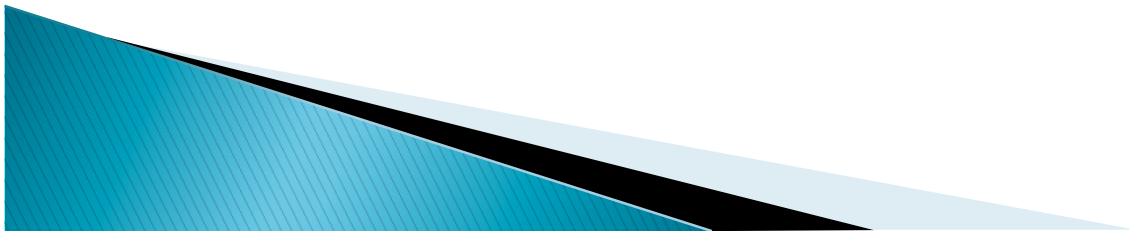


Accounting, Delinquencies, & Collections

Ken Harer, Attorney
Catherine Kuhn, CPA

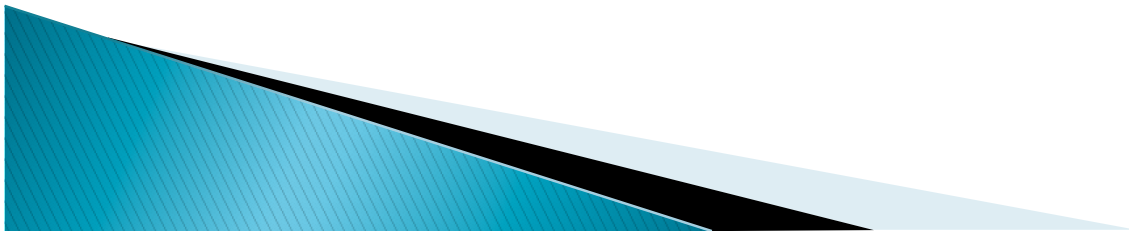
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Topics Today:

- ✓ Accounting Basics– Balance Sheet & Income Statement (Cathy)
- ✓ **Cash vs. Accrual (Cathy)**
- ✓ Delinquencies & Charge Offs– Accounting (Cathy)
- ✓ **Delinquencies & Charge Offs – Legal (Ken)**
- ✓ Late fees, interest, collection costs– Accounting (Cathy)
- ✓ **Late fees, interest, collection costs– Legal (Ken)**



Accounting Basics

✓ Balance Sheet

Financial Position at a Point in Time (ie Dec 31, 2012)

- Assets (What you **OWN**)
- Liabilities (What you **OWE**)
- Members' Equity (**Net Worth, Fund Balance, Retained Earnings**)

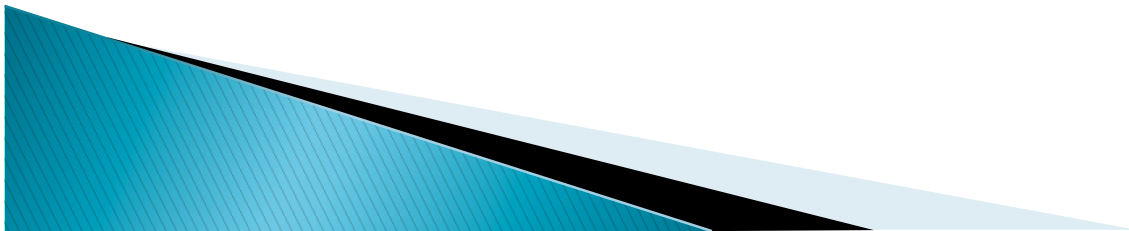
“Accounting Equation”

- Assets MINUS Liabilities EQUALS Members' Equity
- Assets EQUAL Liabilities PLUS Members' Equity(Balance!)



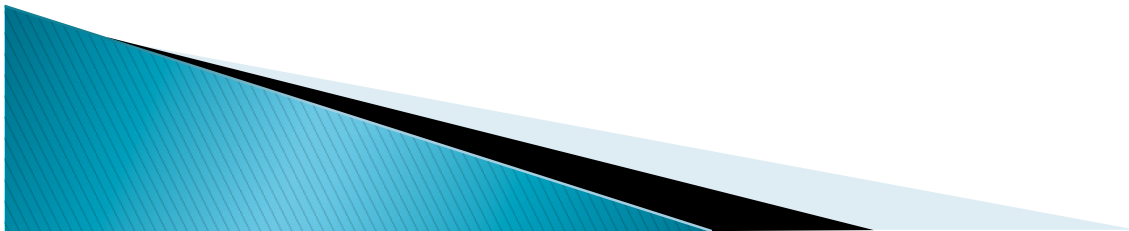
Balance Sheet – Assets

- Cash (Operating & Reserve)
- Accounts Receivable (Cash Yet to be Received)
 - ☐ Typically **Past Due** Assessments (billing 1st of the month)
 - ☐ Allowance for Bad Debt “contra” (offset) account
- Other Owner Receivables (Water billings, bill-backs)
- Prepaid Insurance (Ins Premium Paid in Advance of Use)



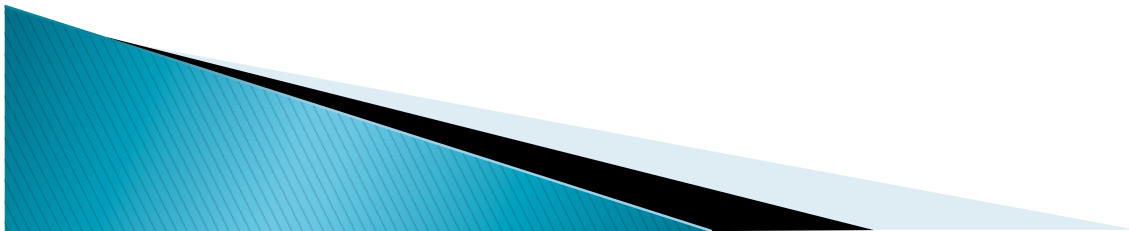
Balance Sheet–Liabilities

- Accounts Payable – Expenses to be paid
- Prepaid Assessments – Assessments that are paid in before they are owed to the Assn
- “Due between Funds” – Can be an asset or a liability depending on the Fund



Members' Equity (Fund Balance)

- ✓ What you OWN (Assets) less What you OWE (Liabilities)
- Two Types of Equity:
 - Operating
 - Reserves

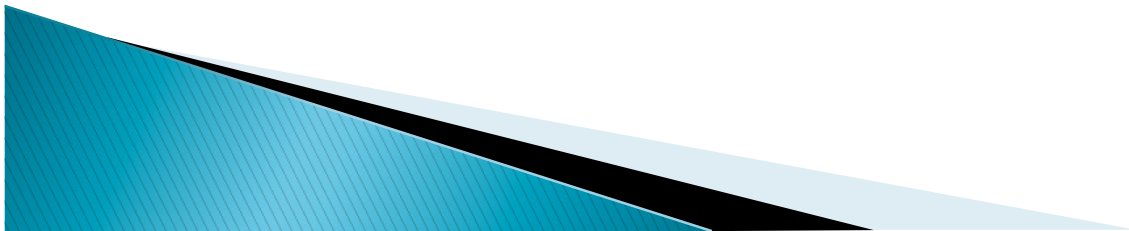


Sample Balance Sheet

	Operating	Reserve	Total
Assets			
Total: Cash - Operating	\$34,301.09	\$0.00	\$34,301.09
Total: Cash - Replacement Fund	\$0.00	\$91,830.88	\$91,830.88
Accounts Receivable	\$267.00	\$0.00	\$267.00
Prepaid Insurance	\$4,839.00	\$0.00	\$4,839.00
Prepaid Taxes	\$24.00	\$0.00	\$24.00
Due To/From OP Fund, Loan	\$0.00	\$57,682.51	\$57,682.51
Total: Other Current Assets	\$5,130.00	\$57,682.51	\$62,812.51
	\$39,431.09	\$149,513.39	\$188,944.48
Accounts Payable, Operating	\$13,860.56	\$0.00	\$13,860.56
Prepaid, Assessments	\$2,563.00	\$0.00	\$2,563.00
Due To/From RR Fund, Loan	\$57,682.51	\$0.00	\$57,682.51
Total: Current Liabilities	\$74,106.07	\$0.00	\$74,106.07
Retained Earnings, Operating	\$1,574.05	\$0.00	\$1,574.05
Retained Earnings, Reserves	\$0.00	\$122,643.08	\$122,643.08
Total: Equity	\$1,574.05	\$122,643.08	\$124,217.13
Net Income Gain/Loss	\$0.00	\$26,870.31	\$26,870.31
Net Income Gain/Loss	(\$36,249.03)	\$0.00	(\$36,249.03)
Total: Liabilities & Equity	\$39,431.09	\$149,513.39	\$188,944.48

Income Statement

- ✓ “Statement of Revenues & Expenses”
- ✓ Results over a *period* of time
- Assessments Revenue – Should be total **budgeted** assessments for the year (**accrual** basis) Some allocated to operations, some to reserves
- Interest income (operating and reserve)
- Expenses – We all know what that is!
- “Net Income” Revenue Minus Expenses (Hopefully positive or \$0!)
- Reserve Net Income can be positive or negative--- OKAY

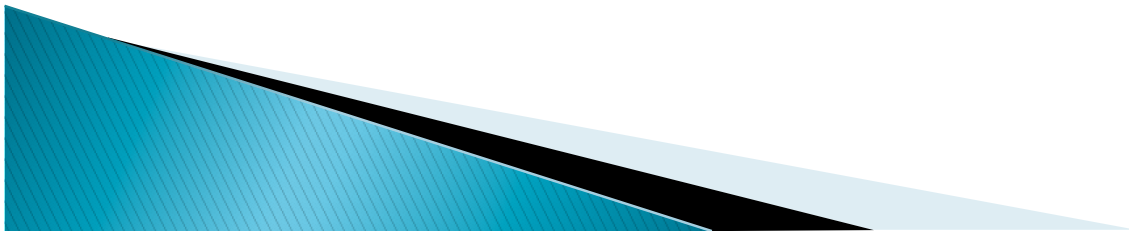


Sample Income Statement

Description	Year-to-date				Annual Budget
	Operating	Reserve	Budget	Variance	
INCOME					
Total Regular Income	\$99,615.00	-	\$ 98,886.20	\$728.80	\$169,519.20
Total Other Income	\$48.62	\$ 716.91	-	\$765.53	-
Total Replacement Fund	\$0.00	\$ 26,153.40	\$ 26,153.40	\$0.00	\$ 44,834.40
TOTAL INCOME	\$ 99,838.62	\$ 26,870.31	\$125,039.60	\$ 1,669.33	\$214,353.60
EXPENSE					
Total Administrative	\$583.61	-	\$ 604.75	\$21.14	\$ 1,101.00
Total Professional Services	\$46,447.39	-	\$ 9,100.00	(\$37,347.39)	\$ 14,800.00
Total Operations	\$16,614.50	-	\$ 18,640.50	\$2,026.00	\$ 31,098.00
Total Utilities	\$29,332.07	-	\$ 29,101.89	(\$230.18)	\$ 53,657.80
Total Building Maintenance	\$5,687.44	-	\$ 1,100.00	(\$4,587.44)	\$ 1,900.00
Total Site / Amenities	(\$0.00)	-	\$ 200.00	\$200.00	\$ 200.00
Total Grounds Maintenance	\$11,095.24	-	\$ 11,268.00	\$172.76	\$ 19,188.00
Total Transfers	\$26,153.40	-	\$ 26,153.40	\$0.00	\$ 44,834.40
TOTAL EXPENSE	\$136,087.65	-	\$ 97,538.54	(\$38,549.11)	\$169,519.20
Revenues in Excess	(\$36,249.03)	\$ 26,870.31	\$ 27,501.06	(\$36,879.78)	\$ 44,834.40

Cash vs. Accrual

- ▶ Cash– Checkbook Accounting – Recorded when **PAID**
- ▶ Accrual – Matches Income with Expense as incurred– Recorded when **Incurred**



Cash vs Accrual

▶ Revenue (Assessments)

- **Accrual** records assessments at the beginning of the month based on **budget**
- **Cash** records assessments as **collected**

▶ Expenses

- **Accrual**– Landscaper performs work in **January**– expense recorded in **January** Income Statement
- **Cash**– Landscaper performs work in **January** and billed paid in **February**– Expense recorded in **Feb**



Is Accrual Required??

- ▶ GAAP is “Accrual”

- “Generally Accepted Accounting Principles”

Old Act Condos:

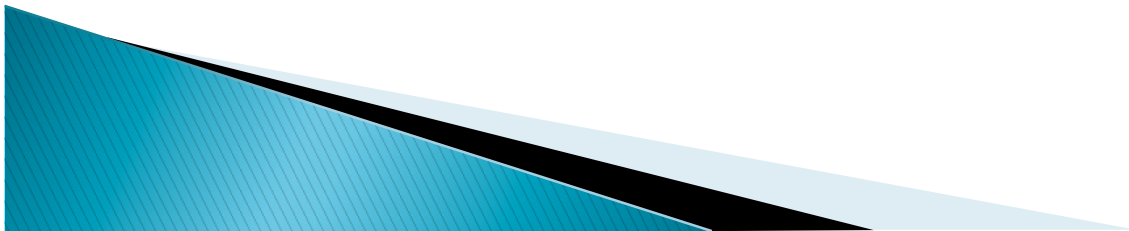
- No mention of GAAP, we recommend GAAP

New Act Condos:

- GAAP required– Resale Certificate Implications

HOA Act:

- GAAP not required – Our preference is GAAP



Is Accrual Required??

▶ Legal opinion

Old Act Condos:

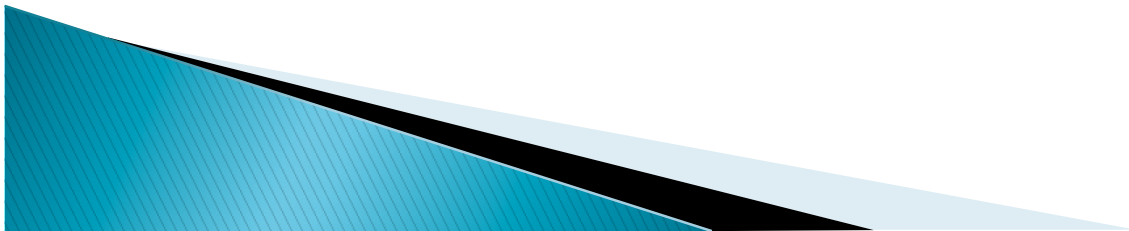
- Resale Certificate provision of RCW 64.34.425(i) applies to Old Act Condos:
 - “A balance sheet and a revenue and expense statement of the association prepared on an accrual basis, which shall be current to within one hundred twenty days”;

New Act Condos:

- GAAP required by RCW 64.34.372(1)–
- Resale Certificate requirement as above

HOA Act:

- GAAP not required, but would meet duty of care



Accrual– Fraud Prevention

▶ Receivables–

- ❑ Accrual Accounting Creates “Accounts Receivable”

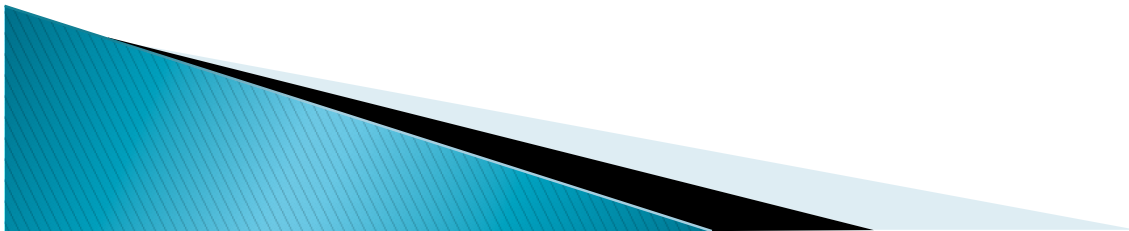
- ❑ BOD knows whether all amounts have been billed

- ❑ BOD knows whether amounts have been collected



Accounting Basics

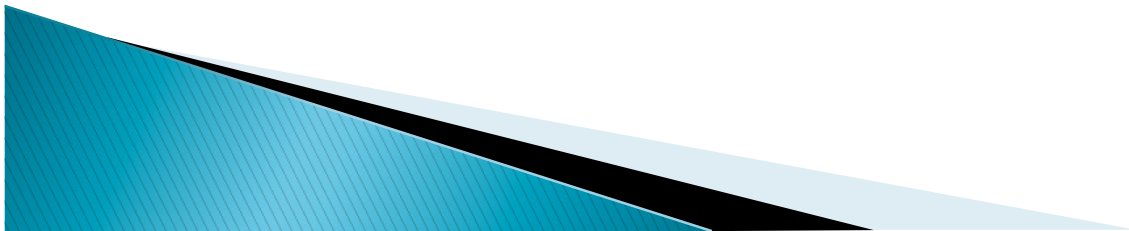
▶ **QUESTIONS** **????**



Delinquencies & Charge-offs: Accounting

- ▶ Allowance for Bad Debts
 - “Contra Account” on the Balance Sheet
 - All amounts ESTIMATED to be uncollectible at Balance Sheet date

- ▶ Bad Debt Expense
 - Income Statement item
 - Total amount estimated to be uncollectible for the period/year
 - BUDGET for bad debt expense



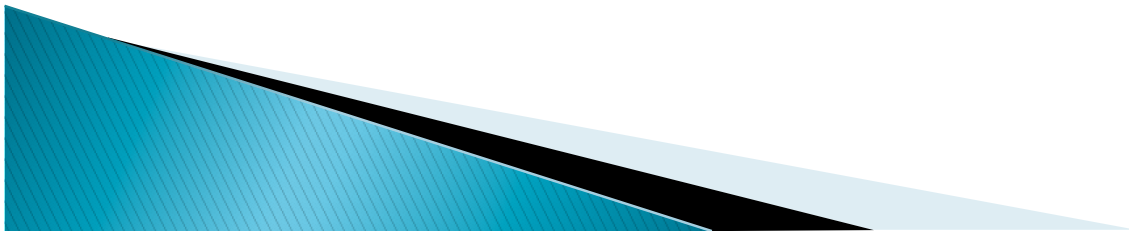
Delinquencies–Charge Offs– Accounting

- ▶ BOARD needs to APPROVE any write-offs to Accounts Receivable (fraud prevention)
- ▶ OK to keep Delinquencies on the AR “Aging” so that the board can keep pursuing the bad debt (Provide for the “bad debt” in the “bad debt allowance” on the Balance Sheet)
- ▶ AR Aging (in total) agrees to the Balance Sheet, then offset AR with Allowance



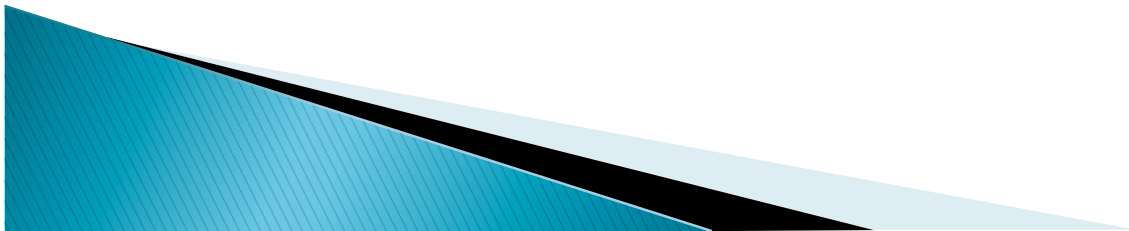
Delinquencies–Charge Offs–Other Considerations.

- ▶ Timing of charge offs has consequences
 - Does GAAP have standards for timing?
- ▶ Charged off amounts are no longer “delinquent”
- ▶ Charged off amounts would not be reported on Resale Certificates.
- ▶ Delinquencies over 60 days affect FHA approvals
- ▶ Delinquencies may affect financing options



Delinquencies–Charge Offs–Other Considerations.

- ▶ Timing of recognizing income has consequences also
 - Does GAAP have standards for recognition of income from fines and interest?
- ▶ CondoLaw would prefer conservative policy so as to not overstate finances of the community.
 - Charge off early
 - Recognize fines and interest when paid
- ▶ Challenges with recoverable attorney fees



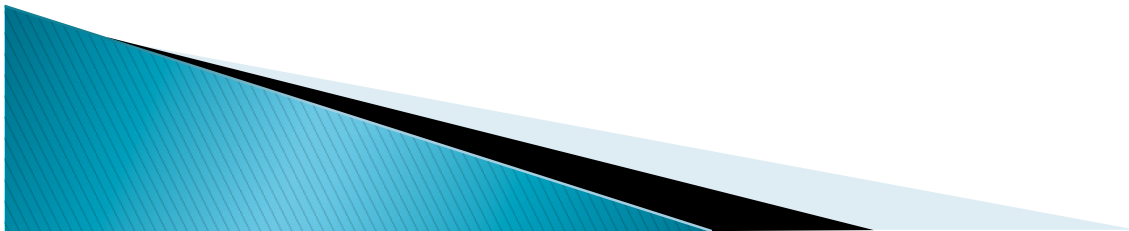
Delinquencies–Charge Offs–Other Considerations.

- ▶ Board's duty of care to accurately represent the financial condition of the association
 - Does Accrual or Cash accounting better do this?
 - Timing of charge offs and income recognition will affect how owners, buyers, and financial institutions view the health of the association.
- ▶ How do you determine the likelihood of payment on delinquent assessments?
- ▶ How do you determine the likelihood of payment for fees and fines assessed to units?



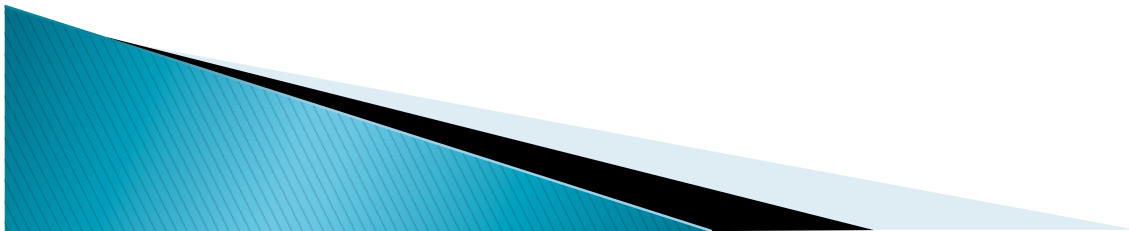
Delinquencies, Charge offs– Legal

- ▶ How do you account for these when file is sent to an attorney?
 - Neutral on accrual, impacts cash flow
- ▶ How do you account for these when file is sent to a collection company?
 - Charged off, and any recovery is unbudgeted income?
 - Take full hit on balance sheet when sent
- ▶ Can you estimate likelihood of recovery?



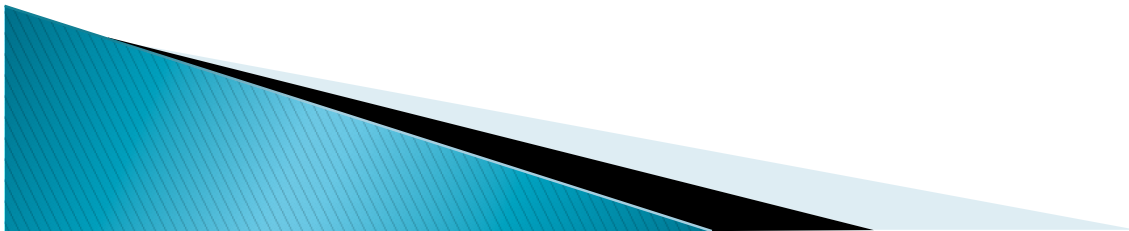
Delinquencies, Charge offs– Legal

- ▶ Passage of time – limitation of 3 years
- ▶ Change of ownership – bank foreclosures
- ▶ Abandonment –
- ▶ Bankruptcy of owner
 - Debt owed by the PERSON
 - Debt owned by the PROPERTY – not affected
- ▶ Many of these events will trigger immediate recognition of a loss



Delinquencies, Charge offs– Legal

- ▶ Distinction between “charging off” for accounting purposes and abandoning collection efforts.
- ▶ Judgments may have “value” for years, even if fully charged off.
- ▶ Recommend boards adopt a policy for charge offs. May be part of the collection policy



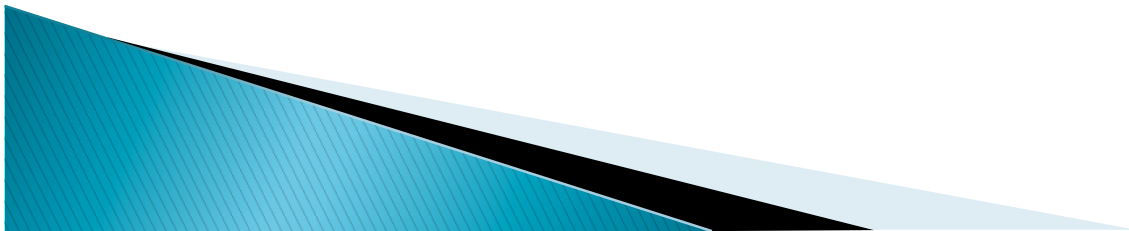
Late Fees, Interest, Collection Costs-- Accounting

- ▶ Late Fees– Billed to the AR ledger according to policy
 - If written off, charge to bad debt expense
- Legal Fee Income– Bill directly to the HO ledger (AR) as the association incurs the legal cost – separate income account
- Legal fee Income and Legal expenses should net to \$0 in the accounting period (keep collection legal costs separate)



Late Fees, Interest, Collection Costs-- Accounting

- ▶ BOD approval for write offs
- ▶ Interest income from owners– keep separate income account from bank interest income
 - Owner interest income is NOT taxable



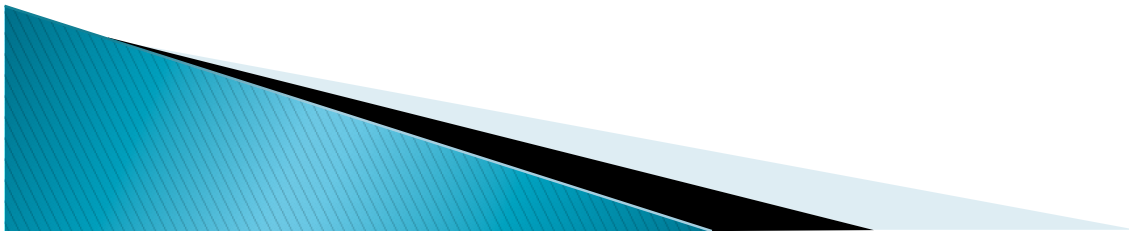
Late Fees, Interest, Collection Costs-- Legal

How do you account for legal fees that are also collectible from the unit owner?

Is It both an expense and income on the accrual ledger?

Attorney fees that you are unlikely to collect must also be charged off as bad debt.

Sometimes these costs are incurred for reasons not related to collection.



Question & Answer Session

Thank you!

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