Controller's Guide to the 2022 Year-End Close

Provided by Grassi's Accounting Services Team

Winter is the best time of the year! Mugs of cocoa and cozy blankets, coupled with time spent with family and friends, add a touch of magic to the year end. But the season also signals the complexity of another year-end business close. If you are a seasoned professional or just starting out on your own, Grassi's Accounting Services Team is here to help you close the books on 2022 and start 2023 on the right path. Remember, change is inevitable, but uncertainty is not. Let us guide you down the road ahead.

Revenue and expense recognition is paramount to maintaining a healthy set of books. Failure to properly account for either can result in unanticipated tax burdens, possible loss of financing, and other avoidable risks. The following are areas in which proper recognition is commonly overlooked:

RETAINAGE

Retainage is money held back from each payment to ensure that a contractor or subcontractor completes a project. It provides a financial incentive to ensure that the work is of appropriate quality and meets the plans and specifications. It is also intended to cover additional expenses if the contractor or subcontractor doesn't finish the work or there is a quality issue. Since retainage is withheld from each payment, all unpaid funds must be recorded and tracked to ensure proper payments are made upon project completion. Retainage is both a receivable *and* a payable and should be listed on the balance sheet as current assets and current liabilities.

Retainage receivable is recorded by general contractors and subcontractors and is the number of funds due from a contractor's customer for retention. Because these funds aren't due until the project is completed, they are recorded in a separate account on the general ledger.

Not recording retainage receivable leads to under reporting of revenue.

ABC Contractor is billing a project owner for $100,000 with **10% retention.**

Example:

Income		$100,000
Accounts receivable	$90,000	
Retainage receivable	$10,000	

By using the above entry, we recognize accurate income in the proper period.

Upon completion of the project, ABC Contractor will invoice their customer for the remaining $10,000 as follows:

Accounts receivable	$10,000	
Retainage receivable		$10,000

The above entry ensures that retainage receivable is now zero.

Retainage payable is recorded by owners and general contractors and is the amount owing to contractors or subcontractors for retainage. Since these funds aren't due until the project is completed, they are recorded in a separate account on the general ledger.

Not recording retainage payable leads to under reporting of expenses.

Example:

XYZ Plumbing is a subcontractor working on a project with ABC Contractor as the general contractor. XYZ Plumbing invoices ABC Contractor $50,000 with 10% retention.

Cost of goods sold	$50,000	
Accounts payable		$45,000
Retainage payable		$5,000

The above entry ensures that the total expense is recognized in the proper period, thus avoiding overstatement of income.

Upon completion of the project, XYZ Plumbing will invoice ABC Contracting for the balance of retainage.

Retainage payable	$ 5,000	
Accounts payable		$5,000

The above entry ensures that retainage payable is now zero.

NEW LEASE STANDARDS

Topic 842 provides financial statement users with more information about an entity's leasing activities. Lessees will recognize all leases, including operating, with a term greater than 12 months on the balance sheet as a lease liability ***and*** a right-of-use (ROU) asset. For the lessor, the overall reporting remains unchanged. Additionally, both lessees and lessors are required to include more robust disclosures about leasing activities than legacy US GAAP.

GIFT CERTIFICATES/CARDS

Gift cards are sold to customers for cash, and the business has an obligation to supply a service or a good in the future. The issuer of the gift card initially records the sale of a gift card as a liability, not a sale. Since the goods or services have not been provided yet, revenue cannot be recognized. The journal entry would include a debit to cash and a credit to unearned revenue (liability account).

When the card is redeemed by a customer, the sale and the cost of goods sold (if applicable) can be recognized by debiting the liability (unearned revenue) and crediting the sales account.

In the case of forfeiture by a customer, if there is a reasonable expectation that a certain portion of the gift card will not be used, that amount must be calculated and recognized as revenue. The portion of gift cards that will not be used can be estimated based on past experience. For example, a business can estimate that 20% of the beginning gift card liability balance has been forfeited by customers. To record the forfeiture, a debit to unearned revenue will decrease the liability (deferred revenue) and an income account, such as "Forfeited Card Revenue" should be credited to recognize income. No cost of goods sold is recognized in this case.

In case the business is unable to estimate the amount to be forfeited, the revenue for the unused portion of the gift card is recognized when the likelihood of the customer redeeming the gift card becomes remote.

FACTORING OF Receivable

In many cases, companies use accounts receivable as an instant source of cash. Entities can use accounts receivable as a collateral for a loan or they can sell the receivable to a third party, known as a factor, rather than wait to collect the accounts receivable themselves. When an organization transfers its receivable to a third party or uses it as a collateral for a loan, it *must* determine if the transaction is a sale or a loan.

Criteria to determine if the transaction is a sale:

1. The transferred assets have been separated from the transferor
2. The transferee can exchange or pledge the assets
3. The transferor has no control over the transferred assets

If the conditions mentioned above are met, the transaction is considered a sale, and the assets should be removed from the books. If the criteria are not met, the transaction is considered a loan. The transferor is using accounts receivable as collateral for a loan. In this case, the assets remain on the transferor's books and a liability is recorded for the liability. There will be no realized gain or loss in the sale of the receivable.

When factoring accounts receivable, the transferor (original creditor) transfers the accounts receivable to a factor or transferee.

An entity can factor its receivable with or without recourse.

Factoring receivable with recourse

If factoring the receivable with recourse, the transferor (seller) is responsible for the nonpayment of the receivable by the original debtor and for the cost of sales adjustments, such as discounts and returns and allowances.

Ex. Accounted as a sale

Company A factors $30,000 of accounts receivable with recourse. The factor charges a fee of 2%. It is estimated that bad debt expense will be $1,000 (recourse liability).

Cash $30,000 (1.00-0.02)	$29,400	
Loss on sale of accounts receivable $30,000 (0.02 + 1,000)	$1,600	
Accounts receivable		$30,000
Recourse liability		$1,000

When accounts are considered uncollectible, the transferor remits the cash to the factor:

Recourse liability	$1,000	
Cash		$1,000

Ex. Accounted as a loan

Accounts receivable is kept in the transferor's accounts receivable, and a loan and interest expenses are recorded.

Cash $30,000 (1.00 – 0.2)	$29,400	
Discount on factor liability $30,000 (0.02)	$600	
Factor liability		$30,000
Allowance for doubtful accounts	$1,000	
Accounts receivable		$1,000

As payments on the receivable are made to the factor, the factor liability is reduced, and interest expense is recognized.

Factor liability	$30,000	
Accounts receivable		$29,000
Cash		$1,000
Interest expense	$600	
Discount on Factor liability		$600

Factoring without recourse

When factoring without recourse, the buyer (factor) assumes the risk of any losses on the collection. Generally, the transaction is considered a sale because control has passed to the financial institution (transferee or factor). The factor bears the cost of uncollectible accounts, and the transferor is responsible for the cost of sales adjustments.

Ex. Journal entries for factoring without recourse

Company A sells without recourse $30,000. The factor charges 2% fee and additional 3% for sales returns.

Cash	$28,500	
Loss on sale of accounts receivable $30,000 (0.02)	$600	
Receivable from factor $30,000 (0.03)	$900	
Accounts receivable		$30,000
Sales returns and allowances	$600	
Receivable from factor		$600

IRS COMPLIANCE FOR REPORTING CASH PAYMENT OVER $10,000 RECEIVED IN A TRADE OR BUSINESS

With the FED changing interest on borrowing, businesses may notice an increase in cash transactions. For compliance, a business may need to file **Form 8300**.

Who must file?

Each person engaged in a trade or business who, in the course of that trade or business, receives more than $10,000 in cash in ***one transaction or in two or more related transactions***, must file Form 8300. Any transactions conducted between a payer (or its agent) and the recipient in a 24-hour period are related transactions. Transactions are considered related even if they occur over a period of more than 24 hours if the recipient knows, or has reason to know, that each transaction is one of a series of connected transactions.

When to file?

File Form 8300 by the 15th day after the date the cash was received. If that date falls on a Saturday, Sunday, or legal holiday, file the form on the next business day.

Where to file?

File the form with the Internal Revenue Service, Detroit Computing Center, P.O. Box 32621, Detroit, MI 48232.

DEFERRED EMPLOYER TAXES - UNDER THE CARES ACT

If you deferred 2020 employer taxes under the CARES Act, the second and final installment is due on December 31, 2022. However, since that date falls on a weekend, the due date has been extended to January 3, 2023.

Under IRC Section 6656, the penalty is 10% of the underpayment if the failure is more than 15 days and 15% if the tax is not paid within 10 days of the first notice sent to the taxpayer demanding payment. The penalty does not apply: (1) if failure is due to reasonable cause and not willful neglect; (2) to certain first-time depositors; and (3) to the extent that a failure to deposit any or all the tax was due to the taxpayer anticipating refundable credits allowed under COVID-relief provisions.

NEW HIRES - BEST PRACTICES

Hiring qualified employees is one of the most important and time-consuming tasks a business undertakes. Just because a candidate is qualified for the role, does not mean they are authorized to work in the United States. The **E-Verify** program is a Department of Homeland Security website that determines the eligibility of US and Foreign individuals to work in the country.

NEW FOR 2023

FICA WAGE BASE

The new 2023 FICA (Social Security) limit has increased from $147,000 to $160,200. With this 8.98% increase, up to $9,932.40 can be withheld from employees' Social Security and Medicare wages in 2023. The withholding percent remains 6.2% for Social Security (FICA) and 1.45% unlimited wage base for Medicare taxes.

For more information, visit **https://www.ssa.gov/cola/**

CHANGES TO 401(K) CONTRIBUTIONS

The IRS has increased the amount individuals can contribute to their 401(k) plans in 2023 to $22,500, up from $20,500 for 2022. The IRS has also issued technical guidance regarding all of the cost of living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2023 in **Notice 2022-55**, posted on IRS.gov.

1099-K REPORTING REQUIREMENTS

The IRS announced a delay in the $600 reporting threshold for third-party settlement organizations, which had been in effect for the 2022 calendar year. As a result, the IRS says third-party settlement organizations *will not* have to report tax year 2022 transactions on a Form 1099-K, P*ayment Card and Third Party Network Transactions*, to the IRS or the payee for the lower, $600 threshold amount that was enacted as part of the American Rescue Plan Act (ARPA) of 2021, P.L. 117-2.

The IRS says that for years after 2022, it will enforce the $600 *de minimis* reporting threshold. The AICPA, according to Ed Karl, CPA, CGMA, Vice President – Tax Policy & Advocacy, continues to call on Congress to raise the $600 *de minimis* exception for reporting by instituting a cost-of-living adjustment (COLA) using 1954 as the base period for the COLA.

INDEPENDENT CONTRACTOR VS. EMPLOYEE

The United States Department of Labor is cracking down on the misclassification of employees as independent contractors. The Department's **proposed ruling** aims to protect workers' rights to minimum wage, overtime wages and other benefits by mandating employers apply economic-reality tests. The tests may include:

- The amount of skill required for the work
- The degree of permanence of the working relationship
- The worker's investment in equipment or materials required for the task
- The extent to which the service rendered is an integral part of the employer's business

The above tests are in addition to two core factors:

- The nature and degree of control over the work
- The worker's opportunity for profit or loss based on initiative and investment

FOR MORE INFORMATION:

If you have any questions or require assistance with your year-end close process, Grassi's **Accounting Services** team is here to help. Please contact your Grassi advisor or a member of our Accounting Services team for more information.

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