

**Financial Statements 102**

Presentation to ABC of Western Washington  
May 14, 2020  
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Basic Financial Statements

- Generally Accepted Accounting Principles (GAAP)
  - Based on historical cost
- Four required financial statements
  - Balance sheet – a snapshot of a point in time
  - Income statement – performance over a period in time
  - Statement of changes in owners' equity
  - Statement of cash flows

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### Balance Sheet – What You Have and What You Owe

Reports classes and amounts of **assets**, **liabilities**, and **owners' equity**

- Fundamental accounting equation:  $assets = liabilities + owners' equity$

ASSETS		LIABILITIES	
current assets	Cash & cash equivalents	Accounts payable	current liabilities
	Marketable securities	Accrued expenses	
	Accounts receivable	Current portion of debt	
	Work-in-process	Long-term debt	
	Inventory		
	Property & equipment (gross)		
Accumulated depreciation	<b>EQUITY</b>	Stock	
Other long-term assets		Retained earnings	

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### Income Statement – What was the Score?

Provides accounting measure of revenues earned and costs incurred

Service revenue/costs	Revenue	
	Less: Cost of good sold (COGS)	
		<b>Gross Margin/Profit</b>
Overhead costs	Less: Selling, general and administrative expenses (SG&A)	
	Less: Depreciation and amortization	
	Less: Other operating expenses	
		<b>Operating Income (EBIT)</b>
+/-	Interest	
+/-	Non-operating income/expense	
		<b>Pre-Tax Income</b>
+/-	Income taxes	
		<b>NET INCOME</b>

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### Statement of Changes in Owners' Equity

Presents a "roll forward" of activity in each equity account

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total
	Shares	Amount			
<b>Balance, January 1</b>	-	\$ -	\$ -	\$ -	\$ -
Stock issuance	xxx	\$ xxx	\$ xxx	\$ -	\$ xxx
Dividends/distributions	-	\$ -	\$ -	\$ (xxx)	\$ (xxx)
Net income	-	\$ -	\$ -	\$ xxx	\$ xxx
<b>Balance, December 31</b>	-	\$ -	\$ -	\$ -	\$ -

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**Statement of Cash Flows – What Really Happened?**

Reporting of cash flows for activity found on both the balance sheet and income statement

<p><b>Operations</b></p> <ul style="list-style-type: none"> <li>+ Net income</li> <li>+ Depreciation and amortization</li> <li>+/- Other non-cash items (gains/losses)</li> <li>+/- Change in working capital accounts</li> <li>+/- <u>Change in other operating activities</u></li> </ul> <p><b>= Operating Cash Flows</b></p>	<p><b>Financing</b></p> <ul style="list-style-type: none"> <li>- Dividends/distributions</li> <li>- Payments on long-term debt</li> <li>+ Proceeds from debt issuance</li> <li>+/- <u>Stock issuance (buyback)</u></li> </ul> <p><b>= Financing Cash Flows</b></p>
<p><b>Investing</b></p> <ul style="list-style-type: none"> <li>- Net capital expenditures ("Capex")</li> <li>+/- Sale/purchase of investments</li> <li>+/- <u>Other investing activities</u></li> </ul> <p><b>= Investing Cash Flows</b></p>	<p><b>Change in Cash on Balance Sheet</b></p> <ul style="list-style-type: none"> <li>+/- Operating cash flows</li> <li>+/- Investing cash flows</li> <li>+/- Financing cash flows</li> </ul> <p><b>= Change in cash on balance sheet</b></p>

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**Notes and other material**

- Required supplement to “external financial statements”
- An integral component of the financial statements and helps tell the story
- Provides important details about the company
  - Greater depth and accounting policies for accounts noted on the financial statements
  - Critical information for items not included on the financial statements

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**Notes and other material**

- Key disclosures
  - Description of business and “reporting entity”
  - Greater detail of general asset and liability categories
  - Details on how revenue is recognized from contracts with your customers
  - Terms and maturity of credit and other long-term debt
  - Concentrations
  - Related-party activity
  - Commitments and contingencies

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Notes and other material

- Other material
  - Supplemental schedules to show additional detail for:
    - Direct costs
    - Indirect costs
    - Selling, general and administrative costs
  - Contracts in progress schedule
  - Completed contracts schedule

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Notes and other material – example; cost of revenues

<b>Direct Costs:</b>	
Subcontractors	\$ 150,000
Labor	2,400,000
Materials	340,000
Equipment	79,000
Rental equipment	171,000
Other direct costs	166,000
<b>Total Direct Costs</b>	<b>3,306,000</b>
<b>Indirect Costs:</b>	
Depreciation	50,000
Small tools	27,000
Taxes and permits	19,000
Other indirect costs	45,000
<b>Total Indirect Costs</b>	<b>141,000</b>
<b>Total Cost of Revenues Earned</b>	<b>\$ 3,447,000</b>

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Notes and other material – example; G&A expenses

<b>General and Administrative Expenses:</b>	
Salaries	\$ 350,000
Payroll taxes, fringe and medical insurance	68,000
Office expense	39,000
Repairs and maintenance	31,000
Depreciation	16,000
Professional fees	15,000
Miscellaneous	15,000
Employer 401(k) contributions	12,000
Business taxes and licenses	10,000
Insurance	9,000
Dues and subscriptions	5,000
Telephone	4,000
Business development	3,000
Utilities	3,000
Donations	2,000
<b>Total General and Administrative Expenses</b>	<b>\$ 582,000</b>

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Notes and other material

- Why Prepare a WIP Schedule?
  - Required by GAAP
  - Expected by users of financial statements
  - Provides a summary report to identify job trends, opportunities and problems.
  - Identifies cash flow and/or billing challenges
  - Identifies remaining work in terms of revenue, costs and gross profit

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Notes and other material – example; completed contract

Contract Number	Name	From inception to December 31, 2018				From inception to December 31, 2019				From inception to December 31, 2020			
		Revenue \$/K	Cost of Materials \$/K	Gross Profit \$/K	Contract Gross Profit Percentage	Revenue \$/K	Cost of Materials \$/K	Gross Profit \$/K	Contract Gross Profit Percentage	Revenue \$/K	Cost of Materials \$/K	Gross Profit \$/K	Contract Gross Profit Percentage
		\$ -	\$ -	\$ -		\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	

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Notes and other material – example; contracts in progress

Contract Number	Name	From inception to December 31, 2018					From inception to December 31, 2019					From inception to December 31, 2020				
		Contract Value	Cost to Date	Revenue to Date	Cost to Date	Revenue to Date	Contract Value	Cost to Date	Revenue to Date	Cost to Date	Revenue to Date	Contract Value	Cost to Date	Revenue to Date	Cost to Date	Revenue to Date
		\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

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CPA's role in financial statement reporting

- Base level = tax preparation and internal reporting
- Users
  - Surety bond providers
  - Banks
- Level of attestation

compilation                      review                      **AUDIT**

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CPA's role in financial statement reporting

- Expectation gap
- Compilation
  - Simply preparing the financial statements and notes
  - No assurance provided by the CPA
- Review
  - Inquiries and analytical procedures
  - "Limited assurance" provided
- Audit
  - Also includes
    - Verifying certain information with third parties; customers, banks, attorneys
    - Examination of source documents on a "test basis"
    - Study of internal controls
  - "Reasonable assurance" provided

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COVID-19

- Coronavirus, Aid, Relief and Economic Security Act (CARES)
  - Paycheck Protection Program loans
- Other resources
  - IRS website
  - SBA website
  - State of WA
  - American Institute of CPAs (search for "AICPA PPP loan")
  - Payroll providers are enabling "calculators"
  - [clarknuber.com](http://clarknuber.com)

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Paycheck Protection Program Loans

- Meet the criteria for a loan?
  - “Current economic uncertainty makes this loan application necessary to support the ongoing operations for the applicant.”
  - Certification must be made “in good faith taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”
- Decision choices:
  - Return funds by May 14
  - Keep funds, spend in approved manner (75% payroll, 25% rent, utilities, etc.) and don't apply for loan forgiveness
  - Keep funds, spend in approved manner and apply for loan forgiveness
  - Any dispute by SBA will be as a result of the forgiveness application process

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Paycheck Protection Program Loans

- What can you spend it on?
  - Payroll costs
  - Interest on mortgage that was in place as of 15-Feb-2020
  - Rent on lease that was in place as of 15-Feb-2020
  - Utility payments
- Forgiveness:
  - Forgiveness prorated based on any reduction in FTE from before pandemic and 6/30
  - Forgiveness reduced for reductions in pay > 25% for those earning less than \$100k
  - If not forgiven, continues at a 24-month loan at 1%
  - Recipients will have up to 90 days after the “covered period” (8 weeks from receipt of loan proceeds) to apply for loan forgiveness
  - Lenders are required to applicant within 60 days of application

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PPP Loans – advice going forward

- Congressional intent v. rules from US Treasury
  - Accrual or cash basis?
  - Deductibility of expenses
- PPP loan proceeds
  - Document why you needed it
  - Document how you are spending it
  - Keep funds in a separate bank account and transfer only the specific amount needed when you spend it
- SBA FAQs are getting updated, keep checking back
- Make a few hours a week to understand how things are moving and what you need to do (or make sure someone does)
- Talk to your CPA
- Talk to your bank

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ANY QUESTIONS?

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