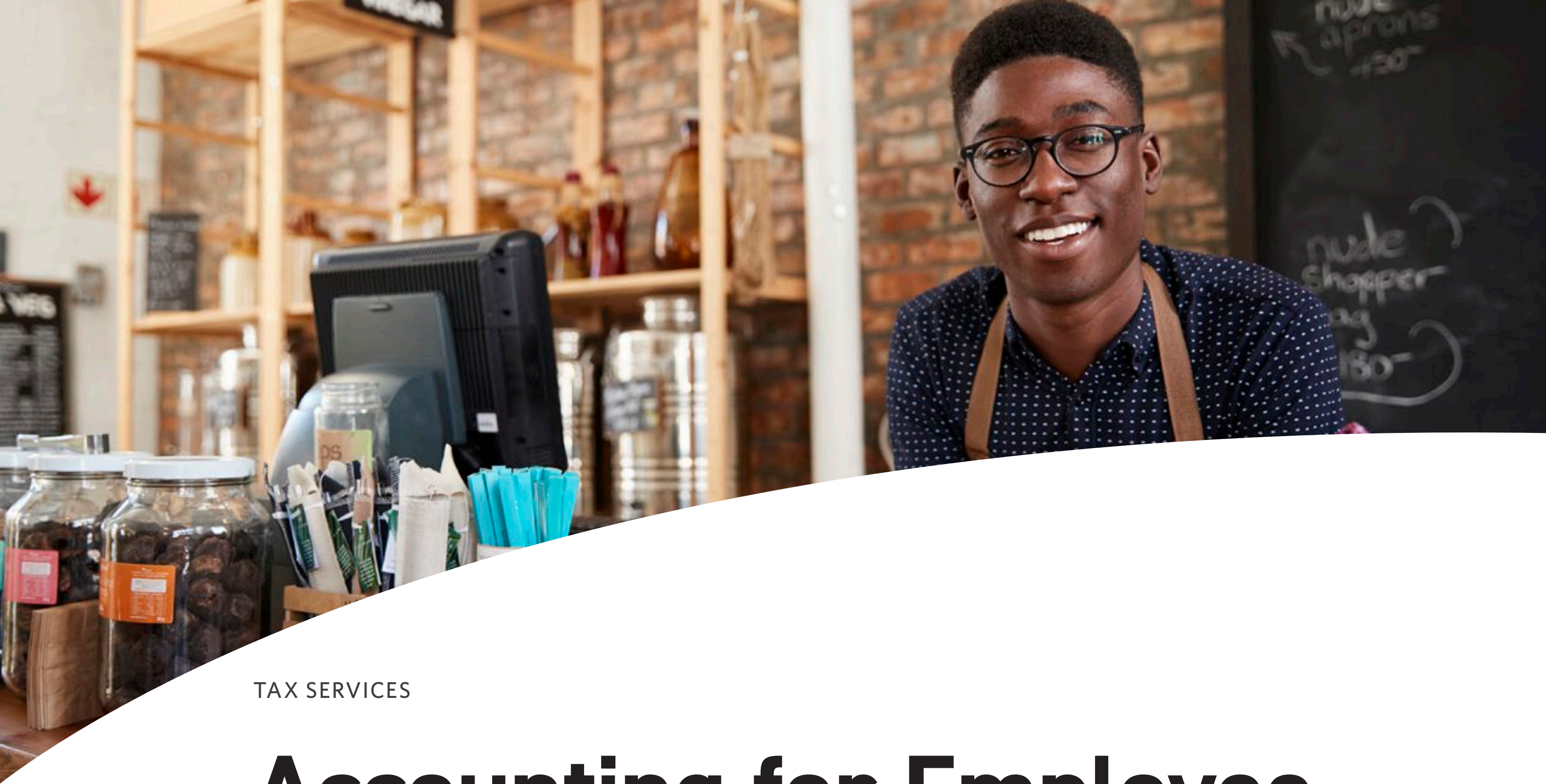

TAX SERVICES

Accounting for Employee Retention Credits

Introduction

In March 2020, the Employee Retention Credit ("ERC") was introduced as part of the Coronavirus Aid, Relief and Economic Security ("CARES") Act to incentivize employers to retain employees during the pandemic by offering a refundable tax credit against employment taxes. In December 2020 and March 2021, the ERC was further expanded and extended. A summary comparison of the 2020 and the 2021 rules is presented on **Appendix I.**

ERCs are similar to the Payroll Protection Program ("PPP") loans as they are another form of government assistance. However, whereas PPP loans provided funds requiring recipients to qualify for forgiveness by incurring qualifying expenditures in subsequent periods, ERCs are an employment tax credit if certain expenses are incurred by eligible employers. While ERCs in 2020 and 2021 could have been obtained as an advance (by filing IRS for 7200), most 2020 ERCs were reported by employers by filing an amended IRS form 941-X (as part of an employer's quarterly payroll tax return). Most employers in 2021 captured ERCs on either a timely filed form 941 or an amended form 941-X.

Both forms of government assistance provide unique challenges as there is little US GAAP guidance, especially for for-profit business entities receiving this assistance.

As with other forms of government assistance provided under the CARES Act, entities will need to consider the accounting and financial reporting implications of receiving ERCs.

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Executive Summary

Similar to the PPP, entities may elect to account for ERCs under one of several accounting principles. Unlike PPP, ERCs will not be accounted for under ASC Topic 470: Debt. Rather, the following accounting standards may be leveraged when determining the appropriate accounting of ERCs:

- International Accounting Standards (IAS) 20, Accounting for Government Grants and Disclosure of Government Assistance
- ASC 958-605, Not-for-Profit Entities — Revenue Recognition
- ASC 450-30, Contingencies

Determination of Appropriate Accounting Principle

Business entities should account for ERCs using one of these standards after considering which standard would provide the most transparency to the users of their financial statements.

ERCs, unlike PPP loans, are structured as a refundable credit and not a loan. If an entity accounted for their PPP loans under IAS 20 or ASC 958, there is a presumption that they will utilize the same guidance to account for their ERCs. Entities that accounted for their PPP loans under ASC 470, Debt will have to determine the appropriate guidance to reference from the options enumerated above.

Accounting under IAS 20

Pursuant to IAS 20, a business entity would recognize ERCs on a systematic basis over the periods in which the entity recognizes the payroll expenses for which the grant (i.e., tax credit) is intended to compensate the employer when there is reasonable assurance (i.e., it is probable) that the entity will comply with any conditions attached to the grant and the grant (i.e., tax credit) will be received.

IAS 20 permits presentation as a credit in the income statement (either separately or under a general heading, such as “other income”) or as a reduction of the related expense (with appropriate disclosure in the footnotes regarding key features of the grant).

Accounting under Subtopic 958-605

If the entity receives ERCs as an advance, it will record a liability for the cash received until such time that the conditions to earn the credit are substantially met. When conditions are met, a not-for-profit entity is required to record the income as revenue, while a for-profit entity may record the amount as grant revenue or other income. Subtopic 958-605 does not permit an entity to net the grant against qualifying costs.

The evaluation of whether all conditions are substantially met will require the use of judgment. Uncertainty regarding whether an entity qualifies for the credit would generally indicate that the conditions were not substantially met at period end. Since the accounting model under Subtopic 958-605 requires that substantially all conditions are met to recognize the grant into income, entities will need to consider whether preparing and submitting the filing is a “more than administrative task” that would defer recognition until such time that the filing with the Internal Revenue Service is made.

Under Subtopic 958-605, the entity would present the amount of an employment tax refund receivable or an unearned refund advance as a current asset or liability.

All not-for-profit entities that receive government grants should apply ASC 958-605. Application of IAS 20 or ASC 450 would be appropriate only for for-profit enterprises.

Accounting under Subtopic 450-30

Application of ASC 450-30 may also be appropriate. Under ASC 450, entities would treat the ERCs (whether received in cash or as an offset to current or future payroll taxes) as if they were gain contingencies. When applying ASC 450-30, entities would not consider the probability of complying with the terms of the ERC program but, rather, would defer any recognition in the income statement until all uncertainties are resolved and the income is “realized” or “realizable”. This approach will likely result in later recognition than in the other approaches discussed herein.

SUMMARY OF POTENTIAL APPROACHES:

Description of Accounting Treatment	Standard	Non-Profit	Business Entities
Develop a pattern to recognize the ERC (either as non-operating income or a contra-expense) that approximates the pattern by which the entity incurs the necessary costs that allowed them to qualify for the ERC.	IAS 20	No	Yes
Account for the ERC as a conditional contribution, recognizing the grant revenue as the entity "substantially meets" the program requirements (i.e. as the qualifying expenditures are incurred and any barriers to realizationen-titlement are overcome).	ASC 958-605	Yes	Yes
Account for the ERC only when all uncertainties regarding its realization have been resolved. Typically, this will result in entities deferring recognition of other income until their employment tax return has been processed and they are entitled to the funds.	ASC 450-30	No	Yes

COMPARISON OF POTENTIAL APPROACHES:

Consider the following fact pattern: XYZ Associates ("XYZ"), a calendar year-end entity, faced economic hardship as a result of the COVID-19 pandemic but chose to keep their W-2 employees on the payroll. Accordingly, XYZ applied for refundable credits for the following periods:

Submission date of IRS Form 7200 or 941	Period Covered by filing	Amount claimed
March 31, 2021	First quarter, 2021	$200,000
July 1, 2021	Second quarter, 2021	$180,000
August 31, 2021	Third quarter, 2021	$150,000
		$530,000

The following is a comparison of how XYZ would account for the ERC's for financial reporting purposes under each of the approaches enumerated above:

Accounting Date	IAS 20	ASC 958-605	ASC 450
First Quarter	XYZ would record $200,000 of either non-operating income or contra-expense (*) and a receivable as the qualifying payroll expenditures were incurred in the quarter ended 3/31/21.	XYZ would record $200,000 of either grant income or contra-expense (**) and a receivable as the qualifying payroll expenditures were incurred in the quarter ended 3/31/21 and the entity had filed the required forms with the IRS.	XYZ would not record anything in the first quarter as there are still uncertainties regarding the acceptance of the filing by the IRS. Based on materiality, it may be a disclosure event. XYZ would recognize the income statement impact of the IRS only upon all uncertainties being lifted (e.g., upon receipt of the funds or formal notice by the IRS that they are entitled to such funds).
Second Quarter	XYZ would record $180,000 of non-operating income or contra-expense (*) for the quarter ended 6/30/21 despite not yet filing the required form with the IRS if they have "reasonable assurance" (i.e. it is probable) that the Company incurred the qualifying expenditures during the quarter.	XYZ would have to determine if "substantially all" of the conditions have been met to earn the credit (since the underlying filing had not been completed at 6/30/21). If such filing is considered to be solely administrative, then XYZ would record $180,000 of grant income or other income (**) and record a receivable. If such filing is considered to be "more than administrative", then there would be no accounting as of 6/30/2021 until all barriers to realization had been overcome.	XYZ would not record anything in the second quarter as there are still uncertainties regarding the acceptance of the filing by the IRS. Based on materiality, it may be a disclosure event. XYZ would recognize the income statement impact of the IRS only upon all uncertainties being lifted (e.g., upon receipt of the funds or formal notice by the IRS that they are entitled to such funds).
Third Quarter	XYZ is filing for the ERC on 8/31/21 for the quarter ended 9/30/21. As of the filing date on 8/31/21, XYZ would record a receivable for $150,000, non-operating income or contra-expense (*) of $100,000 (2/3 of the total as 2 months of qualifying expenditures have been incurred for the quarter as of the filing date) and $50,000 of deferred income.	XYZ would defer all $150,000 upon completing the IRS filings as "substantially all" expenditures have not been incurred as of the filing date (e.g. not all barriers to realization had been overcome). Once all qualifying expenditures have been made, XYZ would record the income statement impact of the ERC.	XYZ would not record anything in the third quarter as there are still uncertainties regarding the acceptance of the filing by the IRS. Based on materiality, it may be a disclosure event. XYZ would recognize the income statement impact of the IRS only upon all uncertainties being lifted (e.g., upon receipt of the funds or formal notice by the IRS that they are entitled to such funds).

(*) If recording contra-expense, XYZ would need to include adequate disclosures informing financial statement users of the quantitative impact of such contra expenses

(**) If XYZ is a for-profit entity, they may will present the income statement impact of the ERC as other income. If XYZ is a not-for-profit entity, they must record the income statement impact of the ERC as grant revenue

Auditor Response

The auditor should consider the risks of material misstatement for ERCs in the design of the audit approach. ERCs in excess of tolerable misstatement are a required consultation matter. If you meet this threshold, you are required to send the client's support for their claimed ERCs to **Marty Karamon** **martin.karamon@cbh.com** and/or **Deb Walker** **dwalker@cbh.com** for their review.

Minimum Disclosure

Similar to disclosure requirements for PPP loans, the entity should disclose its accounting policy for ERCs and their impact on the financial statements. Disclosures should include information about the accounting model applied, significant terms of the program, and a description of the relevant line items and amounts recognized within financial statements. When amounts have not been recognized because conditions have not been substantially met, these conditions should be disclosed. This includes any amount expected to be received and any amounts recognized on the balance sheet if estimable.

Conclusion

Accounting for ERCs (and similar government support payments for for-profit entities) has little US GAAP guidance. Accordingly, management will have to exercise judgment in selecting the appropriate framework under which to record and report ERCs. If applicable, ensure that the framework selected by management to account for ERCs is the same as the framework selected for PPP loans. While there may be no "right" answer, we should ensure as much as possible that the approach taken is consistent and the disclosures regarding ERCs p clearly communicate the details of the transaction to the users of the financial statements.

Let Us Be Your Guide Forward

Martin Karamon, J.D., LL.M.
Partner, Tax Credits & Incentives Advisory Practice Leader
martin.karamon@cbh.com

Deborah Walker, CPA
Director, Tax Services
Compensation & Benefits Leader
dwalker@cbh.com

Roy E. Amler, CPA, CMA
Partner, Assurance Services
ramler@cbh.com

APPENDIX I

ERC Rules: 2021 vs. 2020

ERC	2020 RULES	2021 RULES
Credit Applicability	Qualified wages: Paid after March 12, 2020 and on or before December 31, 2020	Qualified wages: Paid during 2021
Credit Type	Refundable payroll tax credit to eligible employers	Refundable payroll tax credit to eligible employers
Credit Amount	50% of qualified wages	70% of qualified wages
Eligible Employer	Government Mandate Test: Employers (including tax exempt orgs.) carrying on a trade or business during 2020 with respect to any calendar quarter where operations (including those of suppliers) are fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel or group meetings due to COVID-19	Government Mandate Test: Employers (including tax exempt orgs.) carrying on a trade or business during 2021 where operations (including those of suppliers) are fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel or group meetings due to COVID-19
	Gross Receipts Test: Employers of any size carrying on a trade or business and tax-exempt organizations that during a calendar quarter of 2020 had less than 50% of gross receipts in the same calendar quarter during the prior year Status continues until 2021 or, if earlier, the quarter following the quarter when gross receipts return to 80% or more of the gross receipts for that same calendar quarter as the prior year Calculate at controlled group level	Gross Receipts Test: Employers of any size carrying on a trade or business or tax-exempt organizations that during a calendar quarter of 2021 have less than 80% of gross receipts in the same calendar quarter during 2019 Entities that did not exist in the first two quarters of 2019 substitute the corresponding quarter in 2020 Option to compare immediately preceding quarter to the corresponding quarter in 2019 Calculate at controlled group level
Qualified Wages	Employers with more than 100 full-time employees in 2019 determined on a controlled group basis: Wages paid by an eligible employer to employees not performing services Include the eligible employer's qualified health plan expenses Limit: $10,000 per employee	Employers with more than 500 full-time employees in 2019 determined on a controlled group basis: Wages paid by an eligible employer to employees not performing services Include the eligible employer's qualified health plan expenses Limit: $10,000 per employee, per quarter
	Employers with 100 or fewer full-time employees in 2019 determined on a controlled group basis: Wages paid by an eligible employer to all employees Include the eligible employer's qualified health plan expenses Limit: $10,000 per employee limit	Employers with 500 or fewer full-time employees in 2019 determined on a controlled group basis: Wages paid by an eligible employer to all employees Include the eligible employer's qualified health plan expenses Limit: $10,000 per employee, per quarter
Max Credit	$5,000 per employee	$28,000 per employee

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