# Financial Statements 102

Bonding Education & Government Contracting
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- Financial statement components
- Notes and other material
- CPA reports on financial statements
- COVID-19 Relief Programs



#### **Basic Financial Statements**

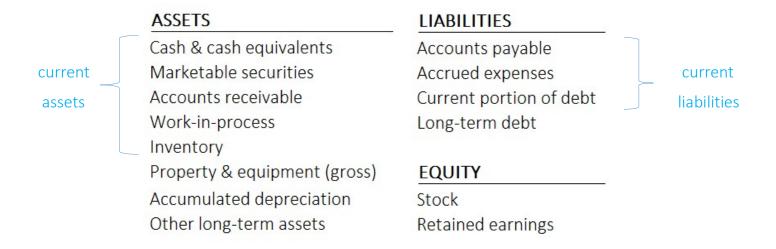
- Generally Accepted Accounting Principles (GAAP)
  - Based on historical cost
- Four required financial statements
  - Balance sheet a snapshot of a point in time
  - Income statement performance over a period in time
  - Statement of changes in owners' equity
  - Statement of cash flows



#### 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





### Income Statement – What was the Score?

# Provides accounting measure of revenues earned and costs incurred

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







# Statement of Changes in Owners' Equity

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

	Common .					
	Shares	Amount	 dditional Paid-in Capital		Retained Earnings	 Total
Balance, January 1	-	\$ -	\$ -	\$	-	\$ -
Stock issuance	xxx	\$ xxx	\$ XXX	\$	-	\$ xxx
Dividends/distributions	-	\$ -	\$ -	\$	(xxx)	\$ (xxx)
Net income		\$ 	\$ 	\$	XXX	\$ XXX
Balance, December 31		\$ -	\$ _	\$	-	\$ -



# Statement of Cash Flows – What Really Happened?

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

<u>Operations</u>	<u>Financing</u>
+ Net income	- Dividends/distributions
+ Depreciation and amortization	- Payments on long-term debt
+/- Other non-cash items (gains/losses)	+ Proceeds from debt issuance
+/- Change in working capital accounts	+/- Stock issuance (buyback)
+/- Change in other operating activities	= Financing Cash Flows
= Operating Cash Flows	
- Operating cush riows	
Investing	Change in Cash on Balance Sheet
, -	Change in Cash on Balance Sheet +/- Operating cash flows
Investing	
Investing - Net capital expenditures ("Capex")	+/- Operating cash flows
<ul><li>Investing</li><li>Net capital expenditures ("Capex")</li><li>+/- Sale/purchase of investments</li></ul>	+/- Operating cash flows +/- Investing cash flows



- 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.

- 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



- 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



# Notes and other material – example; cost of revenues

Direct Costs:	21 M	
Subcontractors	\$ 150,00	0
Labor	2,400,00	0
Materials	340,00	0
Equipment	79,00	0
Rental equipment	171,00	0
Other direct costs	166,00	0
Total Direct Costs	3,306,00	0
Indirect Costs:		
Depreciation	50,00	0
Small tools	27,00	0
Taxes and permits	19,00	0
Other indirect costs	45,00	0
Total Indirect Costs	141,00	0
Total Cost of Revenues Earned	\$ 3,447,00	0



# Notes and other material – example; G&A expenses

General and Administrative Expenses:		
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	8	2,000
Total General and Administrative Expenses	\$	582,000



- 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



# Notes and other material – example; completed contract

		From Ince	ption to December 3	1, 2019		Pri	or to January 1, 20	019	From January 1 - Dece				
(1)			Cost of	Gross	Contract		Cost of	Gross		Cost of	Gross		
Contract Number		Revenues	Revenues	Profit From		Revenues	Revenues	Profit From	Revenues	Revenues	Profit From Contract		
	Name	Earned	Earned	Contract		Earned	Earned	Contracts	Earned	Earned			
		\$ -	\$ -	\$ -		\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		



# Notes and other material – example; contracts in progress

			From Inception to December 31, 2019						From Inception to December 31, 2019					For the Yea	ar Ended December	r 31, 2019
												Costs and	Billings in			
Contract				Estimated	Total				Cost of	Cross		Estimated	Excess of Costs and		Cost of	Gross
		Contract	Costs to	Costs to	Estimated	Estimated	Percent	Revenues	Revenues	Gross Profit From	Billings	Earnings in Excess of	Estimate	Revenues	Revenues	Profit From
Number	Name	Price	Date	Complete			Complete	Earned					Earnings			Contracts
		\$	\$	\$	\$	\$		\$	\$	\$	\$	\$	Ş	\$	\$	\$
						10 10										
						100										
				0												
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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** 

## 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



# CARES Act Relief Programs



## **Table of Contents**

- Paycheck Protection Program
  - Background
  - Forgiveness
  - Audit process
- Employee Retention Credit



#### COVID-19

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



## 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
- How should you account for it?
  - Debt?
  - Government grant?
  - <a href="https://www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-3200-18.pdf">https://www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-section-3200-18.pdf</a>



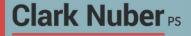
### Loan forgiveness

- Achieving maximum loan forgiveness requires the following:
  - Utilize at least 60% of the proceeds on payroll costs
  - Entire loan proceeds are spent on eligible expenses
  - Restore the number of FTE employees by the end of the covered period
  - Restore wages to employees by the end of the covered period
- FTE exceptions:
  - Government agency required closure
  - Restore FTE by the earlier of forgiveness application or December 31, 2020
  - Bona fide offers for rehire are turned down
- Key dates:
  - Forgiveness application deadline 10 months after the covered period ends
  - Lender approval 60 days from receipt of application
  - SBA approval 90 days from receipt of lender approval
- What if the full amount is not forgiven?
  - The loan is treated like any other loan and the unforgiven portion would need to be repaid on or before maturity



## SBA audit process

- Announced they will audit any loans \$2M or greater
  - They reserve the right to audit any loan under at their discretion
- Document retention need to have documents for six years after the date the loan is (a) forgiven, or (b) paid in full.
- What will be audited?
  - Eligibility current economic uncertainty makes the loan request necessary to support the ongoing operations.
    - Any borrower with a loan less than \$2M is deemed to meet this standard
  - Loan amount
  - Use of proceeds
  - Loan forgiveness calculation



# **PPP Summary**

- Congressional intent v. rules from US Treasury
  - 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



## Employee Retention Credit

- Another mechanism to provide relief for businesses experiencing a decline in revenues.
- Originally, only allowed to do PPP or ERC
- Rules recently changed to allow both
- Eligibility:
  - Wages paid to retain non-working employees
  - Decline of more than 50% in gross receipts in 2020 from the same quarter in 2019 (20% in 2021 from the same quarter in 2020)
  - 2020 50% of wages paid to an employee, up to \$10,000 annually per employee
  - 2021 70% of wages paid to an employee, up to \$10,000 *quarterly* per employee
  - Wages can not have been reimbursed by other relief programs (e.g.; PPP)
- https://clarknuber.com/articles/changes-employee-retention-credit/



## Advice going forward

- 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 you bank





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