500 Alfred Nobel Drive Suite 250 Hercules, CA 94547
Fax (510) 262-1797 Tel (510) 262-1795

Beginners' Guide to Financial Statements

"Show me the money!"

We all remember Cuba Gooding Jr.'s immortal line from the movie *Jerry Maguire*, "Show me the money!" Well, that's what financial statements do. They show you the money. They show you where the Association's money came from, where it went, and where it is now.

There are four main financial statements. They are: (1) balance sheets; (2) income statements; (3) cash flow statements; and (4) Budget Comparison. Balance sheets show what a company owns and what it owes at a fixed point in time. Income statements show how much money a company made and spent over a period of time. Cash flow statements show the exchange of money between a company and the outside world also over a period of time. The fourth financial statement, the Budget Comparison shows changes in the interests of the company's shareholders over time.

Let's look at each of the first three financial statements in more detail.

Balance Sheets

A balance sheet provides detailed information about the Association's assets, liabilities and equity.

Assets are things that the Association owns that have value. Assets for homeowner's associations include savings accounts, such as a money market account.

Liabilities are amounts of money that a company owes to others. This can include all kinds of obligations, like money borrowed from a bank to fund a roofing project, capital improvement expenses such as a dry rot project, and money owed to suppliers for materials.

Budget Comparison or Equity is sometimes called capital or net worth. It's the money that would be left if the Association sold all of its assets and paid off all of its liabilities. This leftover money belongs to the owners, of the company.

> The following formula summarizes what a balance sheet shows:
>
> ASSETS = LIABILITIES + EQUITY
>
> A company's assets have to equal, or "balance," the sum of its liabilities plus equity.

The Association's balance sheet is set up like the basic accounting equation shown above. On the top of the balance sheet, are the assets. Next, the liabilities and equity.

A balance sheet shows a snapshot of a company's assets, liabilities and equity at the end of the reporting period. It does not show the flows into and out of the accounts during the period.

Income Statements

An income statement is a report that shows how much revenue the Association collected over a specific time period (usually for a year or some portion of a year). An income statement also shows the costs and expenses associated with earning that revenue. The literal “bottom line” of the statement usually shows the company’s net earnings or losses. This tells you how much the Association earned or lost over the period.

Cash Flow Statements

Cash flow statements report Association’s inflows and outflows of cash. This is important because the Association needs to have enough cash on hand to pay its expenses and purchase assets.

A cash flow statement shows changes over time rather than absolute dollar amounts at a point in time. It uses and reorders the information from a Association’s balance sheet and income statement.

The bottom line of the cash flow statement shows the net increase or decrease in cash for the period. Generally, cash flow statements are divided into three main parts. Each part reviews the cash flow from one of three types of activities: (1) operating activities; (2) investing activities; and (3) financing activities.

Operating Activities

The first part of a cash flow statement analyzes the Association’s cash flow from net income or losses. For most Associations, this section of the cash flow statement reconciles the net income (as shown on the income statement) to the actual cash the company received from or used in its operating activities. To do this, it adjusts net income for any non-cash items (such as adding back depreciation expenses) and adjusts for any cash that was used or provided by other operating assets and liabilities.

Investing Activities

The second part of a cash flow statement shows the cash flow from all investing activities, which generally include purchases or sales of long-term assets, such as investment securities. If the Association decided to sell off some investments from an investment portfolio, the proceeds from the sales would show up as a cash inflow from investing activities because it provided cash.

Financing Activities

The third part of a cash flow statement shows the cash flow from all financing activities. Typical sources of cash flow include cash raised by selling stocks and bonds or borrowing from banks. Likewise, paying back a bank loan would show up as a use of cash flow.

Bringing It All Together

Although this memo discusses each financial statement separately, keep in mind that they are all related. The changes in assets and liabilities that you see on the balance sheet are also reflected in the revenues and expenses that you see on the income statement, which result in the Association’s gains or losses. Cash flows provide more information about cash assets listed on a balance sheet and are related, but not equivalent, to net income shown on the income statement. And so on. No one financial statement tells the complete story. But combined, they provide very powerful information for homeowners.