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THE HOFFMAN GROUP
Certified Public Accountants & Consultants

Forecasting for the Year

Forecasting your company's financial statements can help keep your business on solid financial footing

Planning for what lies ahead is an important part of running a healthy business. Forecasting your company's financial statements can help you manage inventory and other working capital accounts, offer competitive prices, identify impending cash flow shortages and keep your business on solid financial footing.

No forecast will be 100% accurate, especially during these uncertain times. However, answering the following questions can help make your predictions more relevant.

How far into the future do you plan to forecast?

Forecasting is generally more accurate in the short term — the longer the time period, the more likely it is that customer demand or market trends will change. While quantitative methods, which rely on historical data, are typically the most accurate forecasting methods, they don't work well for long-term predictions or when market conditions change. If you're planning to forecast over several years, try qualitative forecasting methods, which rely on expert opinions instead of company-specific data.

How steady is your demand?

Weather, sales promotions and other factors can cause sales to fluctuate. For example, if you operate an ice cream truck, chances are good your sales dip in the winter. If demand for your products varies, consider forecasting with a quantitative method, such as time-series decomposition, which examines historical data and allows you to adjust for market trends, seasonal trends and business cycles. You also may want to adopt forecasting software, which allows you to plug other variables into the equation, such as individual customers' short-term buying plans.

How much data do you have?

Quantitative forecasting techniques require varying amounts of historical information. For instance, you'll need about three years of data to use exponential smoothing, a simple yet fairly accurate method that compares historical averages with current demand. If you want to forecast for something you don't have data for,

such as a new product, you'll need to either use qualitative forecasting or base your forecast on historical data for a similar product in your arsenal.

How do you fill your orders?

If your business uses "push" production methods (such as a factory that makes and stores large quantities of standard products) rather than "pull" methods (such as a retailer that takes custom orders), forecasting is particularly critical for establishing accurate inventory levels and improving cash flow. For peak accuracy, take the average of multiple forecasting methods. To optimize inventory levels, consider forecasting demand by individual products as well as at the local warehouse level, which will help you ensure speedy delivery.

How many types of products do you sell?

If you're forecasting demand for a wide variety of products, consider a relatively simple technique, such as exponential smoothing. If you offer only one or two key products, it's probably worth your time and effort to perform a more complex, time-consuming forecast for each one, such as a statistical regression.

New year, new forecast

The right forecasting techniques will help you predict your company's future with much more accuracy. We can help you establish the forecasting practices that make sense for your business.

Accounting for Property, Plant and Equipment Assets

Here's a refresher on how to properly report these assets under U.S. GAAP

Businesses and not-for-profit entities capitalize machines, furniture, buildings, and other property, plant and equipment (PPE) assets on their balance sheets. Here's a refresher on some common questions about how to properly report these long-lived assets under U.S. Generally Accepted Accounting Principles (GAAP).

What's included in book value?

PPE is reported on the balance sheet at historical cost. This includes the amount of cash or cash equivalents paid for an asset. Historical cost also may include costs to relocate the asset and bring it to working condition. Examples of capitalized costs include the initial purchase price, sales tax, shipping and installation costs.

Costs incurred during an asset's construction or acquisition that can be directly traced to preparing the asset for service also should be capitalized. In addition, costs incurred to replace PPE or enhance its productivity must be capitalized. However, repairs and maintenance costs may be expensed as incurred.

GAAP doesn't prescribe a dollar threshold for when to capitalize an asset. But, for simplicity, management may set a capitalization threshold as long as it doesn't materially affect the financial statements. PPE below that threshold may be written off as incurred.

How long is the useful life?

Useful life is the period over which the asset is expected to contribute directly or indirectly to future cash flow. When estimating the useful life of an asset, management should consider all relevant facts and circumstances, such as:

- The asset's expected use,
- Any legal or contractual time constraints,
- The entity's historical experience with similar assets, and
- Obsolescence or other economic factors.

What's the right depreciation method?

Depreciation is meant to allocate the cost of an asset (less any salvage value) over the period it's in use. GAAP provides the following four depreciation methods:

1. Straight-line,
2. Sum-of-the-years-digits,
3. Units-of-production, and
4. Declining-balance.

IRS prescribes specific recovery periods for different categories of PPE and provides accelerated depreciation methods.

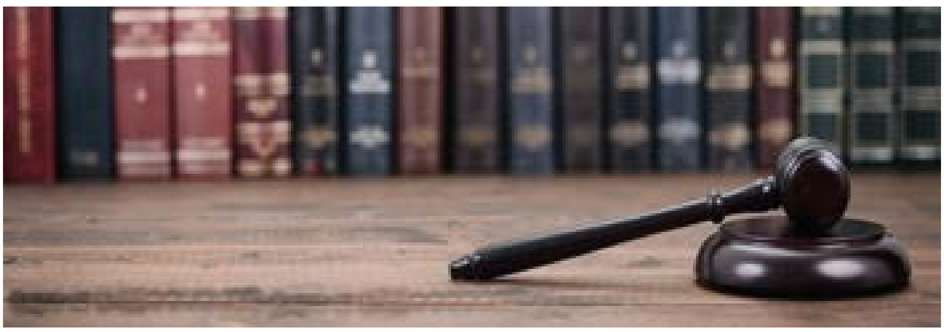
Under current tax law, instead of using the standard Modified Accelerated Cost Recovery System (MACRS) depreciation method, certain entities currently may choose to immediately deduct a qualified PPE purchase under Section 179 or the bonus depreciation program, thus minimizing taxable income in the years the asset is placed in service. The use of these accelerated depreciation methods may create a large spread between the value of PPE on the balance sheets and the assets' fair market values.

For more information

Reporting PPE is a gray area in financial reporting that relies on subjective estimates and judgment calls by management. We can help you report these assets in a reliable, cost-effective manner.

Tax Consequences of PPP Loans

Expenses paid for with forgiven PPP loan funds are now tax deductible



The Small Business Administration (SBA) announced that the Paycheck Protection Program (PPP) reopened the week of January 11. If you're fortunate to get a PPP loan to help during the COVID-19 crisis (or you received one last year), you may wonder about the tax consequences.

Background on the loans

In March of 2020, the CARES Act became law. It authorized the SBA to make loans to qualified businesses under certain circumstances. The law established the PPP, which provided up to 24 weeks of cash-flow assistance through 100% federally guaranteed loans to eligible recipients. Taxpayers could apply to have the loans forgiven to the extent their proceeds were used to maintain payroll during the COVID-19 pandemic and to cover certain other expenses.

At the end of 2020, the Consolidated Appropriations Act (CAA) was enacted to provide additional relief related to COVID-19, certain key provisions are discussed below.

Second draw loans

The CAA permits certain smaller businesses who received a PPP loan and experienced a 25% reduction in gross receipts to take a PPP second draw loan of up to $2 million.

To qualify for a second draw loan, a taxpayer must have taken out an original PPP Loan. In addition, prior PPP borrowers must now meet the following conditions to be eligible:

- Employ no more than 300 employees per location,
- Have used or will use the full amount of their first PPP loan, and
- Demonstrate at least a 25% reduction in gross receipts in comparable quarters in 2019 and 2020.

To be eligible for full PPP loan forgiveness, a business must generally spend at least 60% of the loan proceeds on qualifying payroll costs (including certain health care plan costs) and the remaining 40% on other qualifying expenses. These include mortgage interest, rent, utilities, eligible operations expenditures, supplier costs, worker personal protective equipment and other eligible expenses to help comply with COVID-19 health and safety guidelines or equivalent state and local guidelines.

Eligible entities include for-profit businesses, certain non-profit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors and small agricultural co-operatives.

Deductibility of expenses paid by PPP loans

The CARES Act didn't address whether expenses paid with the proceeds of PPP loans could be deducted on tax returns. Last year, the IRS took the position that these expenses weren't deductible. However, the CAA provides that expenses paid from the proceeds of PPP loans are deductible.

Cancellation of debt income

Generally, when a lender reduces or cancels debt, it results in cancellation of debt (COD) income to the debtor. However, the forgiveness of PPP debt is excluded from gross income. Your tax attributes (net operating losses, credits, capital and passive activity loss carryovers, and basis) wouldn't generally be reduced on account of this exclusion.

Contact us if you have questions or if you need assistance in the PPP loan application or forgiveness process or questions on the tax implications.

Changes to the Employee Retention Credit Under the CAA

The CAA significantly expanded and modified the Employee Retention Credit, and many employers are newly eligible to claim the credit

The Consolidated Appropriations Act (CAA) made significant and beneficial changes to the Employee Retention Credit (ERC). Many companies, including those who participated in the Paycheck Protection Program (PPP), are now eligible to claim the credits for wages paid in 2020 and receive higher benefits for wages paid in 2021. **This can result in a credit of up $14,000 per employee in 2021 for employers who qualify.**

Background on the Employee Retention Credit

The 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act created a refundable Employee Retention Credit (ERC) as an incentive for employers to keep employees on their payroll despite facing economic hardship due to the COVID-19 pandemic. Under the CARES Act, an employer could not take the ERC if it also received a PPP loan.

ERC Under the CARES Act

The Employee Retention Credit was a 100% refundable tax credit for eligible employers equal to 50% of qualified wages (including health care) paid to employees after 3/12/2020 and before 1/1/2021. The maximum amount of qualified wages allowed per employee for all calendar quarters was $10,000, making the employer's maximum ERC credit per employee $5,000 for 2020.

Changes to the Employee Retention Credit Under the Consolidated Appropriations Act

The Consolidated Appropriations Act extends the employee retention credit to July 1, 2021, and makes significant modifications. For 2021, the maximum credit for employers is equal to 70% of qualified wages, including health care costs.

The amount an employer can claim for 2021 increased

to 70% per quarter. Employers may only claim qualified wages for Q1 and Q2, as the credit expires at the end of the 2nd quarter. Thus, the maximum credit an employer can claim for 2021 is $14,000 per employee.

Employer Eligibility in 2020

A business can claim the Employee Retention Credit for 2020 if they meet one of the following two requirements:

1. Business operations were either fully or partially suspended by a COVID-19 lockdown order
   or

2. For any quarter in 2020, gross receipts were less than 50% of the gross receipts for the same quarter of 2019

Once an employer was eligible for the ERC under the pre-CAA ERC rules, every subsequent quarter is also an eligible quarter until the end of the first quarter in which gross receipts exceeded 80% of the receipts from the same quarter in 2019.

2020	2021
In 2020 an eligible employer paid an eligible employee $10,000 in Q3 and $10,000 in Q4 Under pre-CAA rules, the employer's ERC would be **$5,000** because the employer's ERC is capped at 50% of $10,000 in wages	In 2021 an employer paid an eligible employee $10,000 in Q1 and $10,000 in Q2 The employer's ERC would be **$14,000**, which is 70% of $10,000 wages for each of the 2 eligible quarters

Employer Eligibility for 2021

The Consolidated Appropriations Act changed the eligibility requirement for reduction in gross receipts to 80% for 2021. It also allows businesses to determine reduction in gross receipts by continuing to compare gross receipts from 2021 quarters to 2019 quarters.

These changes will result in a large increase in the number of businesses eligible to claim the employee retention tax credit.

Qualified Wages

Before the CAA, qualified wages for employers with 100 or fewer full-time employees referred to wages paid to employees whether they were working or not. For employers with over 100 full-time employees, qualified wages only referred to wages paid to employees not working (ex: furloughed).

The Consolidated Appropriations Act raised the maximum employer size threshold to 500 employees. For 2021, qualified wages for employers with 500 or fewer full-time employees are wages paid to employees working and not working. For employers with over 500 employees, qualified wages are only those paid to employees not working for 2021.

Wages That Do Not Qualify for the ERC

Wages used to calculate:

- Work Opportunity Tax Credit
- PPP loan forgiveness
- FFCRA (Families First Coronavirus Response Act) credit for paid sick or family medical leave related to COVID-19
- Wages paid to relatives of individuals owning 50% or more of the business

Note: Wages paid to owners/shareholders and spouses do qualify

Claiming the ERC

To claim the employee retention credit, report the total qualified wages for the ERC for each calendar quarter on Form 941, Employer's Quarterly Federal Tax Return, which can reduce your payroll tax payments. If you already paid the payroll taxes or the credit is more than the taxes you owed, the ERC is a refundable credit that can be received by amending the 941.

Employers may request an advance by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19.

Contact Us for Assistance

The changes made to the Employee Retention Credit make it especially valuable, and it takes proper planning to earn the maximum benefits from the ERC and PPP. If you have questions or need advice on how you can get the most out of these programs, contact us today by calling 443-320-4101 or emailing info@hoffmancpas.com.

Assessing and Mitigating Key Person Risks

Auditing standards require a year-end risk assessment. One potential source of risk may be a small business's reliance on the owner and other critical members of its management team. If a so-called "key person" unexpectedly becomes incapacitated or dies, it could disrupt day-to-day operations, alarm customers, lenders and suppliers, and drain working capital reserves.

Common among small businesses

No one is indispensable. But filling the shoes of a founder, visionary or rainmaker who unexpectedly leaves a business is sometimes challenging. These risks are usually associated with small businesses, but they can also impact large multinationals.

Consider the stock price fluctuations that Apple experienced following the death of innovator Steve Jobs. Fortunately for Apple and its investors, it possessed a well-trained, innovative workforce, a backlog of groundbreaking technology and significant capital to continue to prosper. But other businesses aren't so lucky. Some small firms take years to fully recover from the sudden loss of a key person.

Factors to consider

Does your business rely heavily on key people, or is its management team sufficiently decentralized? The answer requires an evaluation of your management team. Key people typically:

- Handle broad duties,
- Possess specialized training,
- Have extensive experience, or
- Make significant contributions to annual sales.

Other factors to consider include whether an individual has signed personal guarantees in relation to the business and the depth and qualification of other management team members. Generally, companies that sell products are better able to withstand the loss of a key person than are service businesses. On the other hand, a product-based company that relies heavily on technology

may be at risk if a key person possesses specialized technical knowledge.

Personal relationships are also a critical factor. If customers and suppliers deal primarily with one key person and that person leaves the company, they may decide to do business with another company. It's easier for a business to retain customer relationships when they're spread among several people within the company.

Ways to lower your risk

Your auditor's risk assessment can help determine accounts and issues that may require special attention during audit fieldwork. The assessment can also be used to help you shore up potential vulnerabilities.

Training and mentoring programs can help empower others to take over a key person's responsibilities and relationships in case of death or a departure from the business. Likewise, a solid succession plan can help smooth the transition.

Also consider external replacement options. This exercise can help you understand how much it would cost to hire someone with the same knowledge, skills and business acumen as the key person. In addition, a key person life insurance policy can help the company fund a search for a replacement or weather a business interruption following the loss of a key person.

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Manufacturing & Distribution Industry Services

With increasing regulations, technological changes, and heightened competition, manufacturing and distribution companies are faced with a myriad of challenges in getting their products to clients in a fast and cost-effective manner. The Hoffman Group is experienced in helping manufacturing and distribution professionals develop profit enhancing solutions to improve their bottom lines and anticipate marketplace changes. We become a part of our clients' management teams to help develop and implement strategic decisions geared toward their success.

Tax & Assurance:

- Tax Compliance & Preparation
- Audit, Review & Compile Financial Statements
- Sales & Use Tax
- International Tax
- Cost Segregation Studies
- Mergers & Acquisitions
- Research & Development Credits
- Minimize Multistate Tax Burden

Consulting:

- Strategic Planning
- Forecasting & Budgeting
- Inventory Costing
- Operational Assessments
- E-Business Strategy
- Business Plans
- Financing Assistance
- Internal Control Assessments
- Performance Measurement

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