A FIELD GUIDE FOR BOARD MEMBERS

Writing-Off Delinquent Assessments As Bad Debt

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This marks the eighth installment in a series for board members about commonly faced questions and issues. Many of these challenges require a combination of legal, political and practical solutions. Hopefully these articles will be useful for board members in determining what is in the best interest of the association.

With foreclosures and bankruptcies on the rise, associations are shouldering more debt in the form of unpaid assessments. This presents several important questions, such as: *Does an association have to indefinitely leave delinquent assessments on the financial records? If unpaid assessments are written-off does the association get to keep the funds if they are subsequently collected?*

Before addressing these issues I want to add an important caveat; writing-off bad debt is an accounting procedure and should not be done without consulting a CPA. The accountant can advise regarding generally accepted accounting standards, in addition to any relevant IRS regulations. There are some finer points the CPA will have to consider, such as whether your association uses a cash basis approach or an accrual method of calculation.

Although most types of businesses write-off bad debt for tax benefits, this is not the case for associations because they don't usually owe any income taxes. (Even though an association may not owe any taxes, it is still required to file annual returns.) An association writes-off bad debt to more accurately reflect its financial situation. Delinquent assessments can be looked at as a type of accounts receivable. If it is unlikely the revenue will ever be received the delinquent assessments should be removed from the books.

So how is 'bad debt' defined within the context of a community association? There are actually two categories:

Uncollectible Accounts. An account is uncollectible when it is not legally possible to recover the funds. If a home has been foreclosed and the assessments have been discharged in a chapter 7 bankruptcy, the account is considered legally uncollectible.

Another example is delinquent assessments that are older than the four year statute of limitations for filing suit. The four years is measured from the first day the assessments were late. If assessments are due on January 1st then they are late on January 2nd. This applies regardless of when the association applies the late fee. If suit has not been filed within four years the association loses its claim (including any lien) and the account will be regarded as uncollectible.

Unlikely To Collect. If it is doubtful the assessments will ever be recovered they may be written off as bad debt. A common scenario is where the association has obtained a judgment and it cannot be satisfied through garnishment or attachable assets. Although there is no way to presently collect on the judgment, it still has the possibility of being collected over the next seven years or more

Another situation is where the debtor cannot be located to serve them with suit. Within the four year statute of limitations period, the debt is considered unlikely to be collected. If the four year statute of limitations has expired, the account would go from an unlikely collection to an uncollectible debt. (See above.) It is important to remember that even when an account has been written-off, the association may retain any funds that are later recovered.

During trying economic periods, some associations will include a line item in their annual budget for estimated bad debt. Although this has the effect of increasing assessments on all of the owners, it allows the association to pay its operating expenses without imposing otherwise unexpected special assessments.