

NEW REVENUE RECOGNITION STANDARD AND HOW IT AFFECTS CIRAS

The Financial Accounting Standards Board (FASB) issued a new financial reporting standard update Topic 606, *Revenue from Contracts with Customers*. The standard was issued in 2014 but became effective for year-end 2019 financial statements and is now a generally accepted accounting principle.

The revenue recognition standard establishes an approach for recognizing and measuring revenue from contracts. The entities should recognize revenue from contracts by applying the following five-step process:

1. **Identify the contract with the customer**
2. **Identify the separate performance obligations in the contract.**
3. **Determine transaction price**
4. **Allocate the transaction price to the separate performance obligations.**
5. **Recognize revenue when performance obligations are satisfied (i.e. when the services have been performed).**

What does this mean for CIRAs?

Topic 606 applies to most businesses, including Common Interest Realty Associations (CIRAs) regarding some other revenue streams. Some CPA firms are of the opinion that the services provided (“performance obligations” as defined by GAAP) by CIRAs and their relationship with the owners meet the definitions of contracts (declaration) and customers (owners), respectively. This opinion would significantly impact the presentation and recognition of reserve assessment revenues and fund balances on the financial statements.

There is no consensus among CPA firms regarding the application of Topic 606 to a Common Interest Realty Association (CIRA) regarding assessments. There also has been no guidance from the FASB or the American Institute of Certified Public Accountants regarding the application of Topic 606 to CIRAs. The available unauthoritative guidance, authored by respected leaders in the industry, is also vague saying “it appears that the relationship with the owners meet the definitions of contracts and customers, respectively”. Other industry professionals are of the opinion that the relationship between a CIRA and its owners is that of ownership and not of a customer.

Cukierski & Cochrane, LLC. is one of many firms in the CIRA industry which is recommending that our CIRA clients are **not** required to apply the complex revenue recognition standard in ASU 2014-09 (Topic 606) for the presentation and recognition of assessment revenues. We base this conclusion on the many arguments against defining owners as customers that we believe have significant and credible merit. (See references)

Until the FASB or AICPA release authoritative guidance, it is up to the association, and the function of management to determine if it considers owners as customers. This determination will result in different presentations on the Association's financial statements.

CIRA Owners as Customers

If a CIRA is of the opinion that the services provided ("performance obligations" as defined by GAAP) by CIRAs and their relationship with the owners meet the definitions of contracts (declaration) and customers (owners), respectively, certain "performance obligations" **remain similar** in practice. These would include:

- **Operating Assessments** – this obligation, under the new standard would still be recognized on a periodic basis, similarly to the current practice and presentation on the financial statements.
- **Reserve Interest** - this obligation, under the new standard would still be recognized when earned or received, similarly to the current practice and presentation on the financial statements.
- **Special Assessments** - this obligation, under the new standard would still be recognized when the expenditure is made, similarly to the current practice and presentation on the financial statements.
- **Other Income** - Topic 606 did not change the recognition of all income received by associations. For example, contract income as defined by the new standards does not include interest earned on deposits, insurance settlements, rents, rebates, and some income from ancillary operations.

However, other "performance obligations" **will change the way the CIRA presents its financial statements**. These include:

- **Replacement/Reserve Assessments** - this obligation, under the new standard would be recognized as the reserve expenditures are incurred. This is a significant change in practice. Reserve assessments in excess of expenditures are now presented in a liability (**Contract Liabilities**) much like the treatment of special assessments for the purpose of a specific project. Also, for example, if a reserve project incurs expenditures in excess of the amounts held in that reserve fund, the deficit amount is now presented as an asset (**Contract Asset**). The prior year Replacement/Reserve Fund Balance will require this treatment retroactively upon adoption.
- **Bad Debts** – Topic 606 requires the CIRA to reduce assessments by any amounts deemed uncollectable up front instead of recording an allowance later. Therefore, the CIRA should assess whether it is probable the entire amount of assessments will be collectable. We recommend the association establish a written policy estimating uncollectable accounts on a regular basis.

How will this affect our CIRA?

The implementation of Topic 606 is not an audit function. Accounting Standards Codification is the source of authoritative generally accepted accounting principles (GAAP). Implementation of GAAP is considered a management function and the decision to implement these standards falls on the management (the board of directors or management company) of the CIRA.

Certified Public Accounting firms that perform attest engagements for the CIRA will impair their independence if they are relied upon to implement ASC 606. While your CPA may make recommendations, the CIRA's management is responsible for their revenue recognition policy and the implementation of the new revenue recognition standards.

We recommend management establish a written policy and hierarchy regarding the utilization of the components of reserve fund revenue. We also recommend such hierarchy be established between the following accounts:

- Reserve Interest
- Current Year Reserve Assessments
- Reserve Fund Balance
- Other Reserve Revenues
- Current Year Transfers to Reserves
- Contract Liabilities

Owners not as Customers

As stated above, Cukierski & Cochrane, LLC. is recommending that our CIRA clients are **not** required to apply the complex revenue recognition standard in ASU 2014-09 (Topic 606) to the presentation and recognition of assessment revenues. There are many opinions that differ regarding the application of Topic 606. These opinions are outlined best by the [CPA Firm Discussion Papers](#).

If an Association determines that the relationship between CIRA and owner is not one of contract with a customer, reserve assessments will continue to be recognized when assessed. Bad debts will continue to be a separately stated item.

To reiterate, until the FASB or AICPA release authoritative guidance, it is up to the association, and the function of management to determine if it considers owners as customers. This determination will result in different presentations on the Association's financial statements.

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