11 FREQUENTLY ASKED QUESTIONS (FAQs)
THE NEW FASB REVENUE RECOGNITION ACCOUNTING STANDARD

What is the new FASB ASC 606 accounting standard?

In order to help ensure that all CPA-prepared financial statements, regardless of the type of organization or industry, **report revenues the same way**, new accounting and presentation rules (**FASB ASC 606**) are required for community associations with year ends **beginning with years ended December 31, 2019**.

What is the purpose of this new Revenue Recognition accounting standard?

When boiled down to its essence, the **new standard** reinforces the long-held accounting principle of **matching revenues with expenses** in the same time period by **limiting the recognition of reserve assessment revenue to the total of actual reserve expenditures**. Under the new standard, on the **income and expense statement**, the reserve assessment income will generally be adjusted up or down so that **net reserve income (expense) is zero**. The year-end CPA-reviewed or audited financial statements will contain a **footnote disclosure** which shows the reader the difference between the reserve assessment income (billed) in the annual budget report and that which is now presented in the year-end (CPA) financial statements under the new revenue recognition rules.

The **balance sheet** will generally only show **replacement reserve cash and investments** (**assets**) and an **equal** amount for **contract liabilities** – replacement reserve assessments paid in advance (**liabilities**)(the **funded portion of the major component replacement liability** – the **full amount** of the major component replacement liability is often disclosed in the **supplemental information** portion of the CPA's reviewed or audited financial statements). The **replacement reserve fund balance** will generally be **zero**.

Are homeowner associations required to follow this accounting pronouncement?

Yes. This new accounting standard, set forth by the Financial Accounting Standards Board (**FASB**), must be followed by all Certified Public Accountants (**CPAs**) when they render reports (reviews and audits) in accordance with **Generally Accepted Accounting Principles** (**GAAP**). In FASB terms, it **applies to organizations that provide goods and services to persons who are obligated to pay for them** [i.e. community association members who buy into a common interest development and must (pay assessments pursuant to the CC&Rs].

Is there any penalty for not following this standard?

While there is no direct governmental fine or penalty, **failure to comply** with this accounting standard in the year-end CPA reviewed/audited financial statements distributed to owners **could have negative legal and/or financial consequences** for the Association.

Could the Association avoid implementing this accounting standard by accepting a qualified CPA report that says that the financial statements are NOT in accordance with GAAP?

No. **California law**, **Civil Code Section 5305,** **requires** at least an **annual [CPA] review** **in accordance with generally accepted accounting principles (GAAP)** if gross income (assessments billed and other income) in any year exceeds $75,000, unless the association's governing documents impose a more stringent standard (i.e. an **audit**).

Does the management company have to implement this accounting pronouncement?

Generally, the Association's **management company DOES NOT have to comply** with this new accounting and presentation standard **when preparing monthly financial statements** if they are not represented to be in accordance with generally accepted accounting principles (GAAP).

How is this information going to be presented in the CPA reviewed/audited financial statements?

Under the new standard, on the **income and expense statement**, the reserve assessment income will generally be adjusted up or down so that the **net** reserve income (expense) **is zero**. The year-end CPA reviewed (or audited) financial statements will contain **a new footnote disclosure with a reconciliation** which shows the reader the difference between the reserve assessment income in the annual budget report and the reserve assessment income presented in the year-end (CPA) financial statements.

On the **balance sheet**, the **total of replacement reserve assets** (cash and other investments) **will** generally **equal the** "**contract liability – replacement reserve assessments paid in advance**" in the replacement fund (reserve) column of the financial statements. When reserve funds are expended for major repairs and replacements, the balance in the liability will decrease by the same amount as the decrease in cash and investments.

Will there be a reconciliation which shows how income and expenses would have been under the old rules, and the adjustments made to get to the current presentation under the new rules?

Yes. The CPA will prepare an **assessment revenue reconciliation** will detail for the reader, in both the operations fund and the replacement reserve fund, the adjustments needed to get from the budgeted assessment revenues to the assessment revenues presented in the CPA-reviewed (or -audited) financial statements.

How should special assessment revenues and expenses be presented?

Special assessment revenues and expenses should be presented **in a similar manner to regular reserve assessments and expenses** – generally recognition of special assessment revenues should be limited to special assessment expenses and the difference recorded on the balance sheet as "**contract liabilities – replacement reserve special assessments paid in advance**."

Is the "contract liability – replacement reserve assessments paid in advance" the same thing as the reserve liability in a reserve study?

No. In most instances, the **"contract liability – replacement reserve assessments paid in advance" will NOT equal the reserve liability reported in the reserve study**, the annual budget report or the CPA's supplemental information accompanying the annual review or audit. Rather, it will generally approximate the balance of the accumulated replacement reserve funds (i.e. cash and investments).

How is bad debt expense (recovery) presented according to this new accounting standard?

The new accounting standard requires that bad debt expense (recovery) be grouped with revenues, not expenses. So, if there was **bad debt expense** in the current year, it would not be shown with expenses, but, rather, **as a negative number grouped with revenues**.