

Accounting Methods: What are they, and is an Association required to use one method or the other?

There are two standard methods of accounting: cash-based accounting and accrual-based accounting. Washington's Condo Acts require condo Associations to use accrual accounting. Although the HOA Act does not mandate that HOAs use this method, they are, nonetheless, advised to do so.

Accounting Methods

Under the cash-based accounting method income is recorded when money is deposited and expenses are recorded when actually paid. If the Association has agreed to pay for something but has not yet actually paid, the expense will not appear on the financial statements until the funds are in fact paid out. Assessments owed by owners will not show as income until actually received.

Under the accrual-based accounting method, on the other hand, costs and income are recorded when incurred and due, not when actually received or paid. For instance, if the Association has agreed to pay for something but has not yet actually paid, the expense will appear on the financial statement anyway. Assessments will appear as income when they are due, even if not paid by the owners.

Does Washington law require one method over the other?

Washington law requires that condo Associations prepare an annual financial statement of the Association "in accordance with Generally Accepted Accounting Principles"¹ ("GAAP"). GAAP requires accrual-based financial statements instead of cash-based.² Additionally, condo Associations must prepare a resale

certificate containing a balance sheet and a revenue and expense statement of the Association on an accrual basis.³

The HOA Act does not mention GAAP, and it is not clear that one accounting method is favored over the other.⁴ Nevertheless, because Washington courts often interpret the HOA in accordance with the Condo Act where the HOA is silent, HOAs would be well advised to use the accrual-based method discussed above.

Recently, Associations with significant delinquencies have been challenged with the problem of how to account for unpaid assessments using accrual accounting. We recommend consulting with your CPA and making adjustments for “bad debt” or uncollectible funds so that an accrual based financial statement accurately reflects the Association’s true financial situation.

¹ RCW 64.34.372(1) (Association Records – Funds). This provision is applicable to Old Act condo Associations. See RCW 64.34.010(1) (Applicability).

² Catherine Kuhn, “The World According to ‘GAAP,’” CAI JOURNAL NOV/DEC 2007 (available at <http://www.wscai.org/hoa/assn294/documents/world%20according%20to%20gaap.pdf>).

³ RCW 64.34.425(1)(i) (Resale of unit) This provision is applicable to Old Act condo Associations. See RCW 64.34.010(1) (Applicability).

⁴ See RCW 64.38.045(1) (Financial and other records — Property of Association — Copies — Examination — Annual financial statement — Accounts).