TSS, Inc.
Form 10-K
March 30, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

x	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

OR

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: **001-33627**

TSS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-2027651 *(I.R.S. Employer Identification No.)*
110 E. Old Settlers Road Round Rock, TX (Address of principal executive offices)	78664 *(Zip Code)*

Registrant s telephone number, including area code
(512)-310-1000

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock, $.0001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.Yes o No x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).Yes o No x

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Smaller reporting company x

Non-accelerated filer o
[Do not check if a
smaller
reporting company]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yes o No x

As of June 30, 2015, the aggregate market value of the registrant s voting and non-voting Common Stock held by non-affiliates of the registrant was approximately $6,245,789. Such aggregate market value was computed by reference to the closing sale price of the Common Stock as reported on the OTCQB tier of OTC Markets Group, Inc., a centralized quotation service that collects and publishes market maker quotes for over-the-counter securities, on such date. For purposes of making this calculation only, the registrant has defined affiliates as including all directors, executive officers and stockholders owning more than 10% of the registrant s common stock, but excluding any institutional stockholders owning 10% or more of the registrant s common stock.

Number of shares of Common Stock outstanding as of March 30, 2016: 15,641,824

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s Definitive Proxy Statement, relating to our 2016 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission not later than 120 days after the end of the 2015 fiscal year are incorporated by reference into Part III of this Annual Report on Form 10-K.

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TSS, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2015

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

From time to time, we make oral and written statements that may constitute forward looking statements (rather than historical facts) as defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission (the SEC) in its rules, regulations and releases, including Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We desire to take advantage of the safe harbor provisions in the Private Securities Litigation Reform Act of 1995 for forward-looking statements made from time to time, including, but not limited to, the forward-looking statements made in this Annual Report on Form 10-K (this Annual Report), as well as those made in other filings with the SEC.

Forward-looking statements can be identified by the use of forward-looking terminology such as believes, estimates, anticipates, expects, may, will, continue, forecast, foresee or other similar words. Such forward-looking st based on our management s current plans and expectations and are subject to risks, uncertainties and changes in plans that could cause actual results to differ materially from those described in the forward-looking statements. Important factors that could cause actual results to differ materially from those anticipated in our forward-looking statements include, but are not limited to, those described under Risk Factors set forth in Item 1A of this Annual Report.

We expressly disclaim any obligation to release publicly any updates or changes in our expectations or any changes in events, conditions, or circumstances on which any forward-looking statement is based.

As used herein, expect as otherwise indicated by the context, the terms TSS, Company, we , us and our are use refer to TSS, Inc. and our wholly-owned subsidiaries.

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PART I.

Item 1. Business

Company Overview

TSS, Inc. is a provider of comprehensive services for the planning, design, development and maintenance of mission-critical facilities and information infrastructure as well as integration services. We provide a single-source solution for highly technical mission-critical facilities such as data centers, operation centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, design and engineering, project management, systems integration, system installations and facilities management

We were incorporated in Delaware in December 2004. As a holding company, we operate through our wholly owned subsidiaries, VTC, LLC d/b/a Total Site Solutions (VTC) and Innovative Power Systems, Inc. Our headquarters are in Round Rock, Texas, and we have offices in Columbia, Maryland, Dulles, Virginia, and Los Altos, California.

Our business is concentrated on the data center infrastructure and services market. This market is becoming increasingly dynamic as commerce moves to cloud-based solutions and as data storage requirements continue to escalate exponentially driven by video, mobility and big data requirements. These underlying macroeconomic trends are driving demand for increasingly efficient data center design, construction and operation, resulting in increasing capital expenditures in this market. We compete in large growing market segments often against larger competitors who have greater resources. We have been successful with several large customers in winning contracts and providing business to us under Master Service Agreements , and the loss of such customers could have a material negative effect on our results. We have focused our sales force on diversifying our customer base to reduce this risk and drive revenue growth.

We believe that as one of the few companies providing a single source for all phases of data center ownership, from design through construction, equipment deployment, operations, maintenance and decommissioning, we are uniquely positioned to capitalize on the continued growth and evolution in the data center market. The services we offer are applicable to traditional brick-and-mortar facilities and also to new modular form factors. We believe our ability to help customers lower the cost of operating their mission-critical facilities surpasses the type and scale of equipment or infrastructure being used by our customers. We are also working with IT equipment manufacturers to help them deploy their equipment into data centers, which enables us to establish relationships with their customers.

Beginning in 2013, we changed our business strategy to pivot the business focus from large, one-off data center design and build projects towards offerings such as our facilities management offering that provide greater recurring revenue streams from ongoing services. This shift also transitions us towards higher margin service lines to improve the profitability of the Company. As part of this strategy, we acquired our systems integration business in 2013 to broaden and diversify our service offering for the data center services market.

Service Offerings

We have developed a unique set of solution offerings whereby we provide a range of services that enable our customers and partners to more efficiently plan, develop, deploy and maintain data centers and their related assets. These solutions begin with strategies for the care of information technology assets that are being housed in the facility or modular data center, including power, cooling and heat rejection, as well as disaster recovery backup systems. We assist our customers and partners in developing and implementing total cost of ownership models that enable them to design and build efficient data centers based on their available capital. Our operating expenses are not exclusively aligned to each service offering, as shared resources such as sales, marketing and general and administrative expenses support all services. Our solutions involve all aspects of the life cycle of both traditional and modular data centers and are described in more detail below.

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Consult:

During the initial phase of a data center project, we provide project development related services that typically include establishing project goals and a preliminary budget and schedules, setting technical parameters and requirements, and determining project team members and the overall requirements of the team.

Design and engineering consulting services typically include critical power and mechanical load calculations, mechanical design and engineering, high and medium voltage electrical design and engineering, communications and security systems design and engineering, physical vulnerability assessments, force protection design and bomb blast analyses, fire protection system design and engineering, facility systems equipment selection and facility commissioning and testing. These offerings also include post commissioning support of on-going operations.

Our strategy is intended to increase the amount of recurring revenues we generate from our existing customers, IT equipment partners, and major systems integrators. Our mission critical facilities experience and skills position us as a trusted advisor to our customers, and allow us to work on new opportunities as our customers grow and partners introduce us to new client opportunities.

Deploy:

Activities during this phase involve management of all the detailed preparations required for a successful deployment of a customer s data center or related equipment requirements. Our capabilities include project management, value engineering and design management, bid negotiation support, subcontractor pre-qualification and selection, long-lead equipment procurement, issuance of equipment and construction contracts, and refinement and management of project budgets and schedules. Our project managers mobilize the required expertise for the project, utilizing in-house superintendents, quality control and safety professionals, as well as qualified subcontractors and support personnel, some of which have historically been provided by affiliated or sub-contracted entities. Our project managers supervise work by project team members, including all aspects of the following: architecture and construction, electric power systems, heat rejection and cooling, energy management and controls, cooling tower systems, security systems, voice, data and network cabling, fire and life safety systems, and process piping and plumbing systems. Our project managers remain responsible for managing all aspects of the project until project completion and customer delivery.

Management of the installation portion of facility projects is typically the longest in duration when compared to other project phases. In addition, this portion has the largest number of outside influences that can impact project goals and objectives, such as weather, non-performance of subcontractors, equipment deliveries, unexpected project changes from the owner, and influence from local authorities and utility providers. Therefore, experience, skill and mission focus are critical during the project installation period.

To assist our customers with IT-equipment deployment in their data centers we provide what we call systems integration services. We provide integrated technology services and software tools designed to accelerate the delivery of complex information technology solutions. These services include custom configuration of a broad scope of information technology products including client products, enterprise products, clusters and modular containers. The integration of this equipment is performed to our customer specifications and test criteria. We are generally not responsible for the performance of the related equipment in the field. In addition, we provide warehousing of high value equipment such as servers, switches and other information technology hardware that are generally provided on a consignment basis. Occasionally, we will procure and resell the information technology hardware for our customers.

Manage:

We provide a comprehensive maintenance and service offering designed to ensure that the multiple systems critical to sustaining on-line applications in technologically intensive facilities and modular data centers remain operational and functional. Typical facilities management services include overall management of the post-construction facility maintenance program, on-site staffing of technical engineering positions (*e.g.,* electricians, HVAC mechanics, control technicians and voice/data technicians), and management of non-technical subcontracted services (*e.g.,* security, landscaping, janitorial, pest control, snow removal, carpentry, painting and general maintenance services). Increasingly, data centers are being constructed in a

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modular format, whereby information technology, power and other related assets are deployed in pre-integrated solutions. Modular data centers may have lower overall cost of delivery, lower energy consumption and shorter deployment schedules compared to traditional data centers. We have developed a team to deploy and maintain high-density modular data centers. Our on-site maintenance services provide additional project revenue for us and also position us for involvement in any new facility planning, design and construction initiatives that the customer undertakes.

In addition, we have a 24X7 Network Operations Center in Columbia, Maryland that has the capability of remotely monitoring our data center service contract customers facilities for systems operations and emergency events that could lead to outages. Temperature levels, humidity, electrical connectivity, power usage and fire alarm conditions are among the items monitored. The system maintains all site documentation for repairs and maintenance performed on each critical piece of equipment covered under our services. The information is useful to our customers in assessing operational efficiency and causes of failure, and enables them to make critical decisions on repair or replacement strategies based on the operating history of the monitored systems.

Our facilities maintenance service contracts are typically one to four years in duration with cancellation clauses for nonperformance, and are typically billed annually in advance. Our service contracts take different forms including fixed-price equipment maintenance with optional comprehensive warranty to fix failures, ticket based service with contracted rates in a master service agreement, comprehensive facility services agreements that include on site staffing, scheduled equipment maintenance and nontechnical facility services, and direct contracts for additional moves, add and change work within a facility.

As computer density increased and data centers evolved into the use of modular form factors, we found that we could leverage our facilities maintenance experience and infrastructure by offering maintenance service of modules being deployed into new data centers. Our design services continue to evolve to support changing data center requirements. Ultimately, we started working with IT vendors to help them in the design and integration of their IT equipment into modular data centers, which typically leads to ongoing maintenance contracts as these modular systems deploy.

The margins on our facilities maintenance and systems integration businesses are significantly higher than our traditional consulting and project management activities. We continue to support the entire line of services as it provides multiple points of value for our customers, and provision of some services will lead to higher levels of our more profitable service offerings as we expand our service footprint with existing customers. Since 2013 we have been focusing our sales activities on growing our maintenance and integration services, and re-aligning our cost structure to reflect this change in focus.

Customers

Our customers include IT equipment companies, United States government and homeland defense agencies and private sector businesses that in some cases are the end users of the facility or in other cases are providing a facility to a government or commercial end user.

Three customers comprised 65% and 60% of our total revenue for the years ended December 31, 2015 and 2014, respectively.

Sales and Marketing

Our marketing approach emphasizes expertise in information technology hardware systems, energy consumption, real estate matters and facilities planning and operation. This marketing approach allows the customer to contract for comprehensive facilities services or to contract separately for each individual project phase. Our marketing program seeks to capitalize on our industry standing, including our existing relationships and our reputation based on our performance on completed projects. We also seek to enhance our name recognition through the use of trade shows, technical seminars, direct mailings and the media. A key part of our selling strategy is entering into master service agreements with multiple partners and co-selling our range of services to the end-user customers of our partners, leveraging their customer relationships and broadening the scope of potential customers for us.

Our headcount in sales and marketing has fluctuated as we have worked to align the skill sets with our evolving service offering, leverage partner relationships and increase the consultative capability of our sales organization. We have implemented certain marketing activities including investment in an upgraded customer relationship management software to more efficiently manage our sales and marketing activities.

Maintaining key alliances is also crucial to sales development and growth and often provides us with introductions to the customers of our alliance partners. These alliances reside with various information technology consulting firms, specialty mission-critical engineering firms, application service providers and internet service providers. Key alliance opportunities also reside in other firms within the market sector such as equipment manufacturers, product suppliers, property management firms, developers, information technology system integrators and firmware providers. We have key strategic alliances with large information technology corporations to provide engineering, design, construction management services, systems integration, modular solutions and facility management services.

Competition

The mission-critical information technology solutions market is large, fragmented and highly competitive. We compete for contracts based on the strength of our customer relationships, successful past performance record, significant technical expertise, specialized knowledge and broad service offerings. We often compete against divisions of large design and build construction and real estate firms and information technology service and equipment providers of various sizes. Some of these competitors are large, well-established companies that have broader geographic scope and greater financial and other resources than us. In some cases, because of diverse requirements, we frequently collaborate with these and other competitors for large projects. We expect competition in the mission-critical information technology services sector to continue to increase in the future.

Because of the breadth of services that we provide, we face many different competitors some of which are our customers or vendors. An example of some of our competitors include the following:

Data center assessment	CSC, Emerson, large IT OEMS (IBM, HP, etc.) and consulting firms (Accenture, etc.)
Data center design	Syska Hennesey, Flour, Jacobs Engineering
Data center construction	DPR Construction, Holder Construction, Skanska, Structure Tone
Modular data center design and configuration	IO, AST/Schneider, Skanska, Emerson
Data center rack and modular IT integration	Quanta, Jabil, Avnet, Supermicro
Modular deployment	McKinstry, Lee Technologies
Data center facilities and modular maintenance	Lee Technologies, McKinstry, JLL, CBRE

We believe that, while we face large and small competitors across the spectrum of our service offering, we are uniquely positioned to provide services to IT and facilities across both modular and traditional data center markets. We believe by providing a single source solution focused in the data center market we provide our customers an integrated solution cost effectively.

Employees

At December 31, 2015, we had 90 full-time employees. Our future success will depend significantly on our ability to attract, retain and motivate qualified personnel. We are not a party to any collective bargaining agreement and we have not experienced any strikes or work stoppages. We consider our relationship with our employees to be satisfactory.

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Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statements relating to our annual stockholders meeting with the Securities and Exchange Commission (SEC). Copies of these filings, including amendments to such filings are available, free of charge, on our website, *www.totalsitesolutions.com*, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Information contained on our website is not and should not be deemed to be a part of this Annual Report or a part of any other report or filing with the SEC. All reports that we file with the SEC are available to read and copy at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site at *www.sec.gov* that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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Item 1A. RISK FACTORS

Our business involves a number of risks, some of which are beyond our control. The risks and uncertainties described below are not the only ones we face. Such factors could have a significant impact on our business, operating results and financial condition. We believe the most significant of these risks and uncertainties are as follows:

Our independent registered public accounting firm s report contains an explanatory paragraph that expresses substantial doubt about our ability to continue as a going concern

Our consolidated financial statements included in this annual report have been prepared on the basis that we will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that we will be able to realize our assets and discharge our liabilities in the normal course of business. Our history of operating losses, declining current ratio and stockholders deficit may, by themselves, cause uncertainty about our ability to continue to operate our business as a going concern. Note 1 to our consolidated financial statements describes the actions we have taken and could take to improve our liquidity.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs and our ability to secure additional sources of funding if needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2016 or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs or obtain funding in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. We are seeking additional funding to support ongoing operations. We have no arrangement or commitments for any financing, and financing may not be available when needed on terms favorable to us, or at all.

In its audit report on our financial statements, our independent registered public accounting firm noted that we have suffered recurring losses, have a net working capital deficiency, and a deficiency of stockholders equity. As a result of these conditions, the audit report contains an explanatory paragraph that raises substantial doubt about our ability to continue as a going concern.

Our inability to maintain sufficient availability under our revolving credit facility or sufficient access to capital markets to replace that facility when it matures would have a significant impact on our business.

We currently maintain a revolving credit facility with Bridge Bank, National Association that expires in May 2016. Borrowings under this facility are collateralized by substantially all of our assets. The amount of available borrowings fluctuates based on the underlying asset-borrowing base, which is 80% of our eligible trade accounts receivable. At December 31, 2015 we had $2.16 million outstanding under this facility. In addition to cash on hand, cash flow from operations and our vendor financing facility, this bank facility provides us with the liquidity we require to meet our operating, investing and financing needs. The failure to replace the existing credit facility upon its maturity with a comparable credit facility that provides similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

We may not have sufficient financial resources to carry out our strategy; we may need to issue debt or use our stock to seek additional funding.

We may not have sufficient financial resources to carry out our strategy. As described above, we may need to secure additional capital in the future to improve our liquidity in order to carry out our business plan. The amounts involved in any such transaction, individually or in the aggregate, may be material. To the extent that we raise additional capital through the sale of equity securities, the issuance of such securities could result in dilution to our existing stockholders. If we raise additional funds through the issuance of debt securities, the terms of such debt could impose additional restrictions on our operations. Additional capital, if required, may not be available on acceptable terms, if at all. A failure to obtain additional financing could have a material adverse impact our business, financial condition and earnings.

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We incurred a net loss in 2015 and 2014 and we may experience net losses in the future.

We experienced net losses of $2.2 million and $2.8 million for the years ended December 31, 2015 and 2014, respectively. Although we have had multiple profitable quarters in the last two years including most recently in the fourth quarter of 2015, we have had a history of fluctuating operating results, including a history of annual net losses from inception through 2009 and from 2012 through 2015. Although we have made efforts to align costs with sales and gross margin volume, there can be no guarantee that we will be successful in sustaining or increasing profitability in 2016 or beyond. The uncertainty of a rapidly changing competitive marketplace has created a volatile and challenging business climate, which may continue to negatively impact our customers and their spending and investment decisions. We may not be able to generate the level of revenue necessary to achieve and maintain sustainable profitability, particularly as we continue to incur significant sales and marketing and administrative expenses. Any failure to maintain and grow our revenue volumes would adversely affect our business, financial condition and operating results.

We have substantial amounts of goodwill and other intangibles, and changes in future business conditions could cause these assets to become impaired, requiring substantial write-downs that would adversely affect our operating results.

We have substantial amounts of goodwill and other intangibles resulting from prior acquisitions of businesses, including the acquisition of the systems integration business from arvato digital services, LLC in 2013. Under generally accepted accounting principles, we do not amortize goodwill and intangible assets acquired in a purchase business combination that are determined to have indefinite useful lives, but instead review them annually (or more frequently if impairment indicators arise) for impairment. We are amortizing certain other intangibles over their useful lives. To the extent we determine that such assets have been impaired, we will write-down their carrying value on our consolidated balance sheet and book an impairment charge in our consolidated statement of operations. During each of the years ended December 31, 2015 and 2014, we conducted such analyses that resulted in no impairment. The net carrying value of goodwill and other indefinite lived intangibles totaled $1.9 million at December 31, 2015 and 2014, respectively. The net carrying value of finite lived intangible assets totaled $0.8 million and $1.0 million at December 31, 2015 and 2014, respectively.

We derive a significant portion of our revenues from a limited number of customers.

We derive and believe that we will continue to derive in the near term a significant portion of our revenues from a limited number of customers. To the extent that any significant customer uses less of our services or terminates its relationship with us, our revenues could decline significantly, which could have a material adverse effect on our financial condition and results of operations. Three customers comprised 65% and 60% of total revenues for the years ended December 31, 2015 and 2014, respectively.

Most of our contracts may be canceled on short notice, so our revenue and potential profits are not guaranteed.

Most of our contracts are cancelable on short notice by the customer either at its convenience or upon our default. If one of our customers terminates a contract at its convenience, then we typically are able to recover only costs incurred or committed, settlement expenses and profit on work completed prior to termination, which could prevent us from recognizing all of our potential revenue and profit from that contract. If one of our customers terminates the contract due to our default, we could be liable for excess costs incurred by the customer in re-procuring services from another source, as well as other costs. Many of our contracts, including our service agreements, are periodically open to bid. We may not be the successful bidder on our existing contracts that are re-bid. We also provide a portion of our services on a non-recurring, project-by-project basis. We could experience a reduction in our revenue, profitability and liquidity if our customers cancel a significant number of contracts, we fail to win a significant number of our existing contracts upon re-bid or we complete the required work under a significant number of our non-recurring projects and cannot replace them with similar projects. In addition, we provide services under certain master service agreements. If these agreements are terminated, we would be unable to provide on-going services to those customers.

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A significant portion of our projects are accounted for on the percentage-of-completion method, and if actual results vary from the assumptions made in estimating percentage-of-completion, our revenue and income could be reduced.

We generally recognize revenue for a significant portion of our projects using the percentage-of-completion method. Under the percentage-of-completion method, we record revenue as work on the contract progresses. The cumulative amount of revenue recorded on a contract at a specified point in time is equal to that percentage of total revenue that incurred costs to date bear to the estimated total expected contract costs. The percentage-of-completion method therefore relies on accurate estimates of total expected contract costs. Contract revenue and total cost estimates are reviewed and revised periodically as the work progresses. Adjustments are reflected in contract revenue in the fiscal period when such estimates are revised. Estimates are based on management s reasonable assumptions and experience, but are only estimates. Variation between actual results and estimates on a large project or on a number of smaller projects could be material. We immediately recognize the full amount of the estimated loss on a contract when our estimates indicate such a loss. Any such loss would reduce our revenue and income.

We submit change orders to our customers for work we perform beyond the scope of some of our contracts. If our customers do not approve these change orders, our results of operations could be adversely impacted.

We typically submit change orders under some of our contracts for payment of work performed beyond the initial contractual requirements. The applicable customers may not approve or may contest these change orders and we cannot assure you that these claims will be approved in whole, in part or at all. If these claims are not approved, our net income and results of operations could be adversely impacted.

We may not accurately estimate the costs associated with services provided under fixed-price contracts, which could impair our financial performance.

Approximately 85% of our revenue is derived from fixed price contracts. Under these contracts, we set the price of our services and assume the risk that the costs associated with our performance may be greater than we anticipated. Our profitability is therefore dependent upon our ability to estimate accurately the costs associated with our services. These costs may be affected by a variety of factors, such as lower than anticipated productivity, conditions at the work sites differing materially from what was anticipated at the time we bid on the contract, and higher than expected costs of materials and labor. Certain agreements or projects could have lower margins than anticipated or losses if actual costs for contracts exceed our estimates, which could reduce our profitability and liquidity.

Failure to properly manage projects may result in costs or claims.

Our engagements often involve relatively large scale, highly complex projects. The quality of our performance on such projects depends in large part upon our ability to manage the customer relationship, to manage effectively the project and to deploy appropriate resources, including third-party contractors and our own personnel, in a timely manner. Any defects, errors or failure to meet customers expectations could result in claims for substantial damages against us. We currently maintain comprehensive general liability, umbrella, and professional liability insurance policies. We cannot be certain that the insurance coverage we carry to cover such claims will be adequate to protect us from the full impact of such claims. Moreover, in certain instances, we guarantee customers that we will complete a project by a scheduled date or that the project will achieve certain performance standards. If the project experiences a performance problem, we may not be able to recover the additional costs we will incur, which could exceed revenues realized from a project. Finally, if we underestimate the resources or time we need to complete a project with capped or fixed fees, our operating results could be seriously harmed.

We may choose, or be required, to pay our subcontractors even if our customers do not pay or delay paying us for the related services.

We use subcontractors to perform portions of our services and to manage work flow. In some cases, we pay our subcontractors before our customers pay us for the related services. If we choose, or are required, to pay our subcontractors for work performed for customers who fail to pay, or delay paying us for the related work, we could experience a decrease in profitability and liquidity.

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We operate in a highly competitive industry, which could reduce our growth opportunities, revenue and operating results.

The mission-critical information technology industry in which we operate is highly competitive and continues to become more competitive. We often compete against divisions of large design build construction and real estate firms and other information technology consulting and integration companies, including several that are large domestic companies that may have financial, technical and marketing resources that exceed our own. These larger competitors have an infrastructure and support greater than ours, and accordingly, we continue to experience some price pressure as some companies are willing to take on projects at lower margins. Our competitors may develop the expertise, experience and resources to provide services that are equal or superior in both price and quality to our services, and we may not be able to maintain or enhance our competitive position. Our size often prevents us from bidding on larger, more profitable projects, which significantly reduces our growth opportunities. Although our customers currently outsource a significant portion of these services to us and our competitors, we can offer no assurance that our existing or prospective customers will continue to outsource specialty contracting services to us in the future.

The industries we serve have experienced and may continue to experience rapid technological, structural and competitive changes that could reduce the need for our services and adversely affect our revenues.

The mission-critical information technology industry is characterized by rapid technological change, intense competition and changing consumer and data center needs. We generate a significant portion of our revenues from customers in the mission-critical information technology industry. New technologies, or upgrades to existing technologies by customers, could reduce the need for our services and adversely affect our revenues and profitability. Improvements in existing technology may allow companies to improve their networks without physically upgrading them. Reduced demand for our services or a loss of a significant customer could adversely affect our results of operations, cash flows and liquidity.

We may be unable to obtain sufficient bonding capacity to support certain service offerings.

Some of our contracts, particularly with managing construction related-activities, require performance and payment bonds. Bonding capacity for construction projects has become increasingly difficult to obtain, and bonding companies are denying or restricting coverage to an increasing number of contractors. Companies that have been successful in renewing or obtaining coverage have sometimes been required to post additional collateral to secure the same amount of bonds which would reduce availability under any credit facility. We may not be able to maintain a sufficient level of bonding capacity in the future, which could preclude us from being able to bid for certain contracts and successfully contract with certain customers. In addition, even if we are able to successfully renew or obtain performance or payment bonds in the future, we may be required to post letters of credit in connection with the bonds. At December 31, 2015, we had approximately $7.3 million in outstanding bonds associated with ongoing projects.

We may be unable to hire and retain sufficient qualified personnel and the loss of any of our key executive officers may adversely affect our business.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled, knowledgeable, sophisticated and qualified managerial, professional and technical personnel. Our business involves the development of tailored solutions for customers, a process that relies heavily upon the expertise and services of employees. Accordingly, our employees are one of our most valuable resources. Competition for skilled personnel is intense in our industry. Recruiting and training these personnel require substantial resources. Our failure to attract and retain qualified personnel could increase our costs of performing our contractual obligations, reduce our ability to efficiently satisfy our customers needs, limit our ability to win new business and constrain our future growth.

If we are unable to engage appropriate subcontractors or if our subcontractors fail to perform their contractual obligations, our performance as a prime contractor and ability to obtain future business could be materially and adversely impacted.

Our contract performance may involve subcontracts with other companies upon which we rely to perform all or a portion of the work we are obligated to deliver to our customers. Our inability to find and engage

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appropriate subcontractors or a failure by one or more of our subcontractors to satisfactorily deliver on a timely basis the agreed-upon supplies and/or perform the agreed-upon services may materially and adversely affect our ability to perform our obligations as a prime contractor.

In extreme cases, a subcontractor s performance deficiency could result in the customer terminating the contract for default with us. A default termination could expose us to liability for excess costs of procurement by the customer and have a material adverse effect on our ability to compete for future contracts and task orders.

Because we do not currently intend to pay dividends on our common stock, stockholders will benefit from an investment in our common stock only if it appreciates in value.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain all future earnings, if any, for use in the operations and expansion of our business. As a result, we do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the declaration and payment of cash dividends will be at the discretion of our board of directors and will depend on factors our board of directors deems relevant, including, among others, our results of operations, financial condition and cash requirements, business prospects, and the terms of our credit facility and other financing arrangements. Accordingly, realization of a gain on stockholders investments will depend on the appreciation of the price of our common stock. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders purchased their shares.

Our insiders beneficially own a significant portion of our outstanding common stock. Future sales of common stock by these insiders may have an adverse effect on the market price of our common stock.

Our officers, directors or their affiliates beneficially own approximately 5.8 million shares of common stock or approximately 34% of our outstanding common shares as of March 30, 2016. Stock sales by our directors and officers are subject to compliance with our Code of Conduct and preapproval process from the Chief Financial Officer. Sales of a substantial number of these shares in the public market could decrease the market price of our common stock. In addition, the perception that such sales might occur may cause the market price of our common stock to decline. Future issuances or sales of our common stock could have an adverse effect on the market price of our common stock.

Our shares are thinly traded and may not be readily marketable.

Our shares are not widely traded, and daily trading volume is generally very low compared with most publicly traded companies. As a result, you may not be able to readily resell your shares in the company.

Our common stock may be characterized as a penny stock under applicable SEC regulations.

Our common stock may be characterized as penny stock under SEC regulations. As such, broker-dealers dealing in our common stock may be subject to the disclosure rules for transactions involving penny stocks, which generally require that, prior to a purchase, the broker-dealer determine if purchasing the common stock is suitable for the applicable purchaser. The broker-dealer must also obtain the written consent of the applicable purchasers to purchase the common stock and disclose the best bid and offer prices available for the common stock and the price at which the broker-dealer last purchased or sold the common stock. These additional burdens imposed upon broker-dealers may discourage them from effecting transactions in our common stock, which could make it difficult for an investor to sell his, her or its shares at any given time.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease a production facility, warehouse and office space in Round Rock, Texas. We also lease office facilities in Columbia, Maryland, Dulles, Virginia and Los Altos, California. We believe that our current facilities are adequate for our operations and additional or replacement facilities would be available if necessary.

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Item 3. Legal Proceedings

We are not a party to any material litigation in any court, and we are not aware of any contemplated proceeding by any governmental authority against us. From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We believe that any potential liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The market for our common stock is limited due to the relatively low trading volume of our common stock and lack of analyst coverage. Our common stock is currently quoted on the OTCQB tier of OTC Markets Group, Inc. under the symbol TSSI. The OTCQB is a centralized quotation service that collects and publishes market maker quotes for over-the-counter securities in real time. Over-the-counter market quotations, like those on the OTCQB, reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

The following table sets forth the high and low bid prices for our common stock for each of the quarters of 2015 and 2014 as reported by the OTC Markets Group:

	2015		2014	
	Low	High	Low	High
First Quarter	$ 0.34	$ 0.84	$ 0.31	$ 0.49
Second Quarter	0.34	0.75	0.20	0.48
Third Quarter	0.13	0.40	0.12	0.35
Fourth Quarter	0.03	0.23	0.12	0.49

As of March 30, 2016, there were 59 stockholders of record of our common stock, although we believe there is a larger number of beneficial owners.

We did not pay dividends on our outstanding stock during the years ended December 31, 2015 and 2014. We currently intend to retain all future earnings, if any, for use in the operations and expansion of our business. As a result, we do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the declaration and payment of cash dividends will be at the discretion of our board of directors and will depend on factors our board of directors deems relevant, including, among others, our results of operations, financial condition and cash requirements, business prospects and the terms of our credit facilities and other financing arrangements.

The following table provides information as of December 31, 2015 with respect to shares of our common stock that may be issued under equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	2,405,000	$ 0.48	2,582,208
	1,215,877	$ 0.79	None

Equity compensation plans not approved by security holders			
Total	3,620,877	$ 0.58	2,582,208

Item 6. Selected Financial Data and Supplementary Financial Information

The information called for by this item is not required as we are a smaller reporting company.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains statements that are forward-looking. These statements are based on expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of, among other reasons, factors discussed in Item 1A Risk Factors and elsewhere in this Annual Report. The commentary should be read in conjunction with the consolidated financial statements and related notes and other statistical information included in this Annual Report.

Overview

TSS, Inc. provides comprehensive services for the planning, design, development and maintenance of mission-critical facilities and information infrastructure, as well as integration services. We provide a single source solution for highly technical mission-critical facilities such as data centers, operation centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, design and engineering, construction management, systems integration, system installations and facilities management.

Our headquarters are in Round Rock, Texas, and we have offices in Columbia, Maryland, Dulles, Virginia, and Los Altos, California.

Our business is concentrated on the data center infrastructure and services market. This market is becoming increasingly competitive as commerce moves to cloud-based solutions and as data storage requirements continue to escalate for many industries. These underlying macroeconomic trends are driving demand for increasingly efficient data center design, construction and operation, resulting in increasing capital expenditures in this market. We compete against many larger competitors who have greater resources than we do, which may affect our competitiveness in the market. We rely on several large customers to win contracts and to provide business to us under Master Service Agreements , and the loss of such customers could have a material negative effect on our results. We have recently added to our direct sales force to help diversify our customer base to reduce this risk.

During 2015, our focus was centered on managing and improving liquidity, controlling operating expenses, and driving higher-margin revenue streams for the Company to improve profitability. We also upgraded our direct sales force to expand our sales reach, particularly in the modular data center area, and to further diversify our customer base. These efforts had mixed results but resulted in our achieving profitability during the fourth quarter of 2015, overall revenue growth from the prior year and reductions in the level of losses we incurred. It also resulted in an expanded sales pipeline that we believe will drive improved operating results in 2016.

Our total revenue in 2015 of $29.5 million was a $1.5 million or 5% increase from 2014. This increase was driven by a $3.4 million or 17% increase in facilities services revenues (formerly called facilities construction and maintenance services) as our project management activities, including equipment procurement, increased due to a large customer project in the fourth quarter of 2015. This increase was offset by a $2 million or 26% decrease in our systems integration revenues driven by lower demand from our largest channel partner compared to 2014. This decrease in systems integration revenues also contributed to lower deployment levels of modular data centers and lower facilities maintenance contract revenue compared to the prior year.

Our gross profit of $8.4 million in 2015 was $0.2 million or 2% lower than our gross profit in 2014, despite the increase in revenue levels. This decrease reflects the lower profit margins we make on certain services, including equipment procurement and project management activities, compared to our systems integration and facility management services. Our ability to further improve gross margins will depend, in part, upon our ability to further increase sales of our higher-margin services including maintenance and integration services, improve our service margins through further pricing and operating efficiency including utilization of our direct labor, and increasing our total revenues to a level that will allow us to increase the utilization of our integration and service operations.

Our operating loss of $1.8 million was $0.6 million or 25% lower than 2014. Included in our operating losses was stock-based compensation expenses of $0.5 million in both 2015 and 2014, respectively. This decrease in operating loss was due to cost savings from headcount reductions and lower professional fees. In the aggregate we were able to lower our operating expenses by $817,000 or 7% from the prior year.

We continue to manage our working capital requirements to manage liquidity, and ensure that we have the necessary financial resources to execute on our business strategy.

Critical Accounting Policies and Estimates

We consider an accounting policy to be critical if:

the accounting estimate requires us to make assumptions about matters that are highly uncertain or require the use of judgment at the time we make that estimate; and
changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we could have reasonably used instead in the current period, would have a material impact on our financial condition or results of operations.

Management has reviewed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed these disclosures. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in these and other items could still have a material impact upon our financial statements.

Revenue Recognition

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from fixed-price contracts, time-and-materials contracts, cost-plus-fee contracts (including guaranteed maximum price contracts), facility service and maintenance contracts, and product shipments.

Revenue from fixed price contracts is recognized on the percentage of completion method. We apply Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-35, *Construction-Type and Production-Type Contracts*, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs. This method is used because management considers costs incurred and costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Costs and estimated earnings in excess of billings, or work in process, are classified as current assets for the majority of our projects. Work in process on contracts is based on work performed but not yet billed to customers as per individual contract terms.

Certain of our contracts involve the delivery of multiple elements including design management, system installation and facilities maintenance. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative selling price of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the service when it is sold separately or competitor prices for similar services.

Revenue and related costs for master and other service agreements billed on a time and materials basis are recognized as the services are rendered based on actual labor hours performed at contracted billable rates, and costs incurred on behalf of the customer. Services are also performed under master and other service agreements billed on a fixed fee basis. Under fixed fee master service and similar type service agreements for facilities and equipment, we furnish various unspecified units of service for a fixed price. These services agreements are recognized on the proportional performance method or ratably over the course of the service period and costs are recorded as incurred in performance.

Intangible Assets

We recorded goodwill and intangibles with definite lives, including customer relationships and acquired software, in conjunction with the acquisition of the systems integration business. These intangible assets are amortized based on their estimated economic lives. Goodwill represents the excess of the purchase price over the fair value of net identified tangible and intangible assets acquired and liabilities assumed, and it is not amortized.

We perform an impairment test of goodwill on an annual basis or whenever events or circumstances make it more likely than not that impairment of goodwill may have occurred. As part of the annual impairment test, we first have the option to make a qualitative assessment of goodwill for impairment. If we are able to determine through the qualitative assessment that the fair value of a reporting unit more likely than not exceeds its carrying value, no further evaluation is necessary. For those reporting units for which the qualitative assessment is either not performed or indicates that further testing may be necessary, we then assess goodwill for impairment using a two-step process. The first step requires comparing the fair value of the reporting unit with its carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed, and no impairment charge is required to be recorded. If that fair value does not exceed that carrying amount, we must perform the second step, which requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to the carrying amount with any excess recorded as an impairment charge.

We also review intangible assets with definite lives for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset, a loss is recognized for the difference between the fair value and carrying value of the intangible asset.

Allowance for Doubtful Accounts

We estimate an allowance for doubtful accounts based on factors related to the specific credit risk of each customer. Historically our credit losses have been minimal. We perform credit evaluations of new customers and may require prepayments or use of bank instruments such as trade letters of credit to mitigate credit risk. As we expand our product offerings and customer base, our risk of credit loss has increased. We monitor outstanding amounts to limit our credit exposure to individual accounts. We continue to pursue collection even if we have fully provided for an account balance.

Stock Based Compensation

We account for stock-based compensation using a fair-value based recognition method. Stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data and market information that can change significantly over time. A small change in estimates used can have a relatively large change in the estimated valuation.

We use the Black-Scholes option valuation model to value employee stock awards that are not performance based awards. We estimate stock price volatility based upon our historical volatility. Estimated option life and forfeiture rate assumptions are derived from historical data. For stock-based compensation awards with graded vesting, we recognize compensation expense using the straight-line amortization method. For performance-based stock awards we use third-party valuation specialists and a Monte-Carlo simulation model to ascertain the fair value of the award at grant date.

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Results of Operations

Comparison of 2015 to 2014

Revenue

Revenue consists of fees earned from the planning, design and project-management of mission-critical facilities and information infrastructures, as well as fees earned from providing maintenance services on these facilities. We also earn revenue from providing system configuration and integration services to IT equipment vendors. Currently we derive all of our revenue from the US market.

We contract with our customers under five primary contract types: cost-plus-fee, guaranteed maximum price, time-and-materials, fixed-price contracts and fixed price service and maintenance contracts. Cost-plus-fee and guaranteed maximum price contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements which generate higher profit margins generally, relative to their higher risk. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price arrangements rather than cost-plus-fee and guaranteed maximum price contracts.

Most of our revenue is generated based on services provided either by our employees or subcontractors. To a lesser degree, the revenue we earn includes reimbursable travel and other costs to support the project. Since we earn higher profits from the labor services that our employees provide compared with use of subcontracted labor and other reimbursable costs, we seek to optimize our labor content on the contracts we are awarded in order to maximize our profitability.

We have been concentrating our sales efforts towards maintenance and integration services where we have traditionally earned higher margins. Historically our design and project-management services were tied to a few, high-value contracts for the construction of new data centers at any point in time. In addition to contributing to large quarterly fluctuations in revenue depending upon project timing, these projects required additional working capital and generated lower margins than our maintenance and integration services. We have re-focused our design and project-management services towards smaller scaled jobs typically connected with addition/move/retrofit activities rather than new builds, where we can obtain better margins. We have also focused on providing maintenance services for modular data center applications as this emerging market expands.

Revenues for the year ended December 31, 2015 increased by $1.5 million or 5% compared to 2014. This was driven by a $3.4 million or 17% increase in facilities services revenues as our project management activities, including equipment procurement, increased due to a large customer project in the fourth quarter of 2015. This increase was offset by a $2 million or 26% decrease in our systems integration revenues driven by lower demand from our largest channel partner compared to 2014. This decrease in systems integration revenues also contributed to lower deployment levels of modular data centers and lower facilities maintenance contract revenue compared to the prior year.

Our facility services projects tend to be larger in value than the contracts for our other products and services and from a smaller number of customers. These projects have greater transaction values and can contribute to large quarterly fluctuations in revenue due to the timing of such projects and their fulfillment. We have historically had such projects with values that exceeded $10 million annually. A small number of these transactions can lead to a significant increase in revenue but cause greater volatility in our quarterly results depending on the deployment timetable of the projects. These projects also increase our liquidity risk because they tend to be longer in duration and require larger amounts of working capital to fulfill, which we attempt to manage through customer and vendor payment terms, including paid-when-paid terms, as part of our working capital management.

Cost of revenue

Cost of revenue includes the cost of component parts for our products, labor costs expended in the production and delivery of our services, subcontractor and third-party expense, equipment and other costs associated with our test and integration facilities, including depreciation of our manufacturing property and equipment, shipping costs, and the costs of support functions such as purchasing, logistics and quality assurance. The cost of revenue as a percentage of revenue was 72% for the year ended December 31, 2015 compared to 69% for 2014. This increase is because of higher equipment procurement costs in 2015 tied to a large project in the fourth quarter of 2015, and due to lower utilization of our systems integration facility in 2015 as revenues from this business unit decreased. We have higher costs and lower margins from project management activities including equipment procurement, and as this revenue increased compared to 2014, this resulted in a higher cost of revenue.

Since we earn higher profits on our own labor services, we expect the ratio of cost of services to revenue to decline when our labor services mix increases relative to the use of subcontracted labor or third-party material. Conversely, as subcontracted labor or third-party material purchases for customer projects increase relative to our own labor services, we expect the ratio of cost of services to revenue to increase. Our direct labor costs are relatively fixed in the short-term, and the utilization of direct labor is critical to maximizing our profitability. As we continue to bid and win larger contracts or win contracts that require specialized skills that we do not possess, we would expect to have more third-party subcontracted labor to help us fulfill those contracts. In addition, we can face hiring challenges in internally staffing larger contracts. While these factors could lead to a higher ratio of cost of services to revenue, the economics of these larger jobs are nonetheless generally favorable because they increase income, broaden our revenue base and have a favorable return on invested capital.

A large portion of our revenue is derived from fixed price contracts. Under these contracts, we set the price of our services and assume the risk that the costs associated with our performance may be greater than we anticipated. Our profitability is therefore dependent upon our ability to estimate accurately the costs associated with our services. These costs may be affected by a variety of factors, such as lower than anticipated productivity, conditions at the work sites differing materially from what was anticipated at the time we bid on the contract, and higher than expected costs of materials and labor. Certain agreements or projects could have lower margins than anticipated or losses if actual costs for contracts exceed our estimates, which could reduce our profitability and liquidity.

Gross Profit

Our gross profit margin for the year ended December 31, 2015 was 28% compared to a gross profit margin of 31% in 2014. This decrease resulted in our gross profit being $8.4 million in 2015, down $0.2 million or 2% from the gross profit in 2014, despite revenue increasing by $1.5 million compared to the prior year. This comparison highlights the differences in profit margin for our different service offerings, and our efforts to focus on higher-margin activities such as systems integration and facility maintenance. The decrease in gross profit margin reflects higher design and project-management revenues and the decrease in systems integration revenues compared to the prior year, and in particular the decrease in utilization of our systems integration facility compared to 2014. Our ability to further improve gross margins will depend, in part, upon our ability to further increase sales of our higher-margin services including maintenance and integration services, improve our service margins through further pricing and operating efficiency including utilization of our direct labor, and increasing our total revenues to a level that will allow us to increase the utilization of our integration and service operations.

Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily consists of compensation and related expenses, including variable sales compensation, for our executive, administrative and sales and marketing personnel, as well as related travel, selling and marketing expenses, professional fees, facility costs, insurances and other corporate costs. For the year ended December 31, 2015 our selling, general and administrative expenses decreased by $0.9 million or 9% compared to 2014. This decrease was due to lower salaries due to headcount reductions made in 2014, and lower professional fees, including accounting and legal fees.

Income tax expense

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2015, our accumulated net operating loss carry forward was $34.5 million. We anticipate that these loss carryforwards may offset future taxable income that we may achieve and future tax liabilities. However, because of uncertainty regarding our ability to use these carry forwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

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Comparison of 2014 to 2013

Revenue

Revenues for the year ended December 31, 2014 decreased by $16.4 million or 37% compared to 2013. This decrease primarily relates to a $4.9 million sale of large industrial batteries in the first quarter of 2013, which did not recur in 2014, and due to the absence of large construction projects in 2014 compared to 2013. Such construction revenues decreased by $9.5 million in 2014 compared to 2013. Our facilities management and related service revenues decreased by $4 million from 2013 due to changes in the configuration of modular deployments in the field, lower pricing on contract renewals and lower levels of new modular deployments compared to the prior year. These decreases were offset by a $2.6 million increase in systems integration revenues reflecting the acquisition of our systems integration business in the second quarter of 2013.

Cost of revenue

Cost of revenue includes the cost of component parts for our products, labor costs expended in the production and delivery of our services, subcontractor and third-party expense, equipment and other costs associated with our test and integration facilities, including depreciation of our manufacturing property and equipment, shipping costs, and the costs of support functions such as purchasing, logistics and quality assurance. The cost of revenue as a percentage of revenue was 69% for the year ended December 31, 2014 compared to 80% for 2013. This improvement reflects growth in our higher margin maintenance and systems integration businesses, including higher utilization of our systems integration facility in the current year as this business continued to grow, as well as the change in product mix as our facility services revenues decreased from the prior year. There are higher relative costs from greater construction revenues and this combined with costs associated with a large battery sale in 2013 caused cost of revenue to be a higher proportion of revenue in 2013.

Gross Profit

Our gross profit margin for the year ended December 31, 2014 was 31% compared to a gross profit margin of 20% in 2013. This increase resulted in our gross profit being $8.6 million in 2014, down $0.3 million or 5% from the gross profit in 2013, despite revenue decreasing by $16.4 million compared to the prior year. This comparison highlights the differences in profit margin for our different service offerings, and our efforts to focus on higher-margin activities such as systems integration and facility maintenance. and the increase in gross profit margin reflects the absence of large lower-margin revenue streams in 2014 such as our lower-margin construction projects and the $4.9 million battery project that we had in 2013. Our ability to further improve gross margins will depend, in part, upon our ability to further increase sales of our higher-margin services including maintenance and integration services, improve our service margins through further pricing and operating efficiency including utilization of our direct labor, and increasing our total revenues to a level that will allow us to increase the utilization of our integration and service operations.

Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily consists of compensation and related expenses, including variable sales compensation, for our executive, administrative and sales and marketing personnel, as well as related travel, selling and marketing expenses, professional fees, facility costs, insurances and other corporate costs. For the year ended December 31, 2014 our selling, general and administrative expenses decreased by $0.6 million or 6% compared to 2013. This decrease was due to lower salaries due to headcount reductions made in 2014, lower professional fees, including accounting and legal fees, and temporary labor which were impacted in 2013 by the acquisition of our systems integration business in the second quarter of 2013. These savings were offset by additional costs and overhead of $1.2 million resulting from adding the systems integration business into our operations, which added a new facility and new sales team, with related costs, into our cost structure.

Income tax expense

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2014, our accumulated net operating loss carry forward was $30.9 million. We anticipate that these loss carryforwards may offset future taxable income that we may achieve and future tax

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liabilities. However, because of uncertainty regarding our ability to use these carry forwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity at December 31, 2015 are our cash and cash equivalents on hand, our bank credit facility and projected cash flows from operating activities. In February 2015 we received $945,000 in proceeds from a 5-year debt agreement to provide additional liquidity for the business. During the fourth quarter of 2015 we extended the repayment terms of our promissory notes payable to our Chief Technical Officer to mitigate the impact on our liquidity.

If we continue to meet the cash flow projections in our current business plan, we expect that we will have adequate capital resources necessary to continue operating our business for at least the next twelve months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are potential risks, including that our revenues may not meet our projections, our costs may exceed our estimates, or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2016 and beyond or significantly affect our level of liquidity, which may limit our opportunities to grow our business.

Our Business Financing Agreement with Bridge Bank provides for a total line of credit of up to $6 million, subject to our borrowing base, and has a maturity date of May 2016. The revolving loans made to us under this loan facility are secured by a lien on substantially all of our assets. As of December 31, 2015, we had outstanding borrowings of $2.16 million under this loan facility and, based the borrowing base formula, we were over-advanced by approximately $262,000 which we repaid in January 2016. We are currently in compliance with all loan covenants under the loan facility. Replacement of this bank facility with a similar financing arrangement with another party will be a critical part of our liquidity management in 2016 and failure to replace this facility would have a material impact on our liquidity and ability to continue operating the business.

Our quarterly operating results have shown mixed results during 2015. Our quarterly revenues have fluctuated between $5.8 million to $10.1 million, and our gross profit margin has varied between 25% and 33%. Our operating profit improved from a loss of $1.1 million in the second quarter to an operating profit of $0.1 million in the fourth quarter of 2015. Despite the improvements in our second half results, we continue to look at alternative sources of funding to strengthen our balance sheet and to further improve our liquidity. We are currently evaluating both debt and equity financing alternatives. There can be no guarantee that such financing will be available to us or that we will complete any such financing.

As of December 31, 2015 and 2014, we had cash and cash equivalents of $1.1 million and $1.4 million, respectively.

Significant uses of cash

Operating activities:

Cash used in operating activities was $1.5 million for the year ended December 31, 2015 compared to cash provided by operating activities of $0.6 million in 2014. This decrease despite the improvement in net losses of $0.6 million reflects a $2.8 million change in our working capital needs, mainly at the end of 2015 due to timing of a large project management engagement.

The changes in working capital are driven by changes in the timing of product orders and delivery of products and services. We derive revenue from different products and services and some of these, in particular our project management services, can be large in value, exceeding $10 million in certain cases. As we, or our subcontractors, perform work or purchase equipment on these large contracts, we have significant fluctuations in the level of our receivables and payables, especially on a quarterly basis. We had one large construction project in progress at the end of 2015, but did not have such a project in progress at the end of 2014. Due to the timing of completion of this project, this contributed to a $3 million increase in accounts receivable and unbilled receivables compared to the prior year, offset by a $2 million increase in our accounts payable compared to the prior year. We have increased our level of billings in excess of revenue by $0.5 million this year as we increase our install base of maintenance contracts and have a higher level of annual and renewal billings of those contracts.

Investing activities:

Cash used in investing activities in 2015 consists of purchases of property and equipment of $0.4 million. Our capital expenditures decreased by approximately $0.1 million compared to 2014 as we invested in additional equipment and testing infrastructure in our systems integration facility, and invested in sales management and time management software in 2014.

Finance activities:

Cash provided by financing activities for the year ended December 31, 2015 was $1.7 million compared to funds used in financing activities of $2 million in 2014. In 2015 we received $945,000 in proceeds from new 5-year term debt and increased the amount outstanding under our revolving bank credit facility by $991,000. We repaid $0.2 million against our convertible note borrowing in both 2015 and 2014. In 2014 we repaid $1.8 million against our revolving bank credit facility as our level of eligible assets fluctuated. Much of this repayment occurred in the fourth quarter of 2014 after we entered into a vendor financing facility, as our bank borrowing base of eligible receivables was reduced.

Future uses of cash

Our history of operating losses, declining current ratio, and our stockholders deficit may, in themselves, cause uncertainty about our ability to continue to operate our business as a going concern. In December 2015 we restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical Officer, to defer payments of a large portion of this obligation to 2017, further reducing short term liquidity requirements on our business.. During 2015 we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix changed. We believe that there are further adjustments that could be made to our business if we were required to do so.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding estimated revenues and future costs and our ability to secure sources of funding when needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage during 2016 and beyond or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. The consolidated financial statements included in this Annual Report do not include any adjustments that might result from the Company not being able to continue as a going concern.

If we have to raise additional funds through the issuance of convertible debt or equity securities, the ownership of our existing stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain business activities or to sell all or parts of our operations.

Our primary liquidity and capital requirements are to fund working capital from current operations. Our primary sources of funds to meet our liquidity and capital requirements include cash on hand, funds generated from operations including the funds from our customer financing programs, and borrowings under our revolving credit facility. We believe that if future results do not meet expectations, we can implement reductions in selling, general and administrative expenses to better achieve profitability and therefore improve cash flows, or that we could take further steps such as the issuance of new equity or debt or the sale of part or all of our operations. However, the timing and effect of these steps may not completely alleviate a material effect on liquidity.

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Off-Balance Sheet Arrangements

During the years ended December 31, 2015 and 2014, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow limited purposes.

New Accounting Pronouncements

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, an accounting pronouncement related to the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this guidance. This update will be effective for us beginning in fiscal year 2016, with early adoption permitted, and is applied on a retrospective basis. As of December 31, 2015 and 2014 we had $33,000 and $49,000, respectively, of debt issuance costs reported as assets on our consolidated balance sheet. We do not anticipate that adoption of this guidance will have a material impact on our consolidated financial statements when we implement this pronouncement during fiscal year 2016.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 requires that management assess an entity s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. We plan to adopt ASU 2014-15 as of the end of our fiscal year ending December 31, 2016 and are currently evaluating the impact of this pronouncement on our consolidated statements of financial position and results of operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, an accounting pronouncement related to revenue recognition (FASB ASC Topic 606), which amends the guidance in former ASC Topic 605, *Revenue Recognition*, and provides a single, comprehensive revenue recognition model for all contracts with customers. This standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The entity will recognize revenue to reflect the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is not permitted. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). Under ASU 2016-2, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. The Company plans to adopt this guidance beginning with its first quarter ending March 31, 2019. We are currently evaluating the future impact of ASU 2016-02 on our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information called for by this item is not required as we are a smaller reporting company.

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Item 8. Financial Statements and Supplementary Data.

(a) Audited Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
TSS, Inc.
Columbia, MD

We have audited the accompanying consolidated balance sheet of TSS, Inc. (a Delaware corporation) and subsidiaries (the Company) as of December 31, 2015 and the related consolidated statements of operations, changes in stockholders equity (deficit), and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2015, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has suffered recurring losses and has a net capital deficiency. These conditions raise substantial doubt about its ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

/s/ WEAVER TIDWELL LLP
Austin, Texas
March 30, 2016

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
TSS, Inc.

We have audited the accompanying consolidated balance sheet of TSS, Inc. (a Delaware corporation) and subsidiaries (the Company) as of December 31, 2014 and the related consolidated statements of operations, changes in stockholders equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TSS, Inc. and subsidiaries as of December 31, 2014, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP
McLean, Virginia
April 22, 2015

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TSS, Inc.

Consolidated Balance Sheets (in 000 except per-share amounts)

	December 31, 2015	2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$1,132	$1,378
Contract and other receivables, net	6,997	3,951
Costs and estimated earnings in excess of billings on uncompleted contracts	1,084	1,042
Inventories, net	66	154
Prepaid expenses and other current assets	235	243
Total current assets	9,514	6,768
Property and equipment, net	702	670
Goodwill	1,907	1,907
Other intangible assets, net	841	979
Other assets	63	91
Total assets	$13,027	$10,415
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current Liabilities:		
Long-term borrowings, current portion, net	$293	$149
Borrowings under credit facility	2,162	1,171
Accounts payable and accrued expenses	7,608	5,547
Billings in excess of costs and estimated earnings on uncompleted contracts	2,476	2,009
Total current liabilities	12,539	8,876
Long-term borrowings, less current portion	1,054	575
Other liabilities	34	18
Total liabilities	13,627	9,469
Commitments and Contingencies		
Stockholders Equity (Deficit):		
Preferred stock, $.0001 par value, 1,000 shares authorized; none issued		
Common stock, $.0001 par value, 49,000 shares authorized; 16,366 and 15,853 issued; 15,642 and 15,209 outstanding at December 31, 2015 and 2014, respectively	2	2
Additional paid-in capital	68,329	67,651
Treasury stock 724 and 644 shares at cost at December 31, 2015 and, 2014, respectively	(1,531)	(1,512)
Accumulated deficit	(67,400)	(65,195)
Total stockholders equity (deficit)	(600)	946
Total liabilities and stockholders equity (deficit)	$13,027	$10,415

See accompanying notes to consolidated financial statements.

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TSS, Inc.

Consolidated Statements of Operations (in 000 except per-share amounts)

	Year Ended December 31,	
	2015	2014
Revenue	$ 29,487	$ 27,985
Cost of revenue excluding depreciation and amortization	21,119	19,424
Gross profit	8,368	8,561
Selling, general and administrative expenses	9,651	10,546
Depreciation and amortization	566	488
Loss from operations	(1,849)	(2,473)
Interest expense, net	(344)	(277)
Other income, net	9	
Loss before income taxes	(2,184)	(2,750)
Income tax provision	21	53
Net loss	$ (2,205)	$ (2,803)
Basic and diluted loss per share	$ (0.14)	$ (0.19)
Weighted average common shares outstanding	15,543	15,017

See accompanying notes to consolidated financial statements.

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TSS, Inc.

Consolidated Statements of Changes in Stockholders Equity (Deficit) (in 000)

	Common Stock		Additional Paid-in Capital	Treasury Stock		Accumulated Deficit	Total Stockholders Equity (Deficit)
	Shares	Amount		Shares	Amount		
Balance at January 1, 2014	15,395	$ 2	$ 67,152	823	$ (1,512)	$ (62,392)	$ 3,250
Purchase of treasury stock							
Stock-based compensation	458		499	(181)			499
Net loss for the year						(2,803)	(2,803)
Balance December 31, 2014	15,853	$ 2	$ 67,651	644	$ (1,512)	$ (65,195)	$ 946
Restricted stock issuance	570						
Cancellation of restricted stock	(57)						
Warrants issued with debt			179				179
Treasure stock repurchased				80	(19)		(19)
Stock-based compensation			499				499
Net loss for the year						(2,205)	(2,205)
Balance December 31, 2015	16,366	$ 2	$ 68,329	724	$ (1,531)	$ (67,400)	$ (600)

See accompanying notes to consolidated financial statements.

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TSS, Inc.

Consolidated Statements of Cash Flows (in 000)

	Year Ended December 31, 2015	2014
Cash Flows from Operating Activities:		
Net loss	$(2,205)	$(2,803)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	566	392
Provision (recoveries) for doubtful accounts	(11)	9
Stock-based compensation	499	499
Amortization of discount on note payable	63	146
Changes in operating assets and liabilities:		
Restricted cash		501
Contracts and other receivables	(3,035)	4,450
Costs and estimated earnings in excess of billings on uncompleted contracts	(42)	(498)
Inventories, net	88	63
Prepaid expenses and other current assets	(22)	204
Accounts payable and accrued expenses	2,061	(2,042)
Billings in excess of costs and estimated earnings on uncompleted contracts	467	(308)
Other liabilities	19	9
Net cash provided by (used in) operating activities	(1,552)	622
Cash Flows from Investing Activities:		
Capital expenditures	(411)	(507)
Net cash used in investing activities	(411)	(507)
Cash Flows from Financing Activities:		
Payments on convertible notes and seller notes	(200)	(200)
Proceeds from issuance of debt	945	
Repurchase of treasury stock	(19)	
Proceeds from (repayment of) credit facility	991	(1,828)
Net cash provided by (used in) financing activities	1,717	(2,028)
Net decrease in cash and cash equivalents	(246)	(1,913)
Cash and cash equivalents, beginning of period	1,378	3,291
Cash and cash equivalents, end of period	$1,132	$1,378
Supplemental disclosure of cash flow information:		
Cash paid for interest	$276	$155
Cash paid for taxes	77	27

See accompanying notes to consolidated financial statements.

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies

Description of Business

TSS, Inc. (TSS , the Company , we , us or our), provides comprehensive services for the planning, design, constru and maintenance of mission-critical facilities and information infrastructure as well as systems integration services related to this infrastructure. We provide a single source solution for highly technical mission-critical facilities such as data centers, operations centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services consist of technology consulting, design and engineering, construction management, facilities management and systems integration. Our corporate offices are in Round Rock, Texas, and we also have facilities in Dulles, Virginia, Columbia, Maryland and Los Altos, California.

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States (GAAP) requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates which are based on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form a basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates are reasonable and that the actual results will not vary significantly from the estimated amounts.

The accompanying consolidated financial statements have also been prepared on the basis that the Company will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize it assets and discharge its liabilities in the normal course of business. Our history of operating losses, declining current ratio, and stockholder s deficit may, in themselves, cause uncertainty about our ability to continue to operate our business as a going concern and meet our obligations as they come due. Our operating results improved in the second half of 2015 and generated positive cash from operations. We recently restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical Officer, to defer payments of a large portion of this obligation to 2017, further reducing short term liquidity requirements on our business. During 2015 and 2014 we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix changed. We believe that there are further adjustments that could be made to our business if we were required to do so. Collectively, these steps taken have improved our liquidity position since June 2015.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs and our ability to secure additional sources of funding if needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2016 or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs or obtain funding in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. These financial statements do not include any adjustments that might result from the Company not being able to continue as a going concern.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

Financial Instruments

The Company s financial instruments primarily consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The fair value of the long-term debt is disclosed in *Note 3 Long Term Borrowings* and *Note 4 Credit Facility*. The carrying amounts of the other financial instruments approximate their fair value at December 31, 2015 and 2014, due to the short-term nature of these items. See *Note 7 Fair Value Measurements.*

Accounting for Business Combinations

We allocate the purchase price of an acquired business to its identifiable assets and liabilities based on estimated fair values. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed, if any, is recorded as goodwill.

We use all available information to estimate fair values. We typically engage outside appraisal firms to assist in the fair value determination of identifiable intangible assets such as customer contracts, leases and any other significant assets or liabilities and contingent consideration. Preliminary purchase price allocation is adjusted, as necessary, up to one year after the acquisition closing date if management obtains more information regarding asset valuations and liabilities assumed.

Revenue Recognition

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from fixed-price contracts, time-and-materials contracts, cost-plus-fee contracts (including guaranteed maximum price contracts), facility service and maintenance contracts, and product shipments.

Revenue from fixed price contracts is recognized on the percentage of completion method. We apply Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 605-35, *Construction-Type and Production-Type Contracts*, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs. This method is used because management considers costs incurred and costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Costs and estimated earnings in excess of billings, or work in process, are classified as current assets for the majority of our projects. Work in process on contracts is based on work performed but not yet billed to customers as per individual contract terms.

Certain of our contracts involve the delivery of multiple elements including design management, system installation and facilities maintenance. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative selling price of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the service when it is sold separately or competitor prices for similar services.

Revenue and related costs for master and other service agreements billed on a time and materials basis are recognized as the services are rendered based on actual labor hours performed at contracted billable rates, and costs incurred on behalf of the customer. Services are also performed under master and other service agreements billed on a fixed fee basis. Under fixed fee master service and similar type service agreements for facilities and equipment, we furnish various unspecified units of service for a fixed price. These services

TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

agreements are recognized on the proportional performance method or ratably over the course of the service period and costs are recorded as incurred in performance.

We recognize revenue from assembled products when the finished product is shipped, and collection of the resulting receivable is reasonably assured. In arrangements where a formal acceptance of products or services is required by the customer, revenue is recognized upon meeting such acceptance criteria.

Shipping and Freight Costs

Shipping and handling costs billed to customers are included in revenue. Costs to ship products to customers, which consist primarily of freight expenses, are expensed as incurred and are included in *Cost of Revenue*. Total shipping and freight costs were approximately $0.5 million for each of the years ended December 31, 2015 and 2014.

Stock-Based Compensation

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, net of estimated forfeitures. We award shares of restricted stock and stock options to employees, managers, executive officers and directors.

During each of the years ended December 31, 2015 and 2014, the Company incurred approximately $17,000 in non-cash compensation expense which is included in *Cost of Revenue* and $0.5 million in non-cash compensation expense which was included in *Selling, general and administrative expenses.*

Concentration of Credit Risk

We are currently economically dependent upon our relationship with a large US-based IT Original Equipment Manufacturer (OEM). If this relationship is unsuccessful or discontinues, our business and revenue would suffer. The loss of or a significant reduction in orders from this customer or the failure to provide adequate products or services to them would significantly reduce our revenue. We also periodically perform large construction projects which may comprise a significant portion of our revenues during the construction phase, and which may cause large fluctuations in our quarterly revenues.

The following customers accounted for a significant percentage of our revenues for the periods shown:

	2015	2014
US-based IT OEM	35 %	44 %
US-based retail company	15 %	9 %
US-based data center company	15 %	8 %

No other customers represented more than 10% of our revenues for any periods presented. A US-based data center company represented 47% of our accounts receivable at December 31, 2015. A. US-based retail customer represented 13% and 10% of our accounts receivable at December 31,2015 and 2014, respectively. Our US based IT OEM customer represented 6% and 29% of our accounts receivable at December 31, 2015 and 2014, respectively. A US-based pharmaceutical customer represented 13% of our accounts receivable at December 31, 2014. No other customer represented more than 10% of our accounts receivable at December 31, 2015 or at December 31, 2014.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash in banks and highly liquid instruments with original maturities of three months or less, primarily consisting of bank time deposits. At December 31, 2015 and 2014 we did not have cash invested in interest bearing accounts. At December 31, 2015, we had cash of $0.9 million in excess of FDIC insured limits.

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

Contract and Other Receivables

Accounts receivable are recorded at the invoiced amount and may bear interest in the event of late payment under certain contracts. Included in accounts receivable is retainage, which represents the amount of payment contractually withheld by customers until completion of a particular project.

Under certain construction management contracts, the Company is obligated to obtain performance bonds with various financial institutions, which typically require a security interest in the corresponding receivable. At both December 31, 2015 and 2014, bonds outstanding totaled $7.3 million, and the sureties were indemnified in the event of a loss by related project receivables of $0.04 million.

Allowance for Doubtful Accounts

We estimate an allowance for doubtful accounts based on factors related to the specific credit risk of each customer. Historically our credit losses have been minimal. We perform credit evaluations of new customers and may require prepayments or use of bank instruments such as trade letters of credit to mitigate credit risk. As we expand our product offerings and customer base, our risk of credit loss has increased. We monitor outstanding amounts to limit our credit exposure to individual accounts. We continue to pursue collection even if we have fully provided for an account balance.

The following table summarizes the changes in our allowance for doubtful accounts (in $ 000)

	Year Ended December 31,	
	2015	2014
Balance at beginning of year	$ 25	$ 24
Additions charged to expense	4	78
Recovery of amounts previously reserved	(7)	(64)
Amounts written off	(3)	(13)
Balance at end of year	$ 19	$ 25

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method for all purchased inventory. We write down obsolete inventory or inventory in excess of our estimated usage to its estimated market value less cost to sell, if less than its cost. Inherent in our estimates of market value in determining inventory valuation are estimates related to future demand and technological obsolescence of our products. Any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventories and our results of operations and financial position could be materially affected.

Property and Equipment

Property and equipment are recorded at cost. We provide for depreciation using the straight-line method over the estimated useful lives of the assets. Additions and major replacements or improvements are capitalized, while minor replacements and maintenance costs are charged to expense as incurred. Depreciation expense is included in operating expenses in the statement of operations. The cost and accumulated depreciation of assets sold or retired are removed from the accounts and any gain or loss is included in the results of operations for the period of the transaction.

Goodwill and Intangible Assets

We recorded goodwill and intangibles with definite lives, including customer relationships and acquired software, in conjunction with the acquisition of the systems integration business during 2013. These intangible assets are amortized based on their estimated economic lives. Goodwill represents the excess of the purchase price over the fair value of net identified tangible and intangible assets acquired and liabilities assumed, and it

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

is not amortized. This business is reported as a separate reporting unit as its operations and business model are different to our traditional business, and the goodwill attributable to this transaction was allocated to this reporting unit.

GAAP requires us to perform an impairment test of goodwill on an annual basis or whenever events or circumstances make it more likely than not that impairment of goodwill may have occurred. As part of the annual impairment test, we first have the option to make a qualitative assessment of goodwill for impairment. If we are able to determine through the qualitative assessment that the fair value of a reporting unit more likely than not exceeds its carrying value, no further evaluation is necessary. For those reporting units for which the qualitative assessment is either not performed or indicates that further testing may be necessary, we may then assess goodwill for impairment using a two-step process. The first step requires comparing the fair value of the reporting unit with its carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed, and no impairment charge is required to be recorded. If that fair value does not exceed that carrying amount, we must perform the second step, which requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to the carrying amount with any excess recorded as an impairment charge.

We also review intangible assets with definite lives for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset, a loss is recognized for the difference between the fair value and carrying value of the intangible asset.

We have elected to use December 31 as our impairment date. As circumstances change that could affect the recoverability of the carrying amount of the assets during an interim period, we will evaluate our indefinite lived intangible assets for impairment. The Company performed a quantitative analysis of our indefinite lived intangible assets as at December 31, 2015 and 2014 and concluded there was no impairment. At December 31, 2015 and 2014, the residual carrying value of goodwill was $1.9 million.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting and tax basis of the Company s assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The U.S. net operating losses not utilized can be carried forward for 20 years to offset future taxable income. A full valuation allowance has been recorded against our net deferred tax assets, because we have concluded that under relevant accounting standards it is more likely than not that deferred tax assets will not be realizable. We recognize interest and penalty expense associated with uncertain tax positions as a component of income tax expense in the consolidated statements of operations.

Loss Per-Common Share

Basic loss per common share is computed by dividing net loss by the weighted-average number of shares outstanding for the year. Diluted loss per common share is computed similarly; however, it is adjusted for the effects of the assumed exercise of our outstanding stock options and the vesting of outstanding shares of restricted stock, if applicable.

Treasury Stock

We account for treasury shares using the cost method. Purchases of shares of common stock are recorded at cost and results in a reduction of stockholders equity. We hold repurchased shares in treasury for general corporate purposes, including issuances under various employee compensation plans. When treasury shares are issued, we use a weighted average cost method. Purchase costs in excess of reissue price are treated as a reduction of retained earnings. Reissue price in excess of purchase costs is treated as additional paid-in-capital.

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

Reclassification of Prior Period Financial Statements

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations. During the three-month period ended September 30, 2015 we concluded that the cancellation of previously-issued restricted shares that had been reported as a treasury share transaction should have been presented as a reduction in our outstanding shares, resulting in an overstatement of both our issued number of shares outstanding and the number of treasury shares outstanding.

The consolidated balance sheet at December 31, 2014 reflects corrections to the number of common shares outstanding and the number of treasury shares outstanding, which were both overstated by 52,000 shares.

Recent Issued Accounting Standards

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, an accounting pronouncement related to the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this guidance. This update will be effective for us beginning in fiscal year 2016, with early adoption permitted, and is applied on a retrospective basis. As of December 31, 2015 and December 31, 2014 we had $34,000 and $49,000, respectively, of debt issuance costs reported as assets on our consolidated balance sheet. We do not anticipate that adoption of this guidance will have a material impact on our consolidated financial statements when we implement this in fiscal year 2016.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 requires that management assess an entity s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. We plan to adopt ASU 2014-15 as of the end of our fiscal year ending December 31, 2016 and are currently evaluating the impact of this pronouncement on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, an accounting pronouncement related to revenue recognition (FASB ASC Topic 606), which amends the guidance in former ASC Topic 605, *Revenue Recognition*, and provides a single, comprehensive revenue recognition model for all contracts with customers. This standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The entity will recognize revenue to reflect the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016 and early adoption is permitted only for annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). Under ASU 2016-2, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim

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TSS, Inc.

Notes to Consolidated Financial Statements

Note 1 Significant Accounting Policies (continued)

periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. The Company plans to adopt this guidance beginning with its first quarter ending March 31, 2019. We are currently evaluating the future impact of ASU 2016-02 on our consolidated financial statements.

Note 2 Supplemental Balance-sheet Information

Receivables

Contract and other receivables consist of the following (in 000 s):

	December 31, 2015	December 31, 2014
Contract and other receivables	$ 7,016	$ 3,976
Allowance for doubtful accounts	(19)	(25)
	$ 6,997	$ 3,951

Retainage, which represents the amount of payment contractually withheld by customers until completion of a particular project, represented $0.3 million as at December 31, 2015, and was included in *Contract and other receivables*

Inventories

We state inventories at the lower of cost or market, using the first-in-first-out-method (in 000 s):

	December 31, 2015	December 31, 2014
Work in process	$	$ 33
Raw materials	68	123
Less: Reserve	(2)	(2)
Inventories, net	$ 66	$ 154

Goodwill and Intangible Assets

Goodwill and Intangible Assets consist of the following (in 000 s):

	December 31, 2015		December 31, 2014	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets not subject to amortization:				
Goodwill	$ 1,907			