The Fundamental Equation of Accounting:

- Assets = Liabilities + Equity
- What you HAVE = What you OWE plus what you OWN
- HAVE = OWE + OWN

  (Asset) = (Liability) + (Equity)

The Balance Sheet

- The organization's financial situation at a particular **point in time**
- Shows total **Assets** equal to total **Liabilities plus Equity** – hence the name "Balance Sheet"

Examples of Assets:

- Cash
- Accounts receivable
- Prepaid expenses
- Investments
- Loans Receivable
- Land
- Buildings
- Furniture & Equipment

Examples of Liabilities:

- Accounts payable
- Accrued payroll
- Deferred revenue
- Accrued interest
- Member deposits
- Loans payable

Equity:

- Retained earnings
- Member shares *(This is **equity** if the return is <u>not</u> automatic when the member leaves the co-op. If the return IS automatic, minus any nonpayment of charges and/or damage assessments, this should be recorded as a **liability**.)*

When some of the earnings are returned to the owners of a co-op, this is know as a **patronage dividend** (uncommon for housing co-ops)

The Income Statement:

- The organization’s financial performance over a given **period in time**

Examples of Revenue (Income):

- Member charges (rent)
- Food income
- Membership dues
- Interest income

Examples of Expenses:

- Maintenance and repairs
- Staff salaries/wages
- Food expense
- Depreciation
- Utilities
- Interest
- Insurance
- Telephone
- Supplies
- Education

Balance Sheet example

Assets			
Cash	15,000		
Accounts receivable			2,000
Land	20,000		
Building		80,000	
Total assets		**117,000**	
Liabilities			
Accounts payable			3,000
Mortgage loan		80,000	
Member deposits		10,000	
Total liabilities		93,000	
Equity			
Retained Earnings			24,000
Total liabilities and equity			**117,000**

Income Statement example

Revenue

Rent income	100,000
Food income	30,000
Interest income	1,000
Total revenue	131,000

Expenses

Mortgage loan interest	7,000
Food	29,000
Depreciation	5,000
Maintenance	82,000
Education	4,000
Total expenses	127,000

Net income	4,000

Beginning retained earnings	20,000
Ending retained earnings	24,000

At the end of the year, net income flows into retained earnings

Retained earnings, beginning of the year
Balance sheet

Plus (minus): net income (loss) for the year
Income statement

Equals retained earnings, end of the year
Balance sheet

Retained earnings is also decreased when dividends on net income are paid to the owners – rarely happens with housing co-ops

Depreciation

- Some assets – buildings, renovations, furniture, equipment – are not recorded as expenses when purchased
- Instead, they're recorded as **assets** *(balance sheet)* and then **depreciated** over several years *(income statement)*
- **Depreciation** accounts for the fact that the assets wear out and lose value over time

Methods of Accounting

- **Two primary methods of accounting:**
  - GAAP (Generally Accepted Accounting Principles)
  - Cash

GAAP Method

- **GAAP =** Generally Accepted Accounting Principles
  - Also know as the “accrual method”
  - Used for most formal financial reports, such as audit reports
  - This best reflects the organization’s true economic situation
  - Revenue recognized when it’s actually **earned**
  - Expenses recognized when they’re actually **incurred**

Cash Method

- Simple and straightforward
- Revenue recognized when cash is **received**
- Expenses recognized when cash is **paid**
- Most co-op budgets, and budget variance reports, are done on the cash basis

Co-op Budget Variance Reports

- Important questions to ask:
  - Budget variances – reasonable?
  - Are revenue and expenses expected to be consistent all throughout the year?

Budget Variance Reports

- Distinctions between GAAP financial statements and cash budget reports
- Major points of difference:
  - Depreciation
  - Loan Payments

Budget variance report – cash basis

	Actual	Budget	Difference
Revenue			
Rent income	100,000	97,000	3,000
Food income	30,000	28,000	2,000
Interest income	1,000	1,000	0
Total revenue	131,000	126,000	5,000
Expenses			
Loan payments	11,000	11,000	0
Food	29,000	28,000	1,000
To capital reserve	8,000	8,000	0
Maintenance	82,000	70,000	12,000
Education	4,000	7,000	(3,000)
Total expenses	134,000	124,000	10,000
Net cash surplus (loss)	(3,000)	2,000	(5,000)

Maintenance Projects:

- **Capitalize** major projects. These are recoded as assets on the balance sheet. Then they are depreciated, over several years, and depreciation expense is recorded on the income statement.

- **Expense** minor projects. Recorded on the income statement as maintenance expense.

Mortgage:

- A loan for which real estate serves as collateral

Three Basic Mortgage Components:

- Principal balance
- Interest rate
- Amortization (length of repayment)

Principal Balance

- This is the amount owed on the loan
  - When the loan is first taken out, the principal balance equals the amount borrowed.
  - As the monthly payments are made, the principal balance is gradually reduced.

Interest Rate

- The charge assessed for the temporary use of another entity's money

Amortization Period

- The length of time over which the loan is to be repaid.
  - Most loans for co-ops, and other “commercial” ventures, are amortized over periods between 15 and 25 years.
  - Individual home owners can usually receive loans amortized over 30 years.

Mortgage Payment

- Three variables combine to determine the monthly mortgage payment:
  - Principal balance
  - Interest rate
  - Amortization
- This payment is constant from month to month.
  - What changes is the amount of the payment which is applied to interest *(income statement)* versus the amount of the payment which is applied to principal *(balance sheet)*.

Mortgage Loans Over Time

- During the first few years of the loan, the interest charges take up a relatively high amount of the mortgage payments.
  - Gradually, as the principal balance declines over time, the interest charges decreases, and higher amounts of the mortgage payments are applied to the principal.

Loan Amortization example – beginning of the loan

Loan amount: 300,000

Interest rate: 7%

Repayment period: 20 years

Calculated monthly payment: 2,326

Payment	interest	principal	loan balance
			300,000
2,326	1,750	576	299,424
2,326	1,747	579	298,845

Loan Amortization example – end of the loan

Loan amount: 300,000
Interest rate: 7%
Repayment period: 20 years

Calculated monthly payment: 2,326

Payment	interest	principal	loan balance
			4,611
2,326	27	2,299	2,312
2,326	14	2,312	0

Thank you!

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