EMPLOYEE RETENTION CREDIT

Financial Accounting Considerations

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The intent of this whitepaper is to assist contractors with how to account for the Employee Retention Credit (ERC) for financial statement purposes. Since contractors are for-profit entities there is not any specific guidance that can be looked at to determine how to account for the ERC.

Many thanks to the committee members listed below for their hard work and efforts in compiling this information for our members and their construction clients.

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Employee Retention Credit Financial Accounting Considerations

Because of COVID 19, congress passed many programs to keep people employed when companies were dealing with the impacts of COVID. One of those programs is the Employee Retention Credit (ERC). The ERC was originally introduced under the CARES Act, but the Consolidated Appropriations Act signed on December 27, 2020 made some amendments to it, that expanded eligibility to more contractors. The ERC is a fully refundable payroll tax credit for eligible employers up to a maximum of $5,000 for each employee in 2020 or $7,000 per employee per quarter from January to September 2021.

Many contractors have received employee retention credits over the past year and half or are in the process of receiving employee retention credits. This program is unique and something that contractors have not had to account for in the past. These are credits and not loans so they don't fall under Accounting Standards Codification (ASC) 470, *Debt*, which was one of the accounting options for PPP program loans. These credits also have nothing to do with income taxes because they are payroll tax credits, as such the ERC does not fall under ASC 740, *Income Taxes*.

Since contractors are for-profit entities there is not any specific guidance that can be looked at to determine how to account for the ERC. Therefore, they need to analogize to other guidance and there are <u>two options</u> that are available:

- Treat as a conditional contribution under FASB ASC 958-605, Revenue Recognition under Not-for-Profit guidance.
- Treat proceeds as a grant under International Accounting Standards (IAS) 20, Accounting for Government Grants and Disclosures of Government Assistance.

In either of these two methods, the contractor is going to be treating the ERC as a grant once the program requirements are met.

If the company previously analogized to one of these methods to account for its PPP loan, then the company should use that same method to account for the ERC to be consistent with that policy.

OPTION 1: FASB ASC 958-065, Revenue Recognition under Not-for-Profit Guidance

- A contractor is going to need to qualify for the ERC program and have spent the funds on qualified expenses in order to record the credit as grant revenue or other income. Until the requirements have been substantially met, no amount should be recorded through the income statement.
- The ERC can be received in advance in certain circumstances and as such the advance received ERC should be recorded as an unearned refund advance liability until the funds have been spent on qualified purposes.
- You cannot offset the expenses incurred with the credit, it needs to be separately recorded as grant revenue or other income for financial statement purposes.

> ***Note:*** *Per the IRS, the credit is taken against the employer's share of social security tax for federal income tax reporting.*

- If the company has met the requirements of the ERC program, spent the funds on qualified costs, and plans to or has applied for the ERC retroactively, a refund receivable should be recorded during the period that the qualified costs were incurred. There is no requirement to have actually applied for the ERC in order to record a refund receivable.

OPTION 2: IAS 20, Accounting for Government Grants and Disclosures of Government Assistance

- Similar accounting treatment to ASC 958-605, *except for*:
  - Uses a reasonable assurance threshold vs. ASC 958-605 substantially met threshold. Reasonable assurance is a lower threshold and is equivalent to "probable" under U.S. GAAP. The impact of this in practice may result in recording the income earlier and not waiting to end of the quarter to see if they met the gross receipt reduction requirements, if it is probable that they will meet the requirement.
  - The amounts received can be recorded net against the expenses or can be recorded gross. We are not proponents of recording the amounts net because it impacts comparability. Our recommendation is to record the expenses and the credits gross.

PRACTICAL EXAMPLES

EXAMPLE 1

XYZ contractor met the criteria to qualify for the Employee Retention Credit in Q2 and Q3 2021. XYZ filed their payroll tax filings normally without factoring in the credit throughout 2021 as they were not initially aware of the credit. They have decided to pursue the credit related to 2021 in 2022 by filing amended payroll tax filings. The total credit available is $250,000 ($125,000 per quarter).

In this example, under both FASB ASC 958-065 and IAS-20, once XYZ decides to pursue the credit the $250,000 should be recorded in the period that the qualified expenses were incurred. Under both standards the requirements have been met to receive the credit, they met the program criteria and have spent the funds on qualified expenses.

Entries to book in 2021 books (this could be recorded by quarter for $125,000 each, but was presented as one 2021 entry for example purposes):

FASB ASC 958-065:			
	DR: ERC refund receivable	$250,000	
	CR: Grant revenue or other		$250,000

IAS 20:			
	DR: ERC refund receivable	$250,000	
	CR: Grant revenue, other income, or payroll tax expense		$250,000

EXAMPLE 2

Changing the example slightly, XYZ qualified for the credit in Q2 2021, included the credit in its Q2 payroll tax filings and recorded the credit in their Q2 financials. They also plan to take the credit in Q3 of 2021, if they qualify. Based on the projected sales for Q3 it is likely they will meet the program criteria for Q3.

Accounting considerations on Q3 2021 books:

FASB ASC 958-065:
Under 958-065 nothing is to be booked until the program criteria is substantially met. If using the 20% reduction in gross receipts as the qualifying criteria, XYZ would have to wait until the end of the quarter to make the determination if they had a 20% reduction in gross receipts. Therefore, no amounts should be recorded until the end of the quarter when the criteria can be fully evaluated, even though the qualifying expenses were paid throughout the quarter.

IAS 20:
Under IAS 20 amounts can be booked if it is reasonable assured the program criteria will be met and the qualified expenses have been incurred. In this example, XYZ determined that it is reasonable assured/probable they will meet the criteria. Therefore, as the qualified expenses are being incurred, they could book entries throughout the quarter to recognize the credit. XYZ would not need to wait until the end of the quarter to book the entries.

Disclosures

The financial statements prepared are going to need to disclose the methodology selected to account for the ERC. It should also disclose the details of the program and where the amounts are recorded within the financial statements.

Conclusion

Accounting for the ERC is not difficult. It starts with understanding the credit amount that is available to you. After that you need to consider the time period that the credit relates to and record it in accordance to the accounting policy option selected. The methods are very similar and will have similar results, however there are some differences that may result in the amounts being recorded within a different timeframe or within different categories.

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