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Accounting and Finance Update

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Annual Construction Conference
December 15, 2020

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Outline

1. Accounting Update
2. PPP Accounting and Forgiveness

1. ACCOUNTING UPDATE

Extension of Leasing and Rev Rec

- In June of 2020, the FASB issued ASU 2020-05, *Revenue from Contracts with Customers and Leases: Effective Dates for Certain Entities (Private and NPO's)*

- Extends revenue recognition and Leasing standard required implementation by one year.

- ASC 606 – *Revenue from Contracts with Customers* now required to be implemented for annual years beginning after **December 15, 2019** (**2020**).

- ASC 842 – *Leases* now required to be implemented for annual years beginning after **December 15, 2021** (**2022**).

Revenue Recognition

Core Principle

- An entity shall recognize revenue to depict the **transfer** of goods or services to the customer in an amount that reflects the consideration the entity receives, or expects to receive, in exchange for those goods or services provided.

Revenue Recognition

Five steps to apply the core principle:

1. Identify the contract(s) with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfied a performance obligation.

Revenue Recognition – Observations

- We have now implemented the standard for a wide variety of clients.
- Largely resulted in many new disclosures, very few adjustments.
  - But you can't assume there is no impact, you must document that the standard has no effect.
- The most significant change effects contracts that have large upfront costs before any product or service is transferred to the customer. Mobilization on heavy highway contracts, tooling that is not charged to the customer. We also found some costs that were inventory, rather than construction costs at year end. Lighting fixtures purchased but not installed.

Leases

ASU 2016-02 – Leases

- Issued on February 25, 2016.
- All leases will be capitalized. It is estimated that $2 trillion in liabilities will be added to balance sheets when the standard becomes effective!
- Must be adopted retrospective to the beginning of the earliest year presented in the financial statements.
- The **only exception is for leases of 12 months or less**, these leases can still be expensed.

Lessees

Lease Classification for Lessees

- Two approaches based on the "lease classification test."
  - ✓ Approach A – Financing Type (Current "Capital Lease")
  - ✓ Approach B – Operating Type

The only difference is how you charge the lease asset and payments to operations.

Lessees

Approach A – Financing Type (Capitalized)

- Separately reflected in P&L.
- Present value the lease liability with interest expense.
- Amortize right of use asset on a straight line basis.
- Variable lease payments incurred after commencement are operating expense.
- Shorter of the estimated lease term or underlying asset's useful life.
- If significant economic incentive to exercise a purchase option, amortize asset to end of useful life of underlying asset.

Lessees

Approach A – Financing Type (Capitalized)

	Year 1	Year 2	Year 3	Year 4	Total
Interest Expense	$ 28,911	$ 23,773	$ 17,541	$ 9,775	$ 80,000
Amortization Expense	105,000	105,000	105,000	105,000	420,000
Total	$ 133,911	$ 128,773	$ 122,541	$ 114,775	$ 500,000

Lessees

Approach B – Operating Type, Straight-line Approach.

- For all leases **not** meeting the Financing criteria above.
- Depreciate the "right-of-use" asset each period as a balancing figure such that the total lease expense would be recognized on a straight-line basis regardless of timing of lease payments.
- Recognize lease expense **as a single cost in the income statement.**
- Combine effective interest on lease liability with amortization of ROU asset so that the remaining cost of lease is allocated over remaining lease term equally on a straight-line basis.

Lessees

Approach B – Operating Type, Straight-line Approach.

	Year 1	Year 2	Year 3	Year 4	Total
Interest Component	$ 28,911	$ 23,773	$ 17,541	$ 9,775	$ 80,000
Amortization Component	96,089	101,227	107,459	115,225	420,000
Total Lease Expense	$ 125,000	$ 125,000	$ 125,000	$ 125,000	$ 500,000

What have we learned from Public Company Implementation?

- **Start Early**
  - Many have reported that implementation was more challenging and required larger cross-sectional effort than expected.
- **Review Agreements and Lease Inventory**
  - Identification of the population of leases and review of all lease agreements was consistently noted as a challenging aspect of implementation.
- **Accounting Software Selection**
  - Testing of your current accounting system is critical to identify its ability to handle the new reporting requirements. Do you need to invest in new software?
- **Accountant Communication**
  - Communicate early with your auditor or accountant in order to understand their process of auditing or reviewing the leasing activity and financial statement disclosures.

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2. Paycheck Protection Program

Paycheck Protection Program (PPP)

- Overview -

- SBA unsecured loan program with potential for 100% forgiveness made available through the CARES Act.
- Total funding made available:
  - First Round - $349 Billion (Began April 3, 2020).
  - Second Round - Additional $320 Billion (Began April 27, 2020, closed August 8, 2020).
- Available to small businesses & non-profits (Under 500 employees).
- Business owners had to certify economic need.

Paycheck Protection Program (PPP)

- Overview -

- Maximum loan size was $10,000,000, required to be disbursed within 10 days of loan approval.
- Loan amount was determined based on average monthly “payroll costs” multiplied by 2.5.
- Payroll costs include:
  - Compensation paid to employees (salary, wages, commissions - capped at $100,000 annualized per employee)
  - Payment for vacation, parental, family, medical, or sick leave
  - Payment for the provision of employee benefits (group health care and retirement)
  - State and local taxes assessed on compensation

Paycheck Protection Program (PPP)

- Overview -

- Several issues led to mass confusion and delays in application!
  - What time period is used to calculate average payroll?
  - Are employer paid FICA taxes considered a “payroll cost”?
  - How is the $100,000 compensation cap figured?
  - How do sole proprietors and owners of pass-through entities determine compensation if there is no set salary?
  - How is the 500 employee threshold determined?
  - How is economic need determined?
- U.S. Treasury issued FAQ’s with answers addressing many of these questions.

home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf

Paycheck Protection Program (PPP)

- Statistics -

- **Round one (4/3/20 – 4/16/20)**
  - Loan count: 1,661,367 loans
  - Net approved dollars: $342,277,999,103
  - Average loan size: $206,022
  - NYS: 81,075 loans; $20,345,681,101 ($250,949 average)
- **Total Program (through 8/8/20)**
  - Loan count: 5,212,128 loans
  - Net approved dollars: $525,012,201,124
  - Average loan size: $100,729
  - NYS: 348,870 loans; $38,699,947,686 ($110,929 average)

PPP Loan Initial Accounting

- **So, you received the money, now what??**
  - Our recommendation – Segregate those funds.
    - Separate bank account; or
    - Separate general ledger account
  - Initial accounting should be:
    - Debit: Cash $XXX,XXX
    - Credit: PPP Loan (Debt) $XXX,XXX
  - Continue to record expenses as you have in the past.
  - Move PPP funds out of segregated cash account and into operating cash account as needed for eligible expenses.

PPP Loan Forgiveness

- **How is forgiveness amount determined?**
  - The loan may be forgiven partially, or in whole, based on usage of loan proceeds for eligible expenses over the "Covered Period."
  - The Covered Period is either:
    - (1) the 24-week (168-day) period beginning on the PPP loan disbursement date; or
    - (2) if the borrower received its PPP loan before June 5, 2020, the borrower may elect to use an eight-week (56-day) Covered Period.
  - Eligible expenses for loan forgiveness include:
    - Payroll costs, as defined above (at least **60%** of total forgiveness amount); and
    - Nonpayroll costs (up to **40%** of total forgiveness amount)
      - Interest on business mortgage obligations (personal or real property loans originating prior to February 15, 2020);
      - Business rent or lease payments in force prior to February 15,2020; and
      - Business utility payments for services that began before February 15,2020, including electricity, gas, water, transportation, telephone, or internet access.

PPP Loan Forgiveness

- Forgivable amount will be reduced if during the Covered Period when compared to the applicable reference period there is a:

  1) Reduction in Average Full-Time Equivalency (FTE)

     - FTEs are calculated one of two ways (may only use one method)
       - For each qualifying employee, divide # of hours per week by 40; or
       - Use 0.5 for every employee that works less than 40 hours/week.
     - Reduction quotient determined by dividing average monthly FTEs for covered period by the average weekly FTE's for the chosen applicable reference period (either (i) February 15, 2019 to June 30, 2019, or (ii) January 1, 2020 to February 29, 2020).

  2) Reduction in average annual salary/wage for any employee of greater than 25%

     - Applicable reference period is January 1, 2020 to March 31, 2020.
     - Amount in excess of 25% is a dollar for dollar reduction in forgiveness amount.

PPP Loan Forgiveness

- **Reduction Safe Harbors and Exceptions**

1) Safe Harbor #1 (FTE Reductions)

    - For Borrowers that are unable to return to the same level of business activity prior to February 15, 2020, due to compliance with requirements/guidance between March 1, 2020 and December 31, 2020 from:
        - CDC
        - Secretary of Health and Human Services
        - OSHA

2) Safe Harbor #2 (FTE Reductions)

    - If the Borrower reduced its FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and
    - The Borrower then restored its FTE employee levels by not later than December 31, 2020 to its FTE employee levels in the Borrower's pay period that included February 15, 2020.

PPP Loan Forgiveness

- **Reduction Safe Harbors and Exceptions**

  1) Six exceptions to reduction. For any employees during the Covered Period:

     1. The Borrower made a good-faith, written offer to rehire an employee, which was rejected by the employee;
     2. Were fired for cause;
     3. Voluntarily resigned;
     4. Voluntarily requested and received a reduction of their hours;
     5. Borrower made a good faith, written offer to restore any reduction in hours at the same salary or wages, but the employee rejected; and
     6. Borrower was unable to hire similarly qualified employees for unfilled positions by December 31, 2020.

–These scenarios will not result in a reduction in loan forgiveness.

PPP Loan Forgiveness

- **Forgiveness Application Process**
  - Three different applications:
    1. 3508 (Full application);
    2. 3508EZ – Only for the following borrowers:
       a) Self employed and have no employees;
       b) Did not reduce the salaries or wages of their employees by more than 25%, and did not reduce the number or hours of their employees; or
       c) Experienced reductions in business activity as a result of health directives related to Covid-19 and did not reduce the salaries or wages of their employees by more than 25%.
    3. 3508S – Only for the following borrowers:
       a) Received a PPP Loan of $50,000 or less.

PPP Loan Forgiveness

- **Forgiveness Application Process**
  - Documentation to submit with the application:

1. Bank statements supporting cash wages paid;
2. Payroll reports;
3. Payroll Tax filings;
4. Payment receipts, cancelled checks, or account for employer contributions to employee health insurance and retirement plans;
5. Documentation supporting FTE calculations;
6. Loan and lease agreements supporting existence prior to 2/15/20;
7. Amortization schedules, account statements supporting interest payments on business mortgages during Covered Period;
8. Invoices, cancelled checks, account statements supporting business rent and utility payments made during Covered Period; and
9. Other documentation must be maintained, but not submitted.

PPP Loan Forgiveness

- **Forgiveness Application Process**
  - Once submitted to the lender, lenders have **60 days** to review your application and submit their decision to the SBA.
  - SBA then has **90 days** to evaluate your application.
  - If application is submitted within **10 months** after the end of the Covered Period, the borrower is <u>not required</u> to make any payments until the forgiveness amount is remitted to the lender by SBA.
  - If the loan is fully forgiven, the borrower is not responsible for any repayments.
  - Any portion that is not forgiven is subject to repayment with 1% interest
    - 2-year term for loans originated prior to June 5, 2020 (can request extension to 5 years)
    - At least a 5-year term for loans originated on June 5, 2020, or later

PPP Loan Forgiveness - Accounting

- **How to Account for Forgiveness**
  - The amount of the forgiveness should be brought into income, generally recorded as "Other income" in financial statements.
    - Debit: PPP Loan (Debt) $XXX,XXX
    - Credit: Other Income $XXX,XXX
  - Consider using the title **"PPP Loan Forgiveness"** or something similar in your financials.
  - *But **<u>WHEN</u>**?*
  - Two potential sources of conflicting guidance:
    - FASB ASC Topic 470, *Debt*
    - IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*
  - SEC has indicated it would not object to an SEC registrant accounting for a PPP loan under either standard.

PPP Loan Forgiveness - Accounting

- **How to Account for Forgiveness**

  – FASB ASC Topic 470, *Debt*

  - Initially record the cash inflow from the PPP loan as a financial liability and accrue interest.
  - Do not impute additional interest at a market rate.
  - Continue to record the proceeds from the loan as a liability until either:
    - (1) the loan is partly or wholly forgiven, and the debtor has been legally released; or
    - (2) the debtor pays off the loan.
  - Reduce the liability by the amount forgiven and record a gain on extinguishment **once the loan is partly or wholly forgiven and legal release is received**.

PPP Loan Forgiveness - Accounting

- **How to Account for Forgiveness**
  - IAS 20, Accounting for Government Grants and Disclosure of Government Assistance
    - Nongovernmental entity that is not an NFP (a business entity):
      - Expects to meet the PPP's eligibility criteria; and
      - Concludes that the PPP loan represents a grant that is expected to be forgiven; then
      - It may analogize to IAS 20 to account for the PPP loan.
    - Once there is **reasonable assurance** that conditions for forgiveness will be met:
      - ***Income can be recognized*** **systematically in the same period as related costs**.

PPP Loan Forgiveness - Accounting

- **How to Account for Forgiveness**
  – Other considerations
    - Tax treatment of related expenses
      - Deferred taxes (C-Corp.)
    - Subsequent events
      - Non-calendar year end companies –
        - Have you satisfied ALL conditions for forgiveness?
        - Can you be reasonably certain that forgiveness will occur?
        - Would you benefit from waiting to recognize revenue?
      - Application submitted prior to year end, but not approved until after year end?

Questions

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