So what exactly is a balance sheet?

"A balance sheet is the cumulative financial position of the association at a given point in time, usually the last day of the month," explained Matt Sluizer, director of client relations in client accounting services at FirstService Residential. "A balance sheet includes your assets, liabilities and equity. To calculate your assets, you add up liabilities and equity." To put it another way that anyone who's managed a household budget will relate to, subtracting the liabilities from the assets gives you the association's equity.

David Jandak, vice president of finance for FirstService Residential, agreed and went on to say that the balance sheet provides a clear, easy-to-understand picture of what is an otherwise lengthy, complicated financial statement. It's a summary of the rest of the statement, which also includes the association's income statement, bank reconciliation and general ledger.

What information is on a balance sheet?

The balance sheet has two sides that must balance. One side details the assets of the association. The other side details the liabilities and equity.

- Assets include cash, accounts receivable, reserve accounts, investments and fixed assets, like property and heavy equipment.
- Liabilities include taxes, utility bills, loan payments, pre-paid assessment fees and wages.
- Equity is the net worth of the association, which is what's left after all the liabilities are paid.

"We use a three-column balance sheet," Jandak explained. "For each line item, let's say cash, the balance sheet lists the amount at the end of the previous month in one column, the amount at the end of the month in the second column and then the difference between the two, positive or negative, in the third column. This lets people see very quickly which direction money is moving. It makes being a board member easier."

Patricia Bialek, vice president of FirstService Residential, said that it allows the board to see clearly how the funds are invested, whether that's in CDs, treasury notes or savings accounts. "It helps them spot quickly when accounts approach the FDIC limit and adjust accordingly so they don't exceed it," Bialek said. "And of course, we expect to see those amounts go up each month. If they do not, then we know to look for the reason a monthly reserve transfer was not completed. If there is a decrease in the reserve accounts, then we know to confirm that there was a transfer for a capital expenditure."

How are balance sheets generated?

A balance sheet is automatically generated out of accounting software, once bank records have been reconciled to make sure that all financial activity is reflected on the balance sheet. In the old days, this had to be done manually, but it's automatic now, and should be provided to your association as part of every monthly financial statement provided by your professional property management company. If your community is self-managed, your CPA, bookkeeper or on-site staff can generate a balance sheet from any major accounting software program they use.

How does understanding our balance sheet affect budgeting?

One piece of working on next year's budget is understanding where the association is at the moment. "That clear picture of the current financial situation is critical when budgeting season rolls around," Bialek said. "That's why we show that third column with the increases and decreases. Boards can't know if they're putting enough in reserves, if they need to tighten the belt somewhere or increase assessments if they can't understand the balance sheet."

Bialek explained that, if balance sheets show a deficit, the board may need to increase assessments long term, levy a special assessment or take out a loan. All of those things affect the overall association budget.
Jandak stated that the balance sheet is also a tool for determining how transfers to the reserve fund accounts are detailed. Boards need to look at their reserve study, see how the funding is performing against the projected needs, and make adjustments to the transfer amounts as needed in the upcoming budget. The balance sheet provides the basic information for those decisions.

What can happen if I don't understand the balance sheet?

If you don't understand the balance sheet, you run the risk of not understanding the true cash position of the association and spending more money than you have for the current budget period, which will obviously be harmful to your operating budget. "For example, you may see that you have $100,000 on hand, but if you don't understand that $80,000 of that cash is actually a liability in the form of pre-paid assessments, you can easily spend money you don't really have," Sluizer explained. "That's money in the bank, but you haven't earned it yet, and it needs to be kept for future expenses. Another common mistake is that people see a number in the equity section and assume that equity is equal to cash on hand. But you may have assets that are accounts receivable contributing to that equity amount but aren't yet cash on hand. Equity does not always tie one to one to cash on hand."

Financial matters can be complicated. But board members need to be able to understand the basics of financial statements to be able to work in the best interests of their community association. That includes a working knowledge of what goes into a balance sheet, how they are generated and why they are important.