Fall 2020

CONSTRUCTION INDUSTRY ADVISOR

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Asking for forgiveness?

Contractors should handle PPP loans with care

Many construction companies have taken advantage of the Paycheck Protection Program (PPP) during the COVID-19 pandemic. Established under the CARES Act, the PPP provided eligible businesses with loans — guaranteed by the Small Business Administration (SBA) — to help cover payroll and other costs.

Recipients of PPP loans may also qualify for debt forgiveness if they meet certain requirements and submit a timely application with their lenders. The rules regarding eligibility for forgiveness are complex, so if you plan to apply it's a good idea to ask your professional advisors to guide you through the process.

Eligibility details

To qualify for loan forgiveness, borrowers must spend PPP funds on eligible expenses within 24 weeks (but no later than December 31, 2020). Originally, this "covered period" was only eight weeks, but it was extended by the PPP Flexibility Act (PPPFA) for loans received on June 5, 2020, or later. Borrowers that received loans before that date were given the option to choose between up to a 24-week or eight-week covered period.

Eligible expenses include payroll costs, rent, mortgage interest and utilities. To qualify for full forgiveness of the PPP loan amount, however, at least 60% of the borrowed funds must be used for payroll. (Originally, the threshold was 75%, but it was reduced to 60% under the PPPFA.)

According to SBA guidance, borrowers that spend less than 60% of the loan funds on payroll may apply for partial loan forgiveness, so long as 60% of the amount forgiven is spent on payroll. For example, a borrower that received a $150,000 PPP loan and spent $60,000 on payroll would be eligible for forgiveness on $100,000 of the loan.

Another requirement for loan forgiveness is that borrowers maintain their payrolls at pre-pandemic levels. After all, the PPP was intended as an incentive for small businesses to keep their workers on the payroll.

If your construction company reduced wages or its number of full-time equivalent employees (FTEEs) after February 15, 2020, your eligibility for loan forgiveness may be reduced or eliminated unless you restore wages and headcounts to previous levels by the earlier of the date of the forgiveness application or the end of the year. (This "restoration date" was changed from June 30 by the PPPFA.)

The tax considerations of loan forgiveness

The CARES Act provides that forgiveness of a Paycheck Protection Program (PPP) loan isn't included in the borrower's gross income for tax purposes. However, in Notice 2020-32, the IRS ruled that borrowers may not deduct otherwise deductible expenses allocable to forgiven loan proceeds. The agency cited Internal Revenue Code Section 265, which disallows deductions for expenses related to tax-exempt income.

This ruling effectively erases the benefits of avoiding tax on the amount of loan forgiveness. In addition, the loss of these deductions may reduce the benefit of other tax breaks tied to payroll or taxable income levels. Several prominent organizations, including the American Institute of Certified Public Accountants, have urged Congress to overrule Notice 2020-32, arguing that it's inconsistent with the intent of the CARES Act. As of this writing, whether Congress will do so remains to be seen.

There are also "safe harbors" and exceptions that can help a company avoid or reduce the FTEE or wage rate forgiveness reductions. These may apply if the borrower is 1) unable to rehire former employees or hire qualified replacements by the deadline, or 2) unable to return to its previous level of business because of COVID-19-related governmental guidelines.

SBA guidance

In August, the SBA, in consultation with the U.S. Treasury Department, published Frequently Asked Questions (FAQs) about forgiveness of PPP loans. The FAQs provide welcome guidance on the forgiveness application process. Here are some of the highlights:

Processing period. So long as you submit a forgiveness application within 10 months after the covered period ends, you need not make any loan payments until the forgiveness amount is determined or the application is denied. Accrued interest will be due on any portion of the loan that isn't forgiven.

Eligible payroll. Payroll costs incurred during the covered period but paid after the period ends are eligible for forgiveness, provided they're paid by the next regular payroll date after the period ends. Payroll costs incurred before the covered period but paid during that period are also eligible. Forgivable cash compensation is limited to $100,000 per employee on an annualized basis (that is, $1,923 per week times the number of weeks in the covered period).

Eligible nonpayroll. Like payroll costs, nonpayroll costs incurred during the covered period but paid after the period ends are eligible for forgiveness, provided they're paid by the next regular billing date. Nonpayroll costs incurred before the covered period but paid during that period are also eligible.

Owner compensation. Forgiveness may be available for compensation paid to owners, but it's subject to limits that vary depending on the business entity type and applicable covered period. In addition, payroll for owner-employees and self-employed individuals is capped at $20,833 across all businesses in which they have interests ($15,385 if an eight-week covered period is used).

The FAQs also provide guidance on the treatment of noncash compensation, reductions in forgiveness for businesses that reduce wages or headcounts, and several other issues.

Be prepared

If your construction business received a PPP loan, be sure to look closely into which expenses are eligible for loan forgiveness. To ensure a successful application, document these expenses carefully and ask your CPA for assistance in making sure everything is in order. ■

Accurate job schedules add value to financial reporting

When many contractors read the term "financial reporting," they may naturally think of their financial statements. However, another important aspect of financial reporting is the regular and consistent handling of job schedules. Careful and detail-oriented accounting work is necessary to keep yours as timely and accurate as possible.

3 typical schedules

There are generally three supporting schedules used in association with a construction company's financial statements:

1. Contracts Completed. On this job schedule, a construction company tracks its jobs completed during the statement year. To ensure consistent financial reporting, only those revenues attributed to the current year on this schedule should appear in your company's income statement as revenues for the current year.

The key to success here is strong internal processes that ensure that job schedules are reconciled monthly to the general ledger.

The Contracts Completed schedule needs to specify jobs that spanned more than a year and that were completed during the current year. To do this, a middle portion of the schedule shows revenues and costs that were already recognized in previous years' financial statements for projects completed in the current year.

2. Contracts in Progress. This job schedule lists all jobs in progress at the end of the year, regardless of whether they started during the year or in earlier years. Among the key features of the Contracts in Progress schedule is the portion that lists the revenues, costs, gross profit, billings to date and other data points for each project since its inception.

This is significant because the "costs and estimated earnings in excess of billings" and "billings in excess of costs and estimated earnings" columns reflect whether a project is over- or underbilled. Furthermore, the Contracts in Progress schedule can be used to verify the percentage-of-completion calculations on each job by taking the total costs incurred to date on each project and dividing by the estimated total costs on the project.

3. Earnings from Contracts. This schedule separately reports earnings, costs and gross profit from contracts completed during the year and from contracts in progress at the end of the year. Think of it as a reconciliation tool that summarizes revenues, costs and gross profit from the Contracts Completed and Contracts in Progress job schedules to verify and support the totals as displayed on your construction company's income statement. Specifically, the earnings, costs and gross profit numbers on it should add up to the total gross revenues, cost of revenues earned and gross profit on your income statement.

Why they matter

As you're likely aware, job schedules are instrumental for bonding purposes. Sureties need to be comfortable that a construction company's management has reasonable and accurate estimating abilities. They don't like to see significant profit fade or gain, and substantial costs in excess of billed amounts are typically regarded as red flags that will raise questions and could jeopardize your bonding capacity.

The key to success here is strong internal processes that ensure that job schedules are reconciled monthly to the general ledger. It's also important to maintain supporting job reports using up-to-date job costing software.

Naturally, job schedules are only worthwhile if the information on them is accurate. So, establishing additional procedures — such as monthly meetings with project managers — is a good way to ensure captured information is indeed accurate and reasonable. Job schedules are estimate-driven; if project managers aren't providing realistic data to your accounting department or system, these job schedules won't portray the end results ultimately realized on completion.

In addition, there are ways to sort information on job schedules by project size and type, geographic location, and project manager. Doing so can give ownership and management better insight into which jobs are most profitable for your construction company. You'll also be able to see which project managers tend to run jobs more profitably than others.

Every detail matters

Given the changes to the U.S. economy this year, and the ongoing challenges to the construction industry, it's never been more important to closely monitor every detail of your construction company's financials. Your CPA can help you refine your approach to job schedules specifically and financial reporting as a whole. ■

Boost cash flow with savvy accounts payable strategies

Managing accounts payable is a critical task for any business, but it's particularly important for construction companies. Most contractors juggle payments to a variety of subcontractors, suppliers and other entities. (We'll refer to them collectively as "vendors.") And the players involved may differ from job to job, depending on location and other factors.

As a back-office function, accounts payable don't always get the attention they deserve, but they can have a significant impact on your cash flow and bottom line. Following are some tips and best practices for improving the process.

Be strategic

Too often, contractors take a reactive approach to payables, simply delaying payments as long as possible to improve short-term cash flow. This approach can backfire, however, if it damages relations with vendors.

Poor vendor relationships can affect delivery times, quality of services and payment terms. A proactive, strategic approach to payables can help you strike a balance between optimizing short-term cash flow and getting along well with vendors.

It's also critical to explore the potential benefits of early payment discounts, volume discounts or other incentives that can improve your cash flow and bottom line. That's not to say that you should accept every available discount. Whether you should do so depends on whether your cash flow is strong enough so that the payments and the benefits of the discount truly outweigh the costs.

Strengthen selection and review

Implement policies, procedures and systems to ensure that you properly vet vendors and negotiate the best possible prices and payment terms. Create preferred vendor lists so staff members follow established procedures and don't engage in "maverick" buying (that is, buying from unauthorized vendors).

Automation can provide greater visibility of payables and better control over payments.

It's also important to review vendor contracts regularly and to maintain a database of key contractual terms that's readily accessible to everyone. With an understanding of payment terms and other important contractual provisions, employees can double check vendor compliance and avoid errors (or fraud) that can result in overpayments or duplicate payments.

Leverage technology

Automating the accounts payable process offers many benefits. For one thing, an automated, paperless system can significantly increase efficiency, reduce costs and shorten the time it takes to process invoices.

And, of course, the ability to pay invoices more quickly makes it easier to take advantage of available discounts. (Keep in mind, however, that the viability of a paperless environment depends on the ability and willingness of vendors to accept electronic payments.)

In addition, automation can provide greater visibility of payables and better control over payments. For example, cloud-based systems provide immediate access to account information, allowing you to review and approve invoices from anywhere at any time. The best automated systems also contain security controls that help prevent and detect fraud and errors.

Naturally, there's an upfront cost to buying good accounts payable software and training your staff to use it. You'll need to find a solution that suits your construction company's size, needs and technological sophistication. You'll also incur ongoing costs to maintain the system and keep it updated.

Pay attention to payables

Don't underestimate the impact of accounts payable on your financial performance. A proactive, strategic approach to payables management can help your construction business improve its cash flow and profitability. ■

Qualified opportunity zone deadline extended

The federal government created qualified opportunity zones (QOZs) in 2017 under the Tax Cuts and Jobs Act. By providing valuable tax incentives for investors in QOZs, the government seeks "to spur economic development and job creation in distressed communities," according to the IRS.

Some of the jobs created will be in construction, as investors develop properties within a QOZ and building projects come online. Recently, the federal government extended an important deadline related to QOZs.

Pandemic's impact

Significant tax breaks are available to investors who realize capital gains on the sale of real estate or other assets and reinvest the proceeds in a QOZ through a qualified opportunity fund (QOF). These funds allow investors who have realized capital gains on other assets to reinvest the proceeds in a QOF and defer tax on those gains until the end of 2026 or the date they sell their QOF investments, whichever comes first.

Ordinarily, investors must place the proceeds in a QOF within 180 days after the sale. Unfortunately, for many investors who recognized gains in late 2019 and early 2020, the COVID-19 pandemic's impact on the economy made it difficult to meet this requirement.

To provide some relief, the IRS extended the deadline. Investors otherwise eligible to reinvest capital gains in a QOF now have until the end of 2020 to do so, provided the deadline otherwise would have fallen between April 1, 2020, and December 31, 2020.

Project ramifications

The deadline extension may result in new QOZ construction projects. However, be aware that the rules impose tight deadlines on investors, who may in turn put pressure on their contractors to complete projects quickly.

For example, tax breaks may be available for investors in buildings located in a QOZ, provided the buildings:

- Are new or under construction when purchased,
- Have been vacant for an uninterrupted period of five years or more when purchased, or
- Are substantially improved.

A "substantial improvement" is one that more than doubles the building's adjusted basis (excluding land) within 30 months after it's acquired.

Due diligence needed

If you're thinking about submitting a bid on a substantial improvement project in a QOZ, be sure to do your due diligence. Evaluate whether required timelines are realistic, identify potential issues that may delay the project or increase your costs, and be sure appropriate protections are in the contract if your bid is accepted. Your CPA can help you assess the financial risks. ■