New HOA Accounting Principles
– An Alternate View

By Donald W. Haney, CPA, MBA, MS

The Financial Accounting Standards Board (FASB), the U.S. Accounting standards setting body that establishes Generally Accepted Accounting Principles (GAAP), issued new revenue recognition principles. Principles are not standards or rules. Across the nation certain HOA CPAs have created a new controversial assessment deferral and related contract liability technique based upon their interpretation of what a customer is. It is a really big change in presentation and messaging to HOA stakeholders.

This commentary's purpose is to add clarity, context, caveats, and candor to this controversy. Whether you are a finance professional, a manager, a CID director or other interested party, this topic and its resolution will affect the very core of your operation and messaging to CID stakeholders.

To managers, directors and other HOA stakeholders, the contract liability reporting methodology is not a new rule that HOA's must accept. There are generally acceptable options.

To other CPAs and finance professionals, the "contract liability" method has advocates and adversaries. The adversaries opine that the method misleads, fails to reflect economic reality, and misinterprets the association/owner relationship.

Please be clear, the contract liability advocates have every right and duty to argue their current thinking. It is important to the quest for best practice. On the other hand, to assert their position as rules and required when it is not, compels a response.

Their position is an interpretation of certain revenue recognition principles established by FASB. FASB has specifically declined to establish industry specific rules based upon these principles. Moreover, substantial disagreements exist within the U.S. CPA community about how these principles apply to the CIRA world (Common Interest Realty Developments-CPA lingo for Homeowners Associations).

With that preamble, what follows are FASB standards and financial reporting options:

Editor's Note:
The author provided this article as another point of view about the changes in the Financial Accounting Standards Board principles. Vision Magazine printed another article on this topic in its Spring 2020 issue.

#	Balance Sheet			Comments
1	Balance Sheet			Comments
2	**Assets**			
3	Current Assets			
4	Cash-Operating	$	25,000	
5	Receivables		2,000	
6	Prepaid Expenses		3,000	
7	Other		475	
8	**Total Current Assets**		30,475	
9	Cash & Equivalents Designated for			Looks like a lot of money available
10	Major Repairs & Replacements		459,000	What are the claims on this money?
11	**Total Assets**	$	489,475	
12	**Liabilities & Net Assets**			
13	Current Liabilities			
14	Accounts Payable	$	10,000	
15	Assessments Paid in Advance		1,000	
16	Other Current Liabilities		500	
17	**Total Current Liabilities**		11,500	
18	Major Repair & Replacement Obligation			
19	Beginning of the Year		700,000	
20	Add: Expense Provision		125,000	Equals Annual Replacement Expense
21	Less: Expenditures		(75,000)	Major Components for this year
22	**Net Replacement Obligation**		750,000	Equals "Reasonable" Estimate
23	**Total Liabilities**		761,500	Liabilities Exceed Assets
24	Net Assets			
25	Beginning of the Year		(250,000)	
26	Excess (Deficiency) for the Period		(22,025)	See line 42
27	**Net Assets (Deficit)**		(272,025)	Underfunded Estimate
28	**Total Liabilities & Net Assets**	$	489,475	
29			-	
30	Income Statement			
31	**Revenues**			
32	Assessments	$	500,000	Total Assessments Levied for the year
33	Interest		1,000	
34	Other		2,000	
35	**Total Revenues**		503,000	
36	**Expenses**			
37	Common Area		350,000	Landscape, Utilities, R&M, Etc
38	Replacement Provision (Reserves)		125,000	Common Area Facilities "wearing out" cost
39	Governance		50,000	Management, Other
40	Taxes		25	
41	**Total Expenses**		525,025	
42	**Excess (Deficiency) Revenues over Expenses**	$	(22,025)	CPA speak for Net Income (Loss)

Using the Full Accrual Method For Major Repairs & Replacement
A Simplified Illustration - for Discussion Purposes Only

1. THE ASSOCIATION'S FINANCIAL STATEMENTS ARE THE ASSOCIATION'S.
They are not the CPA's. If the association's has a preferred presentation that complies with GAAP, it has options. Their existing CPA can decline the engagement or accept the client's methodology. The association may seek other providers (Full disclosure – Our firm does not perform audits or reviews).

2. FUND ACCOUNTING IS NOT REQUIRED BY U.S. GAAP.
The AICPA (American Institute of Certified Public Accountants) required the single column Entity option to be included in its CIRA audit and accounting guide published some 35 years ago, which has been incorporated into FASB's Accounting Standards Code (ASC, The CPA Law Book) for CIRAs.

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3. THE HOA'S OBLIGATION TO PERFORM MAJOR REPAIRS AND REPLACEMENTS (MRRS) ARE "LIABILITIES."
One benefit of the contract liability method is the recognition that a homeowners association's legally inescapable obligation to maintain the common areas facilities at an ascertainable standard is a balance sheet liability. The concern is that the proposed contract liability method does not deliver the complete story.

4. THE REPORTING OPTIONS.
Presently, there are at least three GAAP acceptable options for CIRA financial reporting as it relates to these major repair and replacement (MRR, Reserve) obligations:

A. STATUS QUO.
Record assessment revenues when levied (accrual basis). Record MRR expenditures when the check is written (cash basis). Display replacement obligation (fund) on the balance sheet as exactly equal to the current cash on hand.

B. CONTRACT LIABILITY.
Record "operating" assessments as revenue in the year levied. Record "reserve" assessments in the year levied as a "contract liability" in the balance sheet. Transfer those "deferred" assessments back to the income statement when the MRR expenditure occurs. Thus "matching" the assessments with the expenditure.

C. FULL ACCRUAL.
Record assessment revenues when levied (accrual basis). Record the estimated "wearing out cost" of the common area facilities as an annual expense similar to an annual estimated "depreciation" expense (accrual basis). Display the MRR obligation on the balance sheet at its current "reasonably estimable" amount.

The full accrual advocates opine that the status quo and contract liability methods mislead the reader, fail to reflect economic reality, and fail the goldilocks test. Neither tell the reader in clear terms whether the funds available and the related funding plan for MRRs are too little, too much or just right.

Homeowner associations partially adopt the commonsense full accrual method in their annual budgets when their budgeted line item expenses include an amount allocated to reserves. Up to now, they typically do not record the offsetting liability on the balance sheet as part of their normal bookkeeping entries. And, if they do, the status quo advocates reverse that entry to convert the MRR expenditures to the cash basis.

The net result of the full accrual option is that any deficit or underfunding between the cash designated for MRR and the estimated obligation is clearly shown on the balance sheet as a deficit in net assets (the difference between assets and liabilities).

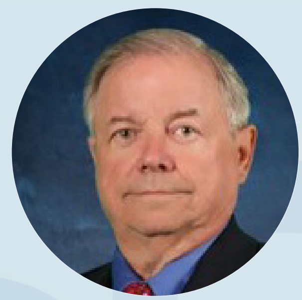
The fundamental principle and rule that drives this thought process and position is FASB's ASC 450-20-25, which requires expense or loss recognition when two tests are satisfied: The expense or loss is "probable" and "reasonably estimable." What situational elements define probable and reasonably estimable are described by the standard setting bodies in mind-numbing supporting position papers available in the linked documents.

The short version is that the CID CPA and legal communities generally agree that the typical CCRs are a contract between the owner/member to maintain the common area at an ascertainable standard which passes the probable test. Less agreed upon is that the typical reserve study passes the reasonably estimable test.

Advocates for this method conclude they are "good enough" and pass that test. On the other hand, they need to get better. FASB has consistently opined in analogous situations (pension obligations, environmental remediation obligations, etc.), that a good estimate is better than no estimate and that the estimates will get better as more attention is paid to them.

On page 43 is a simplified HOA Balance Sheet and Revenue & Expense statement presented in a single column "Full Accrual" method with descriptive comments. It clearly displays the goldilocks "too little" deficit in the balance sheet section titled Net Assets, which is the difference between Assets and Liabilities. A deficit indicates that liabilities exceed the assets available to satisfy those liabilities.

SUPPORTING DOCUMENTS AND MORE DETAILED EXHIBITS CAN BE ACCESSED AT HANEYINC.PRO/RULES



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