

# 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

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- 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:  $\text{assets} = \text{liabilities} + \text{owners' equity}$

	<u>ASSETS</u>	<u>LIABILITIES</u>	
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)	<u>EQUITY</u>	
	Accumulated depreciation	Stock	
	Other long-term assets	Retained earnings	

# 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)
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Gross Margin/Profit			
Overhead costs	{	Less:	Selling, general and administrative expenses (SG&A)
		Less:	Depreciation and amortization
		Less:	Other operating expenses
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Operating Income (EBIT)			
		+/-	Interest
		+/-	Non-operating income/expense
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Pre-Tax Income			
		+/-	Income taxes
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NET INCOME			

## EBITDA

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# Statement of Changes in Owners' Equity

Presents a “roll forward” of activity in each equity account

	<u>Common Stock</u>				<u>Additional Paid-in Capital</u>		<u>Retained Earnings</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>							
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

## Operations

+ Net income  
+ Depreciation and amortization  
+/- Other non-cash items (gains/losses)  
+/- Change in working capital accounts  
+/- Change in other operating activities  
**= *Operating Cash Flows***

## Financing

- Dividends/distributions  
- Payments on long-term debt  
+ Proceeds from debt issuance  
+/- Stock issuance (buyback)  
**= *Financing Cash Flows***

## Investing

- Net capital expenditures (“Capex”)  
+/- Sale/purchase of investments  
+/- Other investing activities  
**= *Investing Cash Flows***

## Change in Cash on Balance Sheet

+/- Operating cash flows  
+/- Investing cash flows  
+/- Financing cash flows  
**= *Change in cash on balance sheet***



## Notes and other material

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- 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

## Notes and other material

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- 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

## Notes and other material

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- 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

<b>Direct Costs:</b>	
Subcontractors	\$ 150,000
Labor	2,400,000
Materials	340,000
Equipment	79,000
Rental equipment	171,000
Other direct costs	<u>166,000</u>
<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	<u>45,000</u>
<b>Total Indirect Costs</b>	<b><u>141,000</u></b>
<b>Total Cost of Revenues Earned</b>	<b><u>\$ 3,447,000</u></b>

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

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### **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	2,000
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<b>Total General and Administrative Expenses</b>	<b>\$ 582,000</b>

- 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

[illegible]

Notes and other material – example; contracts in progress

[illegible]



## CPA's role in financial statement reporting

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- 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

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- 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

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

## COVID-19

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- 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](https://clarknuber.com)

# Paycheck Protection Program Loans

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- 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?
  - <https://www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-3200-18.pdf>

# Loan forgiveness

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- 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

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- 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

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- 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

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- 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

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- 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

ANY  
QUESTIONS  
?

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