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Understanding the Financial Statement

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Today, Association Officers and managers have found themselves in the position of being responsible for hundreds of thousands of dollars in revenue and expenses. In order to keep track of an Association's finances it is extremely important to understand how and why a financial report is compiled. In most instances, these individuals are very responsible but they do not possess an accounting or bookkeeping background and find it difficult to understand financial statements.

In order to become more effective to your Association, you should become more familiar with the basics of what makes up a good financial report and how a bookkeeper makes an Income Statement and Balance Sheet.

We will summarize a typical financial report and how you can better understand this critical area of your Association's operation.

Simply put, a financial statement reflects the financial condition of the Association for a certain period of time (Monthly, Quarterly, Semi-Annually or Annually). The overall equation which expresses the financial condition of an Association is the Income Statement and Balance Sheet.

The Income Statement will detail the income and expense activity for that period of reporting time and it will also show the cumulative activity for the year-to-date. This report will detail the income and expense activity against the budgets. The bottom line will show the Net Surplus or (Loss) for the period and for the year-to-date. The Balance Sheet will detail the Association's Assets, Liabilities and Capital (Equity). In all cases, the Assets will equal Liabilities and Capital.

In order to prepare an Income Statement and a Balance Sheet the following procedures are followed in the accounting cycle.

1. Business transactions are made daily in the Association's accounts.

2. The transactions are entered in the Association's books in the General Journal.

3. The information in the General Journal is posted to a record called the Ledger.

4. A Trial Balance is prepared to verify balances in the Ledger. If required, the trial balance is adjusted to correct the account balances.

5. The adjusted information is then used to prepare an Income Statement and Balance Sheet.

A good financial report will have the following details to substantiate and back-up the Income Statement and Balance Sheet.

GENERAL LEDGER

This will detail daily transactions that have been posted for each account in the books and it will correspond to the Income Statement format. It will show the account code number, the account name, date of the transaction, a brief description of the transaction, whether the transaction was a debit or a credit and, finally, where the transaction was posted as a journal entry.

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This will show any business transactions not recorded in any journals and will again show on the General Ledger. Included in this report will be the date, the amount, the debited account, the credited account, the type of entry and a brief description of the activity.

ACCOUNTS RECEIVABLE DETAIL

This report details who owes maintenance assessments, late fees and penalties, if any. Prepaid maintenance for an individual would be reflected in this section as well.

ACCOUNTS PAYABLE DETAIL

This would show any outstanding bills for goods and services known at the time of the close of the reporting period, owed but not paid.

TRIAL BALANCE

This is a procedure whereby all of the balances of the accounts of the Association are determined. The Trial Balance will then take each individual account as they are listed as a debit or credit. The total of the Debits will equal the total of the Credits. After all accounts are in balance or any corrections have been made, the Balance Sheet and Income Statement can now be prepared accurately.

BALANCE SHEET

A Balance Sheet provides a summary of the financial condition of the Association as of a certain date. It contains the following elements:

ASSETS

The assets portion of the balance sheet will detail the "Current Assets" including all cash balances in the operating account, savings for reserve funds, working capital savings and petty cash. In addition it will also show if any "Other Assets" such as maintenance that are billed but not received, utility deposits, prepaid deposits, prepaid insurance and prepaid expenses.

LIABILITIES AND CAPITAL

The Assets of the Association will always balance or equal the Liabilities and Capital of the Association. Items that are considered liabilities would be accounts payable (all unpaid bills that are known), prepaid maintenance assessments collected, any accrued real estate taxes, any payroll taxes which were unpaid and any other debts. The difference between the Assets and Liabilities for that reporting period is the Capital or Equity for the Association.

Another way to think of it, is to imagine this as the Association's Net Worth. The Equity or Capital will vary from reporting period to reporting period based on the amount of cash on hand, prepaid expenses, prepaid maintenance, maintenance receivables and the amount of net income/loss for that most recent reporting period (this is taken from the Income Statement and added or subtracted from the prior reporting period's Equity.)

INCOME STATEMENT

This report will detail in terms of Income and Expense, changes in the financial condition of the Association over a specified period of time. A good Income Statement will show actual income and expense activity for that period of time (Monthly) and for year-to-date calculations. This report will also detail current budgets for the month and for year-to-date as well. Variances will occur when actual income taken in is more than what was budgeted. This will be shown as (-). Also, the Income Statement will report the Net Surplus (Profit) or Loss for that period and for the year-to-date. The Surplus or Loss for the period will be added or subtracted from the proper reporting period's Fund Equity.

The proper management of any Association is made up of many diverse factors such as rules enforcement, professional management, sound operations and good fiscal management. Boards of Directors, Owners and Managers need to know and understand good accounting practices in order to manage and operate their Association effectively.

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