Financial Reporting

Buying a Condo

When you find a house you want to buy, you usually need to obtain a mortgage. If you want to buy a $100,000 condo, a bank will not give you the full amount in a mortgage. They want you to jeopardize your money before they will jeopardize theirs. They want you to put money down. They would like you to put 20% down and they will provide a mortgage for the remaining 80%. The condo costs $100,000, the mortgage is $80,000, and your down payment is $20,000. For every dollar you put down, the bank will lend you four dollars. This is the first step you have to meet in obtaining the loan, a 4 to 1 debt to equity ratio. They will still not lend you the money until they have an appraisal done to verify the condo is worth at least the $100,000. They need this assurance so that if you default they can force the sale of the condo and get back their money. They get paid back before you. This step assures adequate collateral. We have a person who wants to buy this $100,000 condo. They are going to put $50,000 down. The condo appraises at $150,000 but the bank will not make the loan. The person applying is on social security making only $500 per month. The money they have coming in, less the bills they have to pay, does not leave enough to

pay the mortgage. They do not meet the final step, ability to repay. You need to meet all three steps in the borrowing process whether this is a mortgage for a condo, a business startup loan, or an equipment loan.

The Financial Reports

The $100,000 condo is your asset. The $80,000 mortgage is your liability. The $20,000 down payment is your equity. The total assets, $100,000, equal the total liabilities and equity, $100,000. They are in balance. This is a balance sheet. In a business your assets would not be the condo but cash, accounts receivable, inventory, equipment, etc. Your liabilities would not be a mortgage payable but accounts payable, taxes payable, equipment loans, etc. Your equity would not be a down payment but your capital invested plus any profits you maintain in the business.

You record your business income and you subtract your business expenses. A positive difference is a profit, a negative difference a loss. This is called a profit and loss statement.

The Certified Public Accountant

Before you had your own business you gave your employer name and telephone number when you wanted to buy a car, a house, or a boat. They would call your employer to verify your income and ability to repay. Now that you are your own employer, they are not dumb enough to just take your word. They are looking for an independent person's signature on your records. They are looking for a CPA signature. They will ask for tax returns, balance sheets, and profit and loss statements.

Preparation, Compilation, Review, and Audit

When a CPA is not engaged to prepare a compilation, review, or audit, the level of service provided is a Preparation level. The CPA does not issue a signed letter and designates that no assurance is provided. When the CPA signs a letter, which goes along with a financial report, designed for third party use, he is providing assurance. There are different levels of assurance in these letters. The lowest level simply says the CPA compiled the information based on information you supplied. Third parties usually accept this level. If you have a bank loan or need bonding, a review level letter gives third parties more assurance. If your bank or investors need the highest level, an audit level letter will be needed.

For more resources visit www.rjclark.com.

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