

# COMMUNICATING FINANCIAL INFORMATION

By Gary A. Porter, CPA

The users of financial statements in the homeowners association industry are generally the board of directors, management, and members of the association. Regardless of what they may each do in their private lives, unless they are a CPA or work in financial management, most of them would be considered lay people in relation to the technical financial information that is being presented. The individuals who prepare the financial statements, on the other hand, are generally CPAs or individuals in financial management. They are technicians with a very narrow focus. For audited financial statements, you need to add in a third group of people, the "Standards Setters". This means the American Institute of CPAs and the Financial Accounting Standard Board. These two bodies, composed primarily of CPAs (and many of them in academia), seem to live in an ivory tower. The standards they force onto the accounting profession and the unsuspecting public, while intended to make financial statements easier to read, many times make them more difficult to read. This brings us to the crux of the problem. The people that prepare financial statements generally speak a different language than the people who read financial statements. And we wonder why financial statements are difficult to read.

One of the more cumbersome and yet more useful accounting concepts created in recent years was the establishment of fund accounting as the preferred method of accounting for homeowners associations. This means that the reserve funds are kept completely segregated from the operating funds and, at least in the audited financial statements, generally accounted for in a three-column format showing operating fund, major repair and replacement (reserve) fund, and total funds. This makes it very difficult for someone to miss the analysis of reserves. It almost forces you to see the cash and fund balance amounts on the balance sheet, as they are prominently displayed. On the statement of revenues and expenses, amounts received into and expended from the reserve fund are also prominently displayed.

The operating fund is often a little more difficult, just because there are so many more line items. One of my clients has more than 2,500 accounts in their chart of

***"Preparers of the financial statements need to keep two things in mind. One is the accurate accumulation of the information that is being presented. Second are the intended users of the financial information being reported upon. If the intended users can't understand the financial statements, the information is useless, no matter how accurate the financial statements may be."***

accounts, so this information must be carefully summarized in order to make the financial statements understandable. For many years the chart of accounts for many organizations was arranged with all expense accounts in alphabetical order. That's because the individuals who designed the system and prepared the financial statements wanted to be able to find accounts very easily, by their title. However, this format did not provide a meaningful financial report. Management can better understand financial statements when they prepared on a functional basis. The association industry has generally come around to this point of view. Most associations now group expenses on a functional basis. For instance, categories may consist of Administrative expenses, Landscaping expenses, Repair and maintenance expenses, and Utilities. For those associations with significant member and recreational activities, expenses are generally grouped by such categories as Member services, Golfing activities, Tennis club activities, Equestrian facility activities, etc.

Each association is unique, and each association would generally have a different focus on what is important to their association. That's exactly how it should be. The primary focus of financial statements in this industry is on the statement of revenues and expenses, specifically on the comparison of budgeted activities to actual performance.

Given that the specific orientation of this industry is focused on the statement of revenues and expenses, we have



## Communicating Financial Information (continued)

attempted to make that statement easier to read. First, we always keep the statement of revenues and expenses limited to a single page. We may have multiple pages of supporting detail, but the statement of revenues and expenses never exceeds one page. Second, for many associations, we also prepare a graph or chart of activities that is presented as a supplement to the statement of revenues and expenses. When focusing on a single year financial statement, we use a pie chart format as the easiest to understand for a single year presentation. (See Table 1) When looking at a five-year comparison format, we use a line chart or a bar chart, whichever seems to be most representative based upon the information being presented. (See Table 2)

What is the purpose of this, you might ask? These seem like very minor things, and certainly don't require brain surgery. That's true. However, the little things count. Presentations that are simple, are easy to understand. Presentations that are complex are difficult to understand.

We realize that of the individuals in an association, who will actually take the time to read the financial statements, the range of financial expertise could run from the barely literate, to those who are highly sophisticated. And yet the same financial statement must serve the needs of both. We find that many people are what we call "bottom line" people. It is for this group that we prepare the one page financial statement, because with a single look, they can see all the income, all the expenses, and the bottom line. This allows them to immediately grasp the overall financial status of the association. We back this up with supporting schedules that provide detail of each of the functional revenue and expense categories. This allows those who desire to delve deeper and look at more detail to get the answers they want.

While a graph or chart is intended to accomplish the same purpose, it also can have a very different impact. For instance, as I work with the statement of revenues and expenses, I am involved with the numbers on a very detail level. I know that the overall financial statements are correct. But, I occasionally am surprised when I create the chart to see graphically see the comparison of one block of income in relationship to another.

The bar or line chart, presented in a trend format, typically illustrating a five-year period, is intended to show how the relationship or numbers may change over time. In some cases, it may show that the numbers remain very consistent in relation to each other from year to year.

Another tool we use in constructing financial statements is the use of features that are commonly available on many Windows and Windows 95 products these days. The use of **bolding**, underlining, *italicizing*, and shading guide the reader's eyes to what we believe are the most important parts of the financial statements. When comparing an income statement prepared using a basic courier font to one prepared using word processing enhancing techniques, the differences become obvious. Not only is the enhanced product much more appealing to the eye, but the understanding of the document is also enhanced because you are naturally guided to the most important features of the financial statement.

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