

# The World According to “GAAP”

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What in the world is “GAAP?”

You may have seen the term in the Washington State Condominium Act (“New Act”) or in your Association’s governing documents. In the accounting world, “GAAP” is foundational and refers to “Generally Accepted Accounting Principles.” Contrary to popular belief, accounting is not always black and white; it involves professional judgment. GAAP directs this discretion with a compilation of accounting principles that guide accountants in preparing financial statements and the related disclosures. The point of GAAP is to provide meaningful, consistent information to users of financial statements.

As an example, GAAP requires “accrual basis” financial statements, instead of “cash basis.” This means that assessment revenue is recorded when earned, not when received. Also, expenses are recorded when incurred, not when paid. Revenues are matched with the related expenses. GAAP also means that financial statements include disclosures (“footnotes”) that explain the financial statements and include information needed to ensure the financial statements are not misleading to the users.

So, enough of the accounting lesson. The point of this article is that sometimes we see a gap in how GAAP is being used by community associations. Further, we receive a lot of questions related to GAAP and the Washington State Condominium and Homeowner Acts.

What do the Washington State RCW’s say regarding GAAP requirements and annual CPA audits?

- **“Old Act” Condominiums (pre 7/1/90):** RCW 64.32.170 – There is no mention of GAAP; however, an annual audit is required once per year, regardless of unit size. There are no provisions to waive the audit requirement based on a membership vote. This appears to be a little-known fact as many homeowners and managers assume that if they are under 50 units, an audit is not required. Technically, the language in the law states that the books shall “be audited at least once a year by an auditor outside of the organization.” Since it doesn’t specifically mention a “CPA audit” it is up to the board to interpret what they believe is necessary. In accounting literature, only a CPA is qualified to conduct an “audit.” If the intent of the law is that the audit is conducted by a CPA,

then effectively, annual GAAP financial statements are necessary for these associations since the audit would be in accordance with GAAP.

- **“New Act” Condominiums (post 7/1/90):** RCW 64.34.372 – GAAP financial statements are required “at least annually”, regardless of unit size. If the association has 50 or more units, the books must be audited annually. In this case, the law states specifically that a CPA be used. If under 50 units, an audit is also required, but the requirement may be waived annually by a vote of 60% of the membership, excluding votes allocated to the declarant. If an association has an annual audit, the board can be assured that the books meet GAAP standards.

If the books are not audited, are the internal financial statements considered to be “GAAP?” GAAP means more than accrual basis financial statements. There are certain adjustments made in an audit to be in accordance with GAAP, and there are footnote disclosures presented. It is possible for a CPA to issue a “Compilation” report that provides GAAP financial statements, but it is not the full amount of procedures required for an audit.

- **Homeowners Associations:** 64.38.045 - GAAP financial statements are not required; however, the language states that the association should “keep financial and other records sufficiently detailed to enable the association to fully declare to each owner the true statement of its financial status.” We believe that GAAP financial statements should be used to give each owner the “true statement of its financial status.”

An annual audit by a CPA is required if annual assessments are \$50,000 or more. However, this requirement can be waived annually by 67% of the membership. It is interesting to note that the audit requirement is based on “assessments,” not total income. So, associations that have other forms of income exceeding \$50,000 (but with assessments that are less than \$50,000) are not subject to the requirement. If the other income is significant, we recommend the board consider whether an audit would be prudent.

Here’s one final part of the “New Condominium Act” (post 7/1/90) related to monthly financial statements that you may not be aware of:

- **64.34.425(1)(i) – Resale of a unit** – The resale certificate shall contain “A balance sheet and a revenue and expense statement of the association prepared on an accrual basis, which shall be current to within 120 days.” We believe this means therefore that monthly financial statements (in addition to annual statements) should be presented on an accrual basis instead of on the cash basis.

Wading through the myriad of GAAP requirements can be confusing for everyone. Be sure to consult with your CPA regarding what makes sense for your association.

Clarification to “The World According to GAAP” article, published in CAI Journal Nov/Dec 2007, by Catherine Kuhn, Cagianut & Company, CPA:

Thank you to Brian McLean of Leahy, PS for helping us to clarify the audit requirements as stated in the Washington State RCWs for “Old Act” Condominiums. (Associations created before July 1, 1990)

The article references RCW 64.32.170, which effectively states that (for Old Act Condominiums) there is a requirement for an annual audit each year, which cannot be waived, regardless of unit size. However, Mr. McLean points out that RCW 64.34.010 (in the New Condominium Act) supersedes 64.32.170 with respect to requiring an audit for all condominium associations. Therefore, the same audit requirements in the “New Act” apply to “Old Act” Condominiums.

However, because some of the governing documents for “Old Act” Condominiums include language from the audit requirements stated in the “Old Act”, associations created before July 1, 1990 are advised to review their governing documents carefully for the audit requirements language. This is necessary because 64.34.010 states that the provisions in the “New Act” “.....do not invalidate or supersede existing, inconsistent provisions of the declaration, bylaws.... of those condominiums”. Thus, the audit requirements in either the CC&R’s, or the Bylaws, would govern. If these documents are silent on the audit provision, the audit requirements in the “New Act” (64.34.372) would prevail.

Please contact Catherine Kuhn ([cathy@hoacpa.com](mailto:cathy@hoacpa.com)) with any questions.