BOARD FINANCE 101:
A simple financial primer for community association board members

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Every month, your community association management company, a board member, or someone with financial experience should be producing some sort of financial reporting for your community. These reports provide an overview of your community's revenue and expenses against your financial projections or budget. If not, this should be your first order of business at the next board meeting. It's that important!

Do these reports look like a jumble of numbers and complicated terms? Don't worry and keep reading! With a basic understanding of budgets and reporting, you'll not only understand the information, but you'll be able to ask the important questions necessary to effectively oversee your community's financials.

Start with the roadmap — your budget

All community associations should have some sort of budget in place to help manage revenue and expenses. Simply put, a budget is a summary of projected revenue and expenses for a period of time, normally 12 months. Your community should create a budget at the be beginning of the year, and then track progress against the budget as revenue comes in and expenses are paid out.

Remember that a budget is also like a plant. It requires regular attention for your community to thrive. Monthly budget monitoring can help uncover opportunities to run the community more efficiently, and provide an early warning of potential financial issues like slow assessment collections or high expenses.

How to tell a balance sheet from an income statement

Now that you understand your community's budget, your monthly financial reporting acts like a check-up, giving you insight into the your community's financial health, including budget variances, account balances, and cash flow. Two of the most important components of your community's financial reporting are the balance sheet and the income statement.

Balance sheet:

This report summarizes the financial position of your community at a particular point in time. There are three main components:

- *Assets* – normally the money you have in your bank and investment accounts. The money in your operating account is your cash flow, the lifeblood of your community.
- *Liabilities* – this is essentially what the community owes others.
- *Equity* – the assets that are not being used to cover liabilities.

We use the term balance sheet because it needs to balance. Assets = Liabilities + Equity. It should also match the income statement.

Income statement:

This report summarizes the community's financial activity over a period of time. Results are normally presented monthly and may include quarter-to-date as well as year-to-date columns. The three most important components for your community are probably:

- *Revenue* – the community's income from sources like assessments, rentals, and late fees.
- *Expenses* – the money you're spending on things like management fees and landscaping.
- *Net Income or Loss* – what's left over, hopefully a positive number!

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Operating and reserve accounts

All community associations need to keep two separate "piles" of money, called an operating account and a reserve account. The operating account is for operations – the day-to-day activities associated with running the community. Money comes in from assessments and goes out to pay the landscaping company, pool management company, community association manager, etc.

The reserve account, on the other hand, is like a community savings account. These funds should only be used for repair and replacement of big-ticket items, like resurfacing tennis courts, replacing a water slide, re-carpeting the clubhouse, etc.

The amount of reserves is usually determined by a professional study (reserve study) and funded by a portion of homeowner assessments. If you don't have a reserve account, or that money is being used for community operations, get back on track to save for a rainy day.

Accounting methods – cash is king

There are two ways for community associations, and most businesses for that matter, to keep track of income and expenses – cash basis and accrual basis

- *Cash Basis* – This is the most common accounting method. Income is recognized (counted) when money is collected, and expenses are recognized when money is paid out. This seems perfectly logical, but this method makes projections a little more difficult.
- *Accrual Basis* – Income is recognized when it is billed, not when you receive the check. Expenses are recognized when billed, not when you write the check. While the accrual method gives you better insight into planned revenue and expenses over time, it's sometimes tough to determine how much cash is available at any given time.

Bridging the GAAP

Since financial statements are prepared according to standards called Generally Accepted Accounting Principles (GAAP), you only need to learn this information once. The reports may vary from community to community, but the reporting rules don't change. Now that you're armed with the information you need to review your community's financial reports, ask questions, and impress your fellow board members. Congratulations! ■