

FORVIS

Technologies and Services
Communications Industry

Colorado Telecommunications Association Summer Meeting 2022

Tammy J. Totzke / July 13, 2022

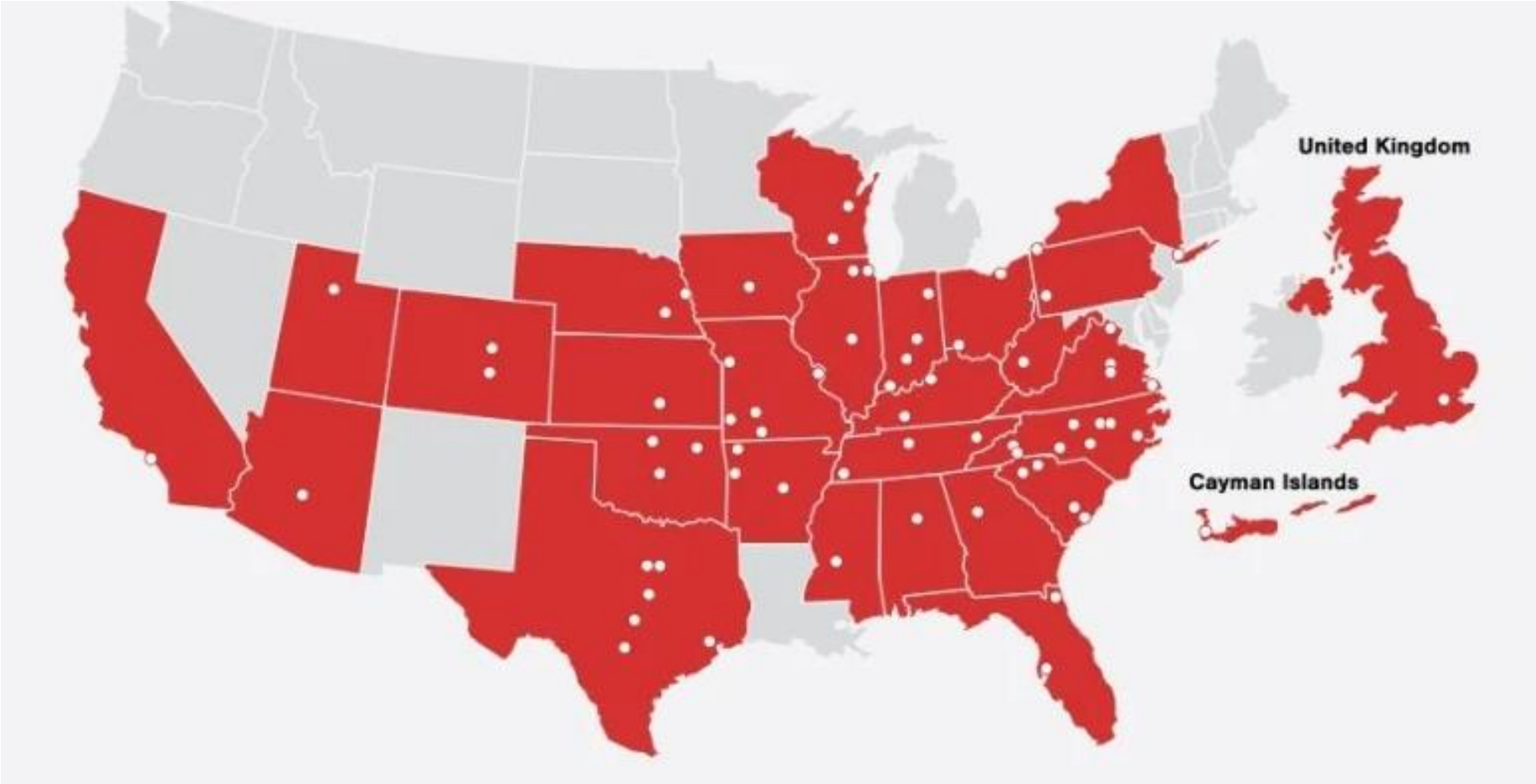
FORVIS - Who Are You?

- Created by the merger of equals between BKD and DHG
 - Effective June 1, 2022
 - Bigger footprint with offices in 28 states, covering 70 different markets
- Where will the team be based?
 - Still your COSL practice unit
 - New email format: Tammy.Totzke@FORVIS.com
 - Still holding the Telecom Client Seminar in Iowa on August 10 & 11
- Let's celebrate – new drawing at the booth tonight

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Office Locations

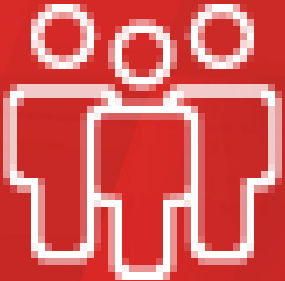


Agenda

- Audit comments for
 - Board members
 - General managers (and accounting staff)
- What in the world is going on?
 - Higher costs
 - Free money and grant accounting
- Leases
- Benchmarking

What does a BOARD member
need to do in an audit

(Highlights)



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- As a whole, the board of directors bears a legal responsibility to govern an entity
- One role of the board is defining fiduciary duties
 - Includes hiring and firing of managers and other staff
 - Monitoring financial reports
 - Conducting the annual audit

What does a BOARD member
need to do in an audit

(Highlights)

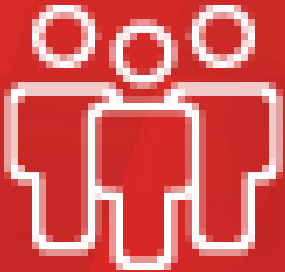


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- While there are many duties, these duties fall under the Duty of Care
 - Give the same care and concern to your board responsibilities as a prudent and ordinary person would
 - + Be actively participating
 - + Oversee monitoring of the entity's activities
 - + Be able to read and understand financial reports
 - + Question expenditures and extreme variances
 - + Responsible for strategic planning and achievement of the entity's short- and long-term goals

What does a BOARD member need to do in an audit

(Highlights)



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- Monitor financial resources
 - You don't need to be an accounting expert
 - You should have a good idea of how much money is coming in and going out
 - Review the reports provided by your accounting staff
- For the audit, the board approves the engagement letter
 - Engagement letters are required for our audit and tax work
 - It is our work contract with you
- Be available for audit inquiry and be honest in your answers
- Attend audit presentations and approve the audit
- Ask questions!



What does the General manager and Accounting staff need to do for an audit

• "Everything Else"

• ? / !

It doesn't have to be stressful,
remember we are here to help

- Be prepared
- Have your list of questions or new things that have happened this year
- But also,
 - Set aside time for audit procedures
 - Provide information as requested
 - Respond to follow up questions timely
- If you don't understand the request as for further clarification or a report that was pulled last year

It takes the full team to get through an audit. Your employees are important!

- Invest in employees so they understand their part
 - Planning lists
 - + Job duties
 - + Cash inflow, cash outflow
 - PBC (prepared by client) spreadsheets & support
 - + Plant accounting and inventory
 - + Account receivables
 - + Account payables
 - Confirmations – electronic advances
 - The goal is no surprises – for anyone

Investing in employees

- If you build good relationships with employees by investing in their talents, you can save yourself
 - The expense of losing their skills
 - Recruiting and training of new employees
 - Other costs of employee turnover
 - + Decreased productivity
 - + Poor teamwork
 - + Lack of morale
 - + This is prime time for a lack in ethics

But everyone is leaving or retiring

- *Maybe, but:*
- There are still new entrants to the market
 - Rebound/Boomerang
 - New families in the area
 - Young adults/College recruits
- Use your networks
 - Word of mouth
 - Prior connections
 - LinkedIn
 - Professional organizations and schools



WHY IS BEING
ALIVE SO
EXPENSIVE
I'M NOT EVEN
HAVING A
GOOD TIME



Things have changed

Let's talk about COSTS



- Inflation is:
 - The increase in the level of prices of the goods and services that households buy. It is measured as **the rate of change of those prices**
- As of Monday, July 11
 - US inflation rate = 8.58%
 - + Versus 8.26 last month
 - + 4.99 last year

Inflation drives prices up



- Have you been monitoring costs?
 - Have you seen an increase in expense items
 - What about an increase in labor costs?
 - + What do your employee raises look like for 2022
- Have items become more expensive due to shipping charges
- The inflation rate is at its highest point since December of **1981**

Show me the free money



- With inflation the cost of your construction projects will also cost more
- Have you factored in the increase?
- Some assistance that has been offered:
 - Connect America Fund (CAF Phase II)
 - + 103 bidders won \$1.49 **Billion** over 10 years – 45 states
 - Rural Digital Opportunity Fund (RDOF Phase I Auction)
 - + \$9.2 **Billion** in support awarded to 180 bidders

Show me the free money



- ReConnect Program Funding (USDA)
- Offers loans, grants, and loan-grant combinations to facilitate broadband deployment
 - \$350,000,000 available for grants
 - \$250,000,000 available for loan/grant combinations
 - \$200,000,000 available for loans
 - Last program application was due 3/9/22
 - Colorado's last round award – an electric cooperative received \$10,595,446 grant (8/11/21)

Show me the free money



- Colorado Broadband Program
- Winter 2022 grant cycle just ended July 12
- Summer 2022 grant cycle kicks off July 27
- 63 projects awarded, \$51M in grants
- 29,024 rural households will benefit from broadband access



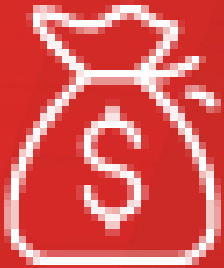
Free Money = The Good Life?

Free money – If you don't play,
you can't win



- Each program has its own specific application procedures and requirements
 - Some are adoption grants which reimburse costs incurred to build or install
 - Some are matching – 25%
 - Most have penalties for not reaching milestones
 - Some applications procedures are quite detailed and expensive to prepare
- Depending on which program you select you need to be sure to carefully ***read and understand*** your agreements
 - Who is requesting the money
 - + Which entity
 - + Parent company or the subsidiary
 - Some require audits, single audits, or program specific audit requirements

Free money - accounting



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- Options for Accounting for Grants
 - The typical default answer used to be that telecommunications providers (ILEC-incumbent local exchange carriers) had to follow FCC Part 32 accounting rules
 - Part 32 only applies if the entity is considered regulated entity under the definition in FASB ASC 980 (Financial Accounting Standards Board, Accounting Standard Codification) *Regulated Operations*
- Do you have regulated operations?
 - Answer, maybe
 - Are you rate – regulated?

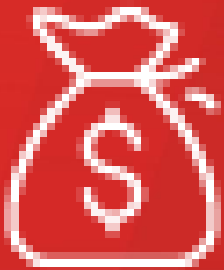
When does ASC 980 apply?

- Grants for infrastructure
 - FCC Part 32 calls for grants to be recognized as aid to construction
 - Reduces the basis of the assets acquired with the fund received (offset)
 - Contra-accounts can be used if you wish to maintain the original basis prior to the aid to construction
- Grants for adoption
 - FCC Part 32 calls for grants that are for the reimbursement of expenses to be offset of those expenses rather than as revenues

When does ASC980 apply?

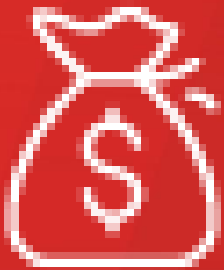
- Grant accounting for for-profit entities is not specifically addressed in the codification
- Need to look at alternative rules for guidance
 - IAS 20 (International Accounting Standards) *Accounting for Government Grants and Disclosure of Government Assistance* is the best alternative guidance to address the issue

Free money - accounting



- Set up the grant as deferred income – Option 1
 - Recognize to income as revenue over the estimated useful life of the asset
 - Also need to consider if there is a lien on assets funded by the grantor that extends beyond the service period. If so recommended to use the estimated useful life of the associated asset

Free money - accounting



- Set up the grant as deferred income – Option 1
 - Results in strong matching of revenues (grant income) and expense (depreciation)
 - Allows for greater transparency of funding sources and costs incurred
 - For example – A \$30M project funded 50% by grant still shows up as \$30M in assets and then revenue is recognized over the life of the asset

Free money - accounting



- Reduced Asset Basis – Option 2
- Deduct the grant in arriving at the carrying amount of the asset (similar to FCC Part 32 accounting treatment) – Option 2
 - Aid to construction approach which reduces the basis and thereby depreciation
 - Less clear on how much was really put in service and continues to be operated
 - + For example: \$30M project funded 50% by grant shows up as \$15M in gross assets rather than \$30M

How does it look in the financial statements

- Deferred Revenue (Option 1)
 - Balance Sheet
 - + Deferred revenue – short and long-term components based on expected recognition
 - Income Statement
 - + Revenues are to be shown either separately or under a general heading such as other income in the operating section

How does it look in the financial statements

- Reduced Asset Basis (Option 2)
 - Balance Sheet
 - + Fixed assets are reported net of the grant proceeds
 - Income Statement
 - + Depreciation is recognized using the net basis of the grant-funded assets

- Be Aware

Keep in mind your “old” requirements relating to long – term debt

- Debt covenants
 - More costs could increase expense line items and reduce net income
 - Declining market values could cause decreases to final net income amounts
 - TIER (Times Interest Earned Ratio) (RUS covenant):
 - + $(\text{Net income} + \text{fixed charges}) / \text{fixed charges}$
 - + Example on next slide
- Additional reporting
 - Free money could trigger additional reporting
 - + Can require quarterly reporting

TIER Example -**Net income****Fixed charges****Net income plus
fixed charges****Quick TIER
calculation**

Year 1

Year 2

Change

200,000

150,000

50,000

decrease

150,000

200,000

(50,000)

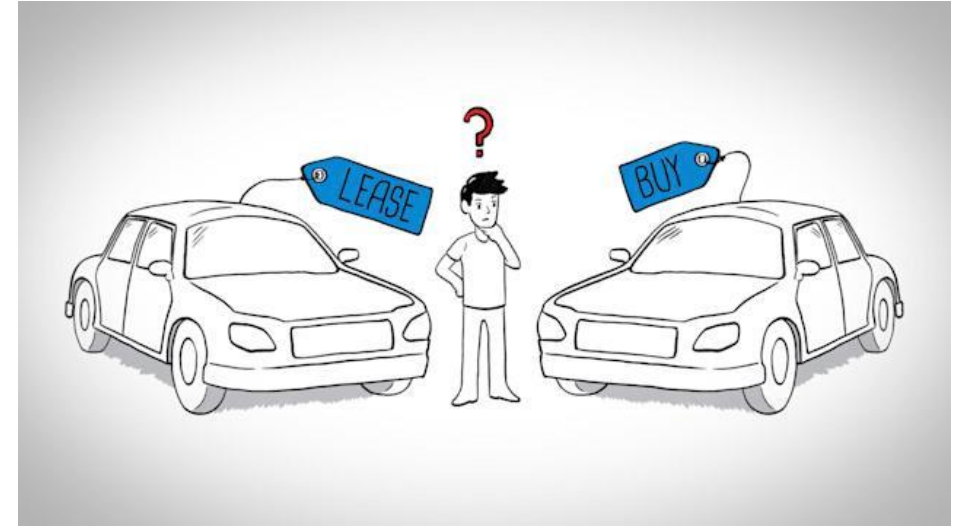
increase

350,000

350,000

2.33

1.75">



Leases – It's Here

Leases



- Effective NOW
- Get your documents together
 - Written agreements
 - More than one year
 - Tangible items
 - + Buildings, vehicles, office equipment
 - + NOT capacity
- Elections can be made to apply on a going forward basis
 - No prior year restatement of the audit report
 - Can affect comparability

Leases

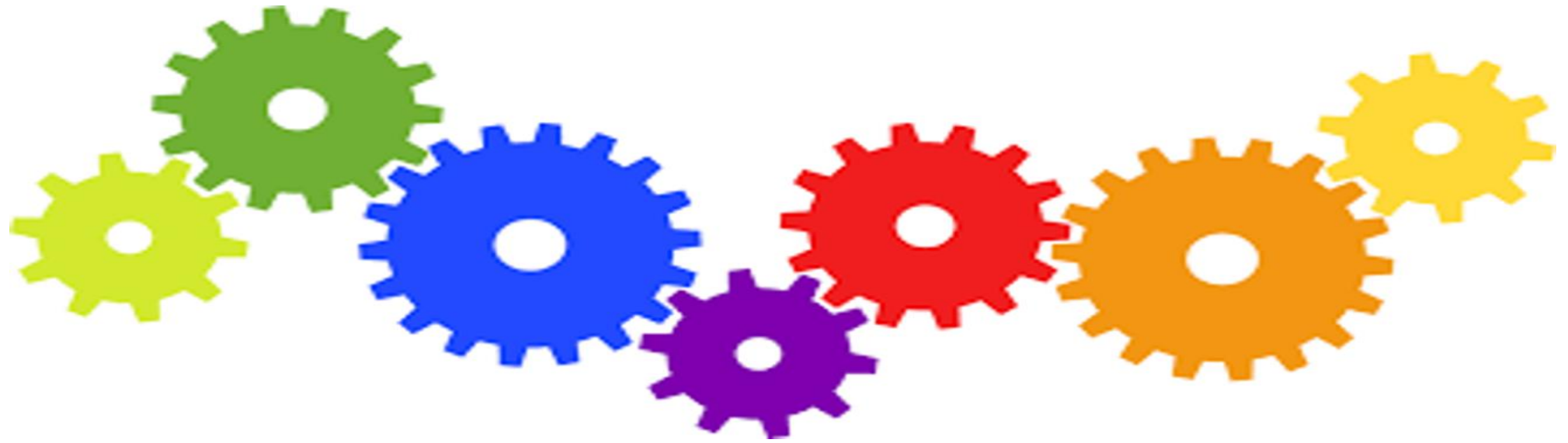


- The new standard will result in more leases being shown on the balance sheet
 - Right to Use Asset
 - Lease Liability
- For each lease, these issues must be defined
 - Is this a lease
 - What are the lease components
 - What is the lease classification
 - + *Financing* or operating

Leases



- Note that the “old” leasing rules provided for two types of leases
 - Operating – monthly payment that was expensed
 - Capital – recorded on the balance sheet
- A majority of your leases will be more like the capital leases under the old rules
- The footnote in your audit report will be **expanded** for a detail leases section to include
 - Lease expense (including amortization and interest)
 - Maturity analysis
 - Other information including
 - + The nature of your leases
 - + Lease terms



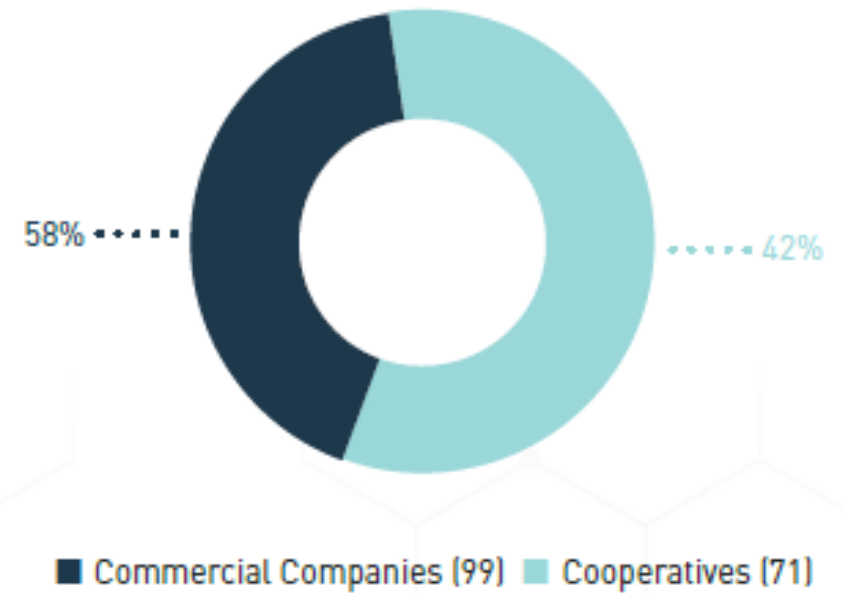
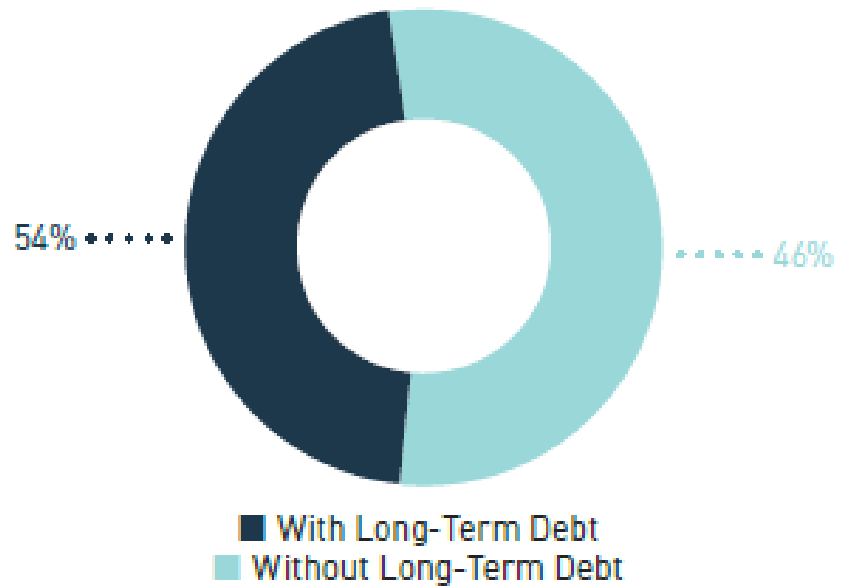
Time to switch gears

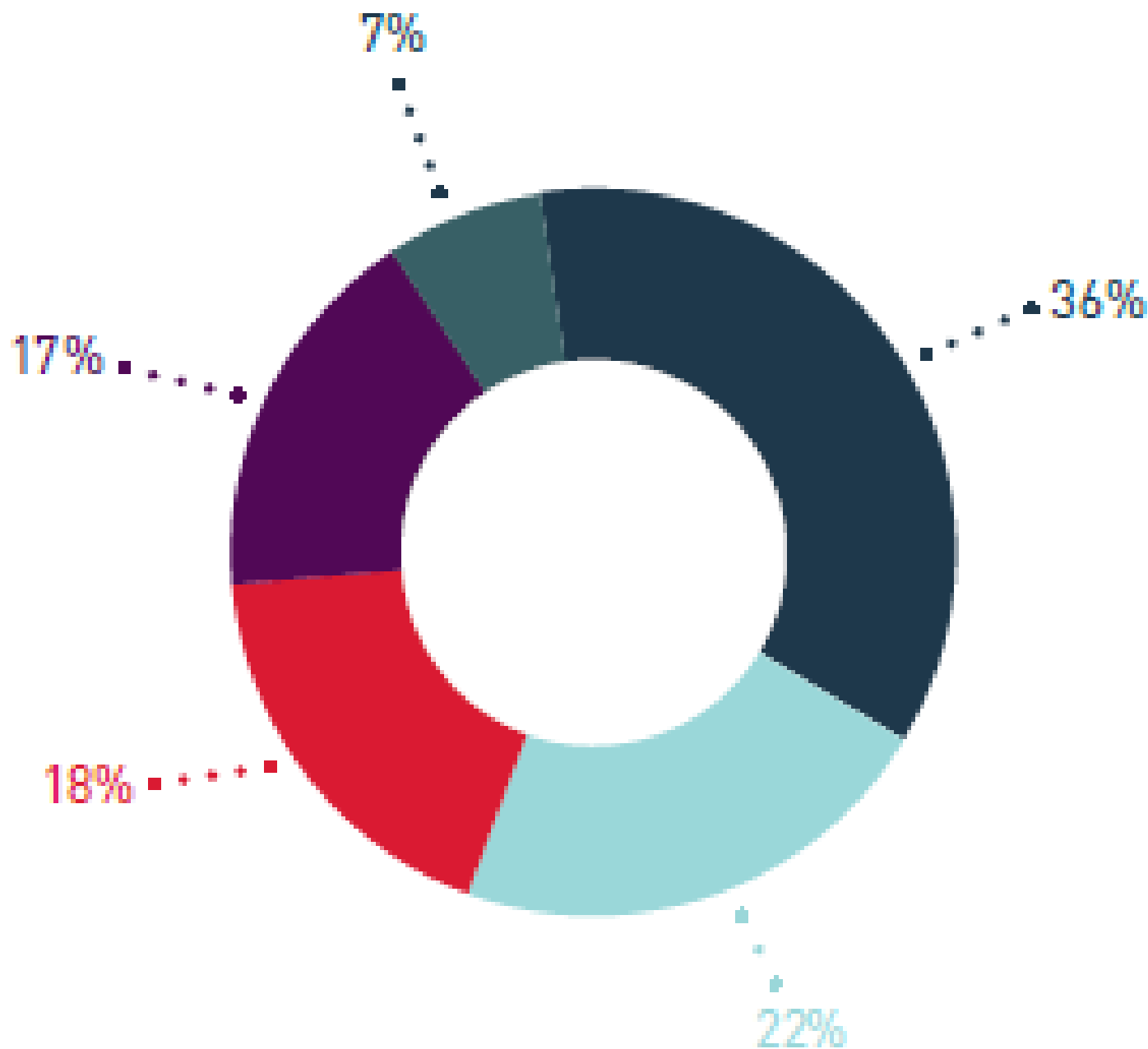
- The 2022 FORVIS Telecommunications Benchmark Study is almost complete
 - Look for webinars to come (Free)
- Provides benchmark results for balance sheet, income statement, and more than 30 other key metrics
 - Employee count
 - Debt/no debt
 - Geographical
 - Investment income
 - Commercial/Cooperative

Slice & Dice

Long – Term Debt

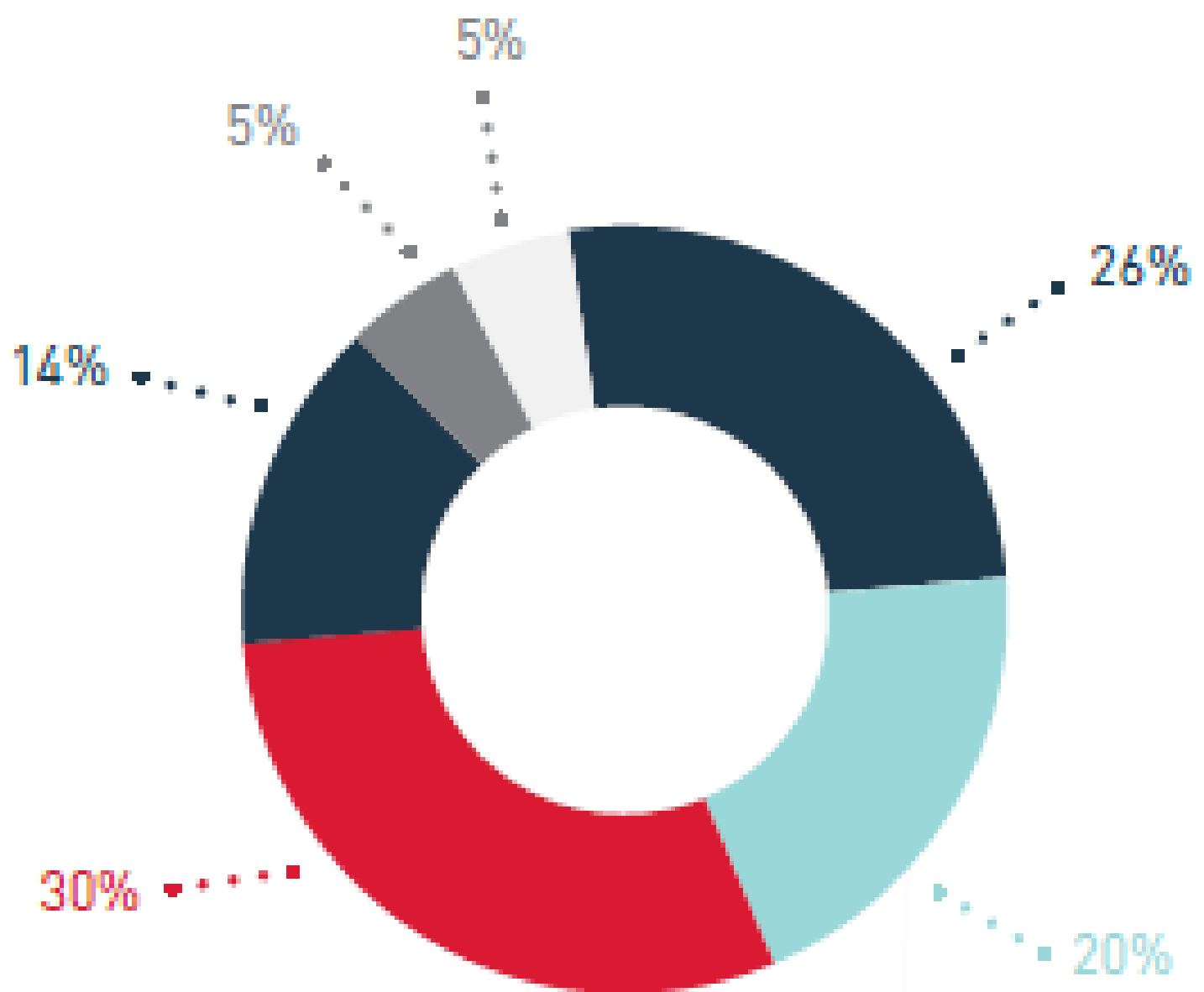
C-corp vs Cooperative





- <\$2.5M (62)
- \$2.5M-\$5M (37)
- \$5M-\$10M (30)
- \$10M-\$25M (29)
- >\$25M (12)

Slice & Dice – Revenue Size



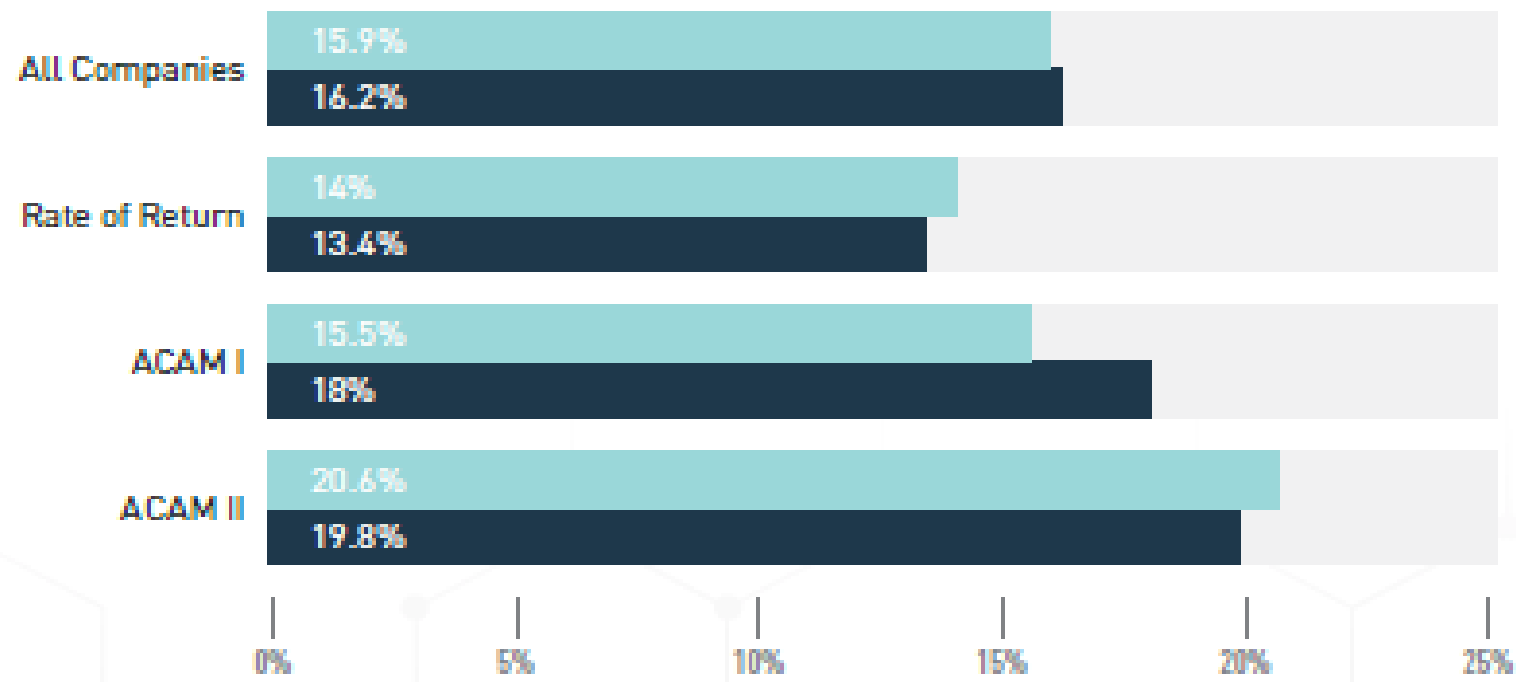
- 1-5 Employees (44)
- 6-10 Employees (33)
- 11-25 Employees (50)
- 26-50 Employees (23)
- 51-100 Employees (8)
- More than 100 Employees (4)

Slice & Dice – Number of Employees

Companies Electing ACAM Continue to Outperform Legacy Rate of Return Companies

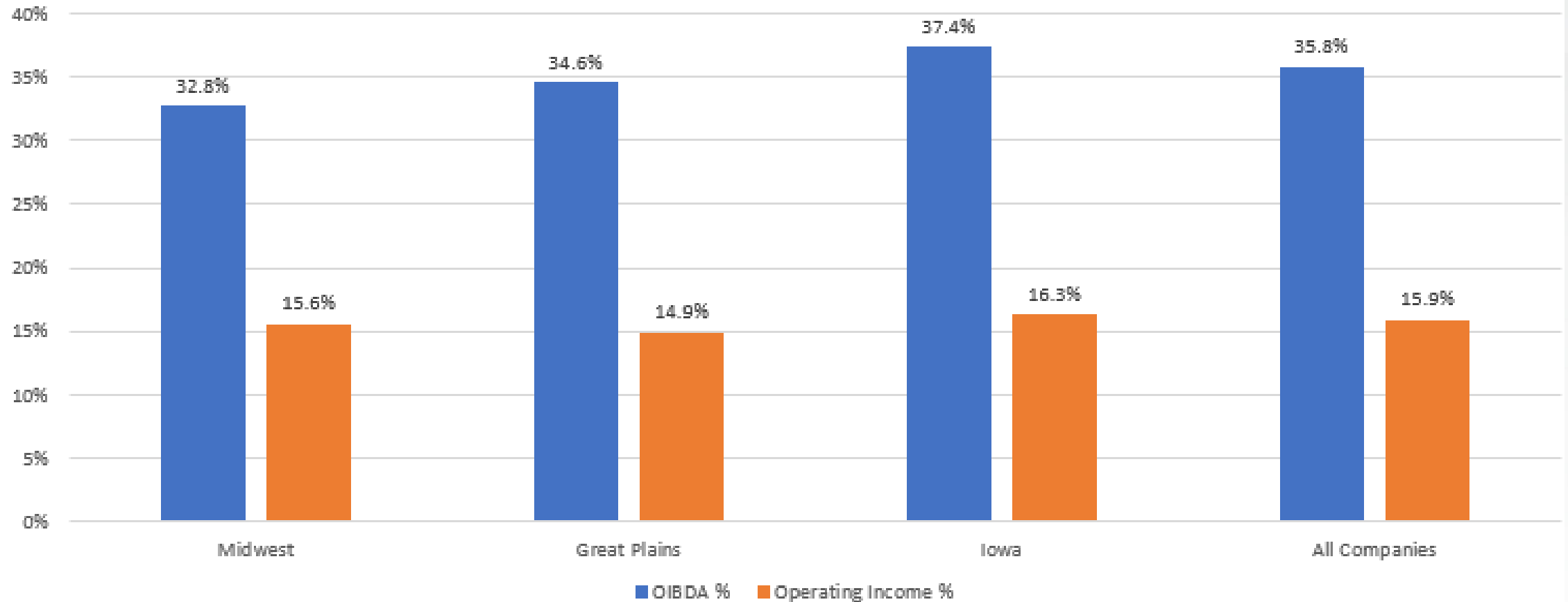
Of the 170 companies that participated in the study, 91 have elected either ACAM I or ACAM II as their form of regulation. The graph below demonstrates—at least early on—that companies electing ACAM have higher operating income as a percentage of operating revenues than legacy rate of return carriers.

Figure 6 - Average Operating Income as a Percent of Revenue



Regions

OIBDA and Operating Income as a Percentage of Total Revenues for 2020



Balance Sheet					Operations				
	Company	Iowa	Great Plains	Midwest		Company	Iowa	Great Plains	Midwest
Cash & Cash Equivalents	8.2%	11.4%	10.8%	9.4%	Local Network Services	7.1%	6.6%	5.6%	8.9%
Temporary Investments	2.8%	0.0%	0.0%	0.0%	Network Access Services	64.1%	49.4%	49.8%	39.1%
Interexchange Customers	1.7%	0.7%	1.3%	0.8%	Internet Services	23.8%	20.8%	23.7%	27.7%
Materials and Supplies at Avg Cost	1.9%	0.5%	2.2%	1.7%	Long Distance Services	0.7%	0.8%	0.7%	0.8%
Other Current Assets	<u>0.7%</u>	<u>6.6%</u>	<u>5.0%</u>	<u>9.3%</u>	Miscellaneous Revenue	3.6%	5.2%	6.1%	5.6%
Total Current Assets	15.3%	19.3%	19.3%	21.3%	Other Revenue	<u>0.8%</u>	<u>17.2%</u>	<u>14.1%</u>	<u>17.8%</u>
Net Fixed Assets	74.7%	49.7%	55.5%	63.4%	Total Revenue	100.0%	100.0%	100.0%	100.0%
Available for Sale Securities	7.6%	0.0%	0.2%	0.0%	Plant Specific Operations	23.2%	19.6%	21.7%	19.4%
Held to Maturity Securities	0.0%	0.0%	0.0%	0.0%	Depreciation Exp	20.3%	25.0%	24.9%	24.5%
Other Investments	2.4%	13.6%	4.6%	4.2%	Plant Non-Specific Op Exp	6.4%	3.7%	8.0%	6.0%
Held to Maturity Securities	0.0%	0.0%	0.0%	0.0%	Cost of Internet Services	5.2%	4.2%	6.4%	5.2%
Other Non-Current Assets	<u>0.0%</u>	<u>12.0%</u>	<u>16.8%</u>	<u>6.8%</u>	Customer Operations	4.8%	8.4%	6.8%	7.5%
Total Non-Current Assets	<u>10.0%</u>	<u>25.6%</u>	<u>21.6%</u>	<u>11.0%</u>	Corporate Operations	16.9%	20.8%	20.8%	15.6%
Total Assets	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	Other Op Exp	<u>4.5%</u>	<u>1.0%</u>	<u>-2.2%</u>	<u>4.1%</u>
Current Portion LTD	1.7%	0.1%	1.0%	0.5%	Total Op Expense	<u>81.2%</u>	<u>82.5%</u>	<u>86.5%</u>	<u>82.2%</u>
Accounts Payable: other	0.5%	0.7%	1.3%	1.7%	Operating Income (Loss)	18.8%	17.5%	13.5%	17.8%
Accrued Taxes	0.9%	0.1%	0.3%	0.0%	Other Income (Exp)	4.7%	10.6%	6.1%	6.4%
Current Portion of Deferred Grant Re	0.1%	0.0%	0.0%	0.0%	Interest Expense	-4.9%	0.0%	-1.3%	-0.5%
Other Current Liabilities	<u>0.5%</u>	<u>1.1%</u>	<u>3.1%</u>	<u>3.6%</u>	Income Taxes	<u>-0.3%</u>	<u>-4.5%</u>	<u>-2.4%</u>	<u>-3.3%</u>
Total Current Liabilities	3.6%	2.1%	5.8%	5.8%	Net Income (Loss)	<u>18.3%</u>	<u>23.5%</u>	<u>15.9%</u>	<u>20.4%</u>
Long Term Debt	34.8%	0.0%	9.4%	4.6%	EBITDA	43.7%	50.9%	47.3%	45.9%
Deferred Income Taxes, Long term	0.2%	4.8%	2.1%	3.1%	# of Companies in Peer Group		96	31	40
Deferred Grant Revenue, net of curre	0.7%	0.0%	0.0%	0.0%					
Other Long Term Liability	<u>0.7%</u>	<u>6.9%</u>	<u>6.1%</u>	<u>7.9%</u>					
Total Long Term Liabilities	35.7%	11.7%	17.6%	15.6%					
Total Liabilities	<u>39.3%</u>	<u>14.3%</u>	<u>23.6%</u>	<u>26.6%</u>					
Total Equity	60.7%	85.5%	76.4%	73.0%					
Total Liabilities & Equity	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>					

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Questions??

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