
# Bad Debts
# "Lucky 7" Q & A

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### "Survey Said...."

Our CPA practice probably receives more questions on "All Things Bad Debt" then most any other topic.

This article will highlight some of the questions we receive, and our thoughts on each subject. Keep in mind we need to throw in the usual "caveats" such as . . . "we are not attorneys," and "there isn't always one clear answer." We, like you, are working through the maze of events that are occurring; and using our best judgment and experience, to help solve these (often complex) issues.

### Question #1
### Should we budget for bad debts?

YES. It's true; other members are paying for those who don't pay their bills. However, the alternative is that the association will be short on cash. Assessment income in the budget assumes that all monies will be collected, and this is not the reality. Thus, budgeted assessment income needs to be reduced through a budget line item called "Bad Debt Expense."

How do you do that? Use one or a combination of these techniques:

- Look at prior year average write-offs.
- Look to local industry averages. An average we see is 3-5% of annual assessment income. WARNING—This should only be used as a "fallback" or "benchmark" as each Association is unique.
- Look to the actual "past due" unit owner balances. This is the most accurate. If you prefer, you may use percentage estimates such as:
  - ◊ Fully collectible - 0% bad debt
  - ◊ Potentially uncollectible- 50% bad debt
  - ◊ Very unlikely to be collected – 100% bad debt

### Question #2
### How should our financial statements show bad debts?

The Income Statement needs to present "Bad Debt Expense" and the Balance Sheet needs to present an "Allowance for Doubtful Accounts." The "Allowance" is deducted from Accounts Receivable, to show the "net" Receivable. The Net Receivable represents the amount of cash that the association expects to collect, as of the Balance Sheet date. Like budgeting, this is definitely an "estimate" as no one has a "crystal ball." However, it's important (at least at year end) for the Board to make this estimate in the internal financial statements, as this is "GAAP," (Generally Accepted Accounting Principles). If there is an annual audit, the CPA will look to the financial statements to see if this has been recorded.

Keep in mind that the account balance will still remain on the Accounts Receivable Aging (so that collection efforts continue); however the financial statements will show the net receivable.

### Question #3
### How should the board document the bad debt estimate and write offs?

Prior to year-end, the Board should document in the minutes that they have estimated the year-end "Allowance for Doubtful Accounts" and a brief summary of the methodology used. (Actual units/names do not need to be shown in the minutes).

When the board determines that it is time to actually WRITE OFF the account from the Accounts Receivable aging, then it's important that the *minutes* reflect the approval of that write off, by unit number and amount, for *all* write offs. This is so there is a clear trail of board approval for reduction of Accounts Receivable, which can be traced to the accounting records, and is a fraud prevention measure.

### Question #4
### Are bad debts JUST assessment income?

NO. Late fees, administrative fees, fines, and "bill-backs" for attorney fees and other costs could/should all be charged to bad debt expense. In this way, the true billings, and the related write -offs, are all reflected in the financial statements. We do see where smaller amounts of fines and late fees are reversed against the related income, rather than charged to bad debt expense. This is acceptable as long as the practice is consistent, follows a policy (for certain limits), and appropriate approvals are documented. There is no absolute on this.

### Question #5
### We recovered bad debts previously written off. Now what?

Take it to the bank! First, the amount of the recovery is used to reduce existing bad debt expense in the year of the recovery. Then, if there is STILL income left over, then, an income account called "Bad Debt Recovery" is created, for the net amount remaining.

### Question #6
### Our Association obtained a unit through Sheriff Sale/ Foreclosure. Should we record the "value" of the unit on our books?

Our firm recommends that the only amount to record as an "asset" is the amount of uncollectible assessments (and fees) that will be recovered through this action. Because title may not be clear, the association is not the mortgage-holder, and many other questions may remain, it is not conservative to record the unit value (assessed or otherwise) in the books. Additionally, we recommend a 100% "Allowance" be recorded against the Accounts Receivable amount, until collection is certain. This area is VERY complex and beyond the scope of this article.

### Question #7
### Is there a tax benefit for recording bad debt expense?

Generally, NO. (The tax complexities of this industry are very unique).