

THE COMMUNITY BUILDER

Financial Statement Explained

By far, one of the questions we are asked most frequently is “why is our financial so complex”? Can’t we just know how much income (assessments) came in; how much we spent and what is left? Of course, you can, and the financial that is produced each month provides that very answer. However, it may not be in the format as simple as the formula above. Even cash accounting isn’t that simple. It is not like balancing a check book. It is more complex than that.

The truth of the matter is the Board is managing a business and many times a very large business depending on the complexity of the common areas, whether you have a clubhouse, a pool, a fitness center, private roads, private storm water system, ponds, etc. Most of the time knowing what is left after all the bills for that month have been paid, isn’t enough information.

The main difference between Cash accounting and Accrual Accounting is:

Cash basis accounting includes income when it is received and claim deductions when expenses are paid.

Accrual basis accounting includes income when it is earned and claim deductions when they are incurred.

A very smart friend of mine likes to make the following analogy:

“Cash accounting is like sitting in the back seat of a car, looking out the rear window. You can only see where you’ve been and not where you’re going.

Accrual accounting is like sitting in the driver’s seat, knowing where you are going and how to get there.”

Sentry’s financial statements are organized in report form. The very first page is like a Table of Contents showing what is included. The two main items that tell the story are the Balance Sheet and the Revenue & Expense Budget Comparison Report (Profit and Loss Statement). All of the other reports: Monthly Transaction Register, Check Register, Accounts Receivable Report, Closing Report, Accounts Payable Report and the Sorted Accounts Payable Purchase Journal all provide the

THE COMMUNITY BUILDER

supporting data shown on the Balance Sheet and the Revenue & Expense statement.

To follow will be a simple guideline to the COA's (Chart of Account) on your Balance Sheet and Profit & Loss Statement. While your association may not have all of these or may have more, this is a basic overview of a typical financial and what the numbers mean and how they relate to the reports provided in your financial statement.

Financial Summary

Is a single page summary of the financial report that is produced each month to track the financial activity of your association? It is not intended to replace the financial, merely present a very shortened version of the information provided.

Balance Sheet

Assets

*Current Assets

COA 1015 through 1099 represent the cash currently contained in your checking account, money market account, reserve account, and any other cash asset such as a CD. These are actual cash amounts as of the very last day of the month being reported.

*Accounts Receivable

COA 1210 through 1290 represent Assessments that are owed to the Association, special assessments for a specific purpose, legal fees for the collection of past due accounts and can contain items such as Due from Operating to Reserve (meaning a transfer of funds from operating are due to the reserve account), etc. These items are considered an asset as there is the probability that you will collect them at some point.

*Prepaid Assets

COA 1300 through 1498 and may represent items such as prepaid insurance premiums, termite bonds, income tax, or any bills that may have been paid prior to them being due.

THE COMMUNITY BUILDER

Liabilities

COA 2000 through 2199. The most common of these would be:

2010 Accounts Payable – invoices that have been coded and accounted for in the period they occurred but have not yet been paid.

2020 Accrued Estimated Expenses – are expenses that are anticipated as they occur routinely i.e., water, sewer, electric, landscape maintenance., trash removal etc. If the invoices for these services are not received for the month the service occurred, either the monthly contract amount or the budget is used as the determining amount to be accrued. (See Monthly Transaction Register to see what these expenses are)

2030-2038 Deferred Assessment- this is assessment income that has been invoiced to the homeowner but not yet earned. An example would be an owner is invoiced for semi-annual assessments. You will earn 1/6 of that amount each month. Although the cash, when received, is accounted for in the bank, you should not spend it before it is earned. This would only show on an accrual financial. In a cash statement all 6 months of the assessment would show in the income statement when the cash was received and the remaining 5 months would show no income.

2130 Prepaid Assessments – this is payments that you have received, but have not yet invoiced the homeowner. An example would be an owner pays in advance say six months, knowing they will be traveling. Each month the prepaids will be reduced as the fees are invoiced to the homeowner. Although the cash is accounted for in the bank, you should not spend it before it is earned. (The detail can be seen in the Account Receivable Report)

Reserves

COA 2200 through 2395. The other major liability is the breakdown by category of your reserve accounts. The total of these accounts should match the cash in the bank under assets. If they do not match, it means that either a transaction has not yet been made to transfer funds from Operating to Reserves (will be reflected on the Balance Sheet); that funds are insufficient to pay the Reserve account from Operating; or that money has been spent from operating from one of these

THE COMMUNITY BUILDER

categories for its intended purpose and the funds have not been transferred back to the operating account.

If that is the case, you will also see an entry called “Spent from Reserves” (COA 2400 through 2599). The amount spent will be reflected in (\$0.00) to indicate the amount that has been spent. To determine the net cash left in that category, if any, you will simply take the total shown in that reserve and subtract the “spent from”. This will give you the actual cash remaining in that category. Throughout the year, if and when any expenditures are made, the spent from will be reflected in this manner. At the beginning of the new fiscal year, all reserve categories will be netted to show the actual cash remaining in the line items.

Operating Equity

This is a cumulative number from the beginning of the operation of the association. If all of the assessments had been collected and all of the bills paid, this is what your association would be worth.

Revenue & Expense Budget Comparison Report

This report shows Income and expenses both budgeted and actual. The statement is broken out into two parts: Current Period (meaning the actual & accrued expenses and accrued income for the month of the financial report) and Year to Date (meaning the total accrued income and expenses to date from the beginning of the year).

Income

4020 Assessments. This is probably the most misunderstood figure represented in the financial. In compliance with Accrual Accounting, this figure is the amount of income earned, not received. The offset to the actual amount received, will be reflected in the amount of increase in accounts receivable. For those of you who really, really want to know exactly how much cash was received, you can request from your Manager an additional report called “Cash Receipts Report”. This report will be for the month, and will detail by week who paid, how much was paid and the date it was paid.

THE COMMUNITY BUILDER

4060 Late Charges. Represent the late fees and interest charged on past due accounts.

4100 Interest Operating Accounts (if applicable). Represents the interest earned on operating accounts in an interest-bearing account (money market or other)

4340 Interest – Reserves. Interest earned on Reserve Accounts (cumulative)

4350 Interest Alloc to Reserves. Unless otherwise directed by the Board, reserve interest is allocated semi-annually to each category of reserves the Association has in the same percentage as the category has to the overall total. (Example: If roof reserves are 20% of your total reserve amount – 20% of the interest will be allocated to the roof reserve).

These are some of the basic categories that most everyone will have. There are many communities with an extraordinary number of other income sources such as Special Assessments; Rental Income; Parking Space Income; Storage Closet Income; Clubhouse use income, etc.

Expenses

The financial is categorized into specific expense areas:

5000 Building Maintenance

6000 Grounds Maintenance

7000 Pool & Clubhouse

7900 Utilities

8000 Administrative

Expenses in each of these categories are either actual expenses for services rendered or invoices paid in that month; or they are accrued expenses as it is a contractual obligation to the association; a utility bill or other expense that occurs on a routine and monthly basis. The difference can be determined by looking at the Assorted Accounts Payable Journal that will detail the expense(s) to that COA and when they were paid or in the Transaction Register as noted earlier in this article. Either way, the COA represented will match to the COA in the Revenue and Expense report.

THE COMMUNITY BUILDER

This report provides a very definitive position for the current month and year to date with the variances indicating that a certain line item has been underspent (represented by a “-” sign in front of the amount) or overspent (if there is no “-” sign). This historical data should provide the Board with a clear picture of what is happening in the community.

By way of example, if the community is experiencing a tremendous number of roof leaks or plumbing leaks, it may be that it is time to look further into the specifics of the needed repairs which may necessitate roofing or re-piping. If there is an extraordinary expense for irrigation repairs, it may be time to evaluate the overall system to see if something else should be done to mitigate the constant repairs.

The individual categories of expenses should be reviewed with the thought in mind that a budget is an estimated guideline for the expenses. If there are some extraordinary expenses in a specific area, it may be time to review why that is. The budget however, should be looked at as a whole with a thought to the overall picture, not just individual line items and that it really is the bottom line that is most important. You may overspend in one area and underspend in another, but if the end result is that you are within the adopted budget as a whole, then you have successfully planned for the maintenance and operation of your community.