Finances 101

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Course Description

This course is for anyone who wants to know more about the co-op's money -- where your money goes when you write your check to your co-op each month, how your co-op pays for its buildings, how you can reduce room rates, and much more. We'll focus on lots of "big-picture" ideas, rules of thumb, and practical applications, so you won't get just a bunch of dry numbers and definitions, you'll walk away with a practical understanding of your co-op's money and what it means to current and future generations of co-opers.

Prior Knowledge required: None, we'll start from the beginning

Introduction

This course is based on the financial training that I've delivered to the ICC-Austin board of directors annually for the last few years. I created that training because while I was on the board myself I never really understood the organization's finances, and only really "got it" about the time I left the board. I didn't want future boards to suffer under the same confusion, so I attempted to give them what I wish I'd had when I joined the board.

This handout, as well as the other jumbo bitchin' packet, are available online in both PDF and MS Word formats on my website at http://michaelbluejay.com. It is my hope that you will use these as starting points to create training for your own co-op.

If you enjoyed this training, you'll probably go nuts over the related articles available on my website, such as How to Lower Room Rates, Cost of Rebuilding a Burned-Down Co-op, All about Mortgages, and Compensating Leaders, as well as promotional co-op videos.

Feel free to contact me at coop(at)michaelbluejay.com if you have ideas for how to make this course better. Thanks for coming!

Why is important to understand finances?

1. **Legal/Moral Responsibility.** As a board member the co-op's members are trusting you with their money. You can't be a competent custodian of that money if you don't know how the system works.
2. **To ensure success and survival.** Your co-op was formed to serve a need in society. If you mismanage the money then the co-op won't be able to serve as many people as it could have as well as it could have. If you really screw up the co-op could go under and then it won't serve *anybody.*
3. **To improve decision-making.** The more you understand how the money works, the better the decisions you can make about how the co-op should spend its income.
4. **To make planning possible.** You may have creative ideas for increasing member involvement, expanding services, or growing the organization. To do these things you'll have to understand the financial impact.
5. **To improve communication with members.** It's their money, and they have a right to know how it's being spent. Can you tell them? Do you know where all the money goes? Can you justify how it's allocated?

Glossary of Financial Terms

Accounts Payable. Money that you owe. Any bill you get from a supplier, utility company or service provider is Accounts Payable. Sometimes these are just called "payables".

Accounts Receivable. Money that others owe you.

Accrual Method. A method of accounting in which sales are recorded when they're earned (not when the cash is actually received), and expenses are recorded when the organization becomes liable for them (not when they're actually paid). Yes, this is a little more complicated than the way you're used to dealing with record keeping. But all except the tiniest of organizations use the accrual method, not the cash method.

Amortization. Spreading the cost of something over a period of time. The best example is a loan to buy a house. Rather than paying cash for the house all at once, you get a loan and spread the payments over 15 or 30 years.

Appraisal. A professional estimate of the value of a piece of property. When buying a house the lender (the bank) will hire an appraiser to do an appraisal of the house, so the lender can make sure the house is worth what you're paying for it. If you don't make your payments and the bank has to repossess the house, they want to make sure they can recoup their loss by selling the house. If the house isn't worth as much as you're paying for it then they can't do that, so they have an appraisal done to find out how much the house is actually worth.

Appreciation. The act of property becoming more valuable over time. This is good for investors because when they buy a house and it appreciates a lot they can sell it at a profit. It doesn't matter as much to co-ops because we generally don't sell our houses. But one way that appreciation helps us is that when our houses are worth more, it's easier for us to get loans to buy more houses.

Assessed Value. How much the government says your house is worth. The government makes an assessment on your property so they know how much to charge you for property taxes.

Assets. Things you own, like cash, land, buildings, and equipment.

Audit. A professional review of an organization's finances, usually by an outside company. Both companies and not-for-profit organizations routinely hire an auditor to perform a yearly audit to make sure the books are in good shape, and to identify any areas where record keeping or other financial processes need improvement.

Bad Debt. Money owed to you that you can't collect. When someone moves out and hasn't paid their room charges and won't pay it, it's bad debt. Note that it's only bad debt if you can't collect it. If someone is behind in their payments but just hasn't paid yet, then it's accounts receivable.

Balance Sheet. An accounting report showing how much the organization is worth at a particular point in time. It lists the organization's assets, liabilities, and equity.

Budget. A *plan* for making money and spending/saving it. Budgets are usually made on an annual basis, by an organization's board of directors.

Collateral. Something of value you pledge to secure a loan, that the lender can take back if you fail to make your loan payments. When you get a loan to buy a house, the collateral is the house itself. Also a movie with Tom Cruise.

Closing Costs. Incidental expenses you pay when buying a home, to the lender, government agencies, and other professionals involved in the process.

Default. The act of failing to make payments on a loan. When you default, the lender can seize your collateral.

Depreciation. The act of an asset becoming less valuable over time. It is kind of silly to apply that to real estate, because that property gets more valuable over time, not less. But it's generally accepted accounting practice to consider that your property depreciates, so most organizations record that depreciation every year, even though the depreciation really exists only on paper.

Equity. The value you own after subtracting what you owe. For real estate, your equity is the value of the house minus the amount you have left on your loan. You build equity by making mortgage payments, and by the house naturally appreciating in value over time. For the organization as a whole, your equity is all your assets minus all your liabilities. This is also called Net Worth.

Expenses. Money paid for something that's used up. Food is an expense because it's used up. But buying a house isn't because the house is still worth something after you buy it. The house is therefore an asset, not an expense. However, the interest you pay to the bank for the house loan is an expense, as is the taxes and insurance you pay on the house.

Financing. The process of getting a mortgage to buy a house.

Gross. The raw amount before subtracting something (like a subtotal, not the final total). All the money you collect is Gross Sales. After you subtract expenses you have your Net Income.

Income Statement. An accounting report that shows profit, which is sales minus expenses. For co-ops, "sales" are the monthly room charges paid by members.

Interest. The profit the bank makes on a loan. Interest is paid on the outstanding balance as part of the monthly loan repayment. If you have a $500,000 loan at 7% interest, then in the interest paid the first month will be $500,000 x 7% ÷ 12 = $2917. The reason you divide by 12 is that the 7% rate is for a whole year, but your payment is made monthly, so dividing by 12 months gives you the amount for one month of interest.

If your payment was $3300, then after the $2917 in interest you paid $383 towards the principal of the loan. Your outstanding balance is now $499,617. The next month you will pay $499,617 x 7% ÷ 12 = $2914 in interest. That means that $3300 - $2914 = $386 is paid towards the principal.

Ledger. A list of transactions. A checkbook is the simplest kind of ledger — it's a line by line listing of money coming in and money going out. A ledger should contain the date, the amount, who it was to or from, and what it was for. Even if you don't have a real accounting system and don't know how to generate reports, if you have a good ledger any accountant can take it and do your entire books from that.

Lender. The bank that makes a loan. Loans to buy houses come from banks, but instead of saying "bank" we usually say "lender", because that's the function the bank is serving when they make the loan.

Liabilities. Amounts you owe. The biggest and most common liability is a mortgage. Other liabilities include amounts you hold but which don't really belong to you, such as the security deposits paid by members, since that money really belongs to them, not to the organization, and must be returned to them when they move out.

Market Value. How much something is worth, considering the amount a reasonable person would pay. In other words, the amount you could sell something for.

Mortgage. The special name for the loan you get to buy a house or building.

Net. The amount you have after subtracting something. The money you collect is Gross Sales. After you subtract your expenses you have your Net Income.

Non-profit. The old term for not-for-profit organization.

Not-for-profit. An organization whose purpose is educational, religious, or charitable, not for profit. These groups can and do make profits; the point is that that's not why they exist. What separates them from for-profit businesses is that their mission is to serve the common good rather than to make money. It doesn't mean they can't make money, just that that can't be their whole purpose in life, like it is for Wal-Mart.

Principal. The amount borrowed or paid back. When you take out a $500,000 loan, the $500,000 is the principal. When you repay the loan part of your payment will be for principal, which reduces the amount you still owe, and part will be for interest, which is the bank's profit. See interest for a more detailed example.

Profit. The money that's left from sales after subtracting expenses. The term "profit" has a negative connotation among leftists and anti-capitalists, but the term itself is actually objective and profit itself is morally-neutral — it's the way the profit was achieved and where the profit goes that determines whether it's morally questionable.

Real Property. Another word for real estate, which is another word for land plus any buildings on it.

Refinance. To take an existing mortgage and turn it into a brand-new mortgage with new terms. You might refinance to combine various loans into one, or when you can get better terms than your current mortgage (e.g., lower interest rate, shorter term, no balloon).

Return. The amount of profit yielded from an investment. If you bought a house for $100,000 and a year later it's worth $10,000, then the $10,000 is your return. The RATE of return is the return expressed as a percentage, in this case 10%.

Term. The length of a mortgage. A mortgage term is generally 15 or 30 years.

Terms. The various conditions of a mortgage, including the length in years, the interest rate, whether the interest rate is fixed or variable, and whether the mortgage has a balloon. This gets confusing because "term" refers to the length of the mortgage while "terms" refers to all the conditions of a mortgage.

Transaction. The action of receiving money or paying it out. Actually, money doesn't have to change hands, a transaction can involve anything of value, but it's usually money. Transactions are recorded in a ledger.