec. 623), for reporting on compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements.

Reports issued pursuant to the aforementioned auditing standards are based on the results of procedures designed to enable an auditor to express an opinion on the financial statements taken as a whole, not to provide assurance on the specific subject matter of the report. These reports are by-products of an audit of financial statements and are referred to as by-product reports in this Statement.

Because the issuance of the by-product report is not the primary objective of the engagement, an audit generally includes only limited procedures directed toward the subject matter of the by-product report. Accordingly, because of the potential for misinterpretation or misunderstanding of the limited degree of assurance associated with a by-product report, the use of such reports should be restricted. For example, a report issued under SAS No. 60 should be restricted because the purpose of the engagement is to report on an entity's financial statements, not to provide assurance on its internal controls.

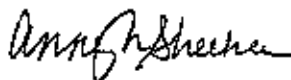
An auditor may issue a by-product report in connection with other engagements conducted in accordance with generally accepted auditing standards, such as an engagement to express an opinion on one or more specified elements, accounts, or items of a financial statement.

In consideration of the foregoing, the use of by-product reports should be restricted to an entity's audit committee, board of directors, management, others within the organization, specified regulatory agencies, and in the case of reports on compliance with aspects of contractual agreements, to the parties to the contract or agreement."

The management letter falls under SAS No. 60, and therefore, the distribution of the management letter is appropriately restricted.

Please do not hesitate to contact us if you have any additional questions.

Very truly yours,



Anne M. Sheehan  
Certified Public Accountant