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Employee Retention Credit (ERC)
Financial Reporting & Disclosure Examples

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The Employee Retention Credit (ERC) was established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, P.L. 116-136, in March 2020. It was intended to help businesses retain their workforces and avoid layoffs during the coronavirus pandemic. It provides a per employee credit to eligible businesses based on a percentage of qualified wages and health insurance benefits paid to employees. It works as a refundable payroll tax credit claimed quarterly, and it can provide reductions to payroll taxes or cash refunds. The ERC is available to both for-profit and not-for-profit (NFP) entities, but not every business is eligible. Two critical tests for eligibility exist — a partial or total government-ordered shutdown, or a decline in gross receipts. The decline in gross receipts test is based on a "significant" decline in gross receipts in quarters of 2020 (more than 50%) and 2021 (more than 20%) compared with the same quarters in 2019.

The CARES Act did not allow businesses that received Paycheck Protection Program (PPP) loans to also claim the ERC, but the Consolidated Appropriations Act, 2021, P.L. 116-260, which was enacted at the end of 2020, retroactively removed the limitation so entities that had applied for or received PPP loans could still get the ERC. The American Rescue Plan Act, P.L. 117-2, provided that the ERC would go through December 31, 2021; however, the ERC was terminated a quarter early by the enactment of the Infrastructure Investment and Jobs Act, P.L. 117-58, at the end of the third calendar quarter of 2021 (for entities other than recovery startup businesses under Sec. 3134(c)(2)).

This report addresses the financial reporting considerations related to the ERC. An appendix presents ERC disclosure excerpts. For information about ERC rules, eligibility, filing payroll tax returns, and other non-financial reporting issues related to ERC, visit the AICPA's employee retention credit guidance and resources webpage.

Applicable U.S. Generally Accepted Accounting Principles (U.S. GAAP)

The ERC is a refundable credit. The CPEA does not believe that claiming the ERC is an income tax position within the jurisdiction of FASB *Accounting Standards Codification* (FASB ASC) 740, *Income Taxes*, as it applies to entities that do and do not pay federal income tax at the entity level, is not based on income, and the primary method of claiming the credit is on federal payroll tax forms.

Many entities consider the ERC a type of government assistance or grant. The CPEA believes that accounting for ERC depends on whether an entity is a for-profit or NFP entity. For-profit entities can analogize to the guidance in either:

- FASB ASC 958-605, *Not-for-Profit Entities: Revenue Recognition*
- International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*
- FASB ASC 450-30, *Contingencies: Gain Contingencies*

NFP entities account for government grants under U.S. GAAP in accordance with FASB ASC 958-605. As such, the IAS 20 model and the FASB ASC 450-30 model do not apply to NFP entities.

Practice Note: Many entities applied FASB ASC 958-605 or IAS 20 when accounting for PPP loans. As such, those entities will be familiar with the accounting models applicable to the ERC. Another accounting model many entities used to account for PPP loans was the debt model in FASB ASC 470, *Debt*. The debt model is not applicable to the ERC because the ERC is a refundable payroll tax credit and not a loan.

Retroactive Application of the ERC to 2020

The CPEA believes that the accounting for retroactively applying the ERC to 2020 involves different accounting compared to prospective accounting of the ERC.

We believe that the recovery of amounts previously paid and expensed to an employee is best analogized a loss recovery. Prevailing practice in financial reporting for a loss recovery is to use guidance in FASB ASC 410, *Asset Retirement and Environmental Obligations*, specifically FASB ASC 410-30-35-8, which indicates that a claim for recovery should be recognized only when the claim is probable as it is defined in FASB ASC 450, *Contingencies*, more specifically in FASB ASC 450-20-25-1. Accordingly, if an entity feels that it is probable that it is entitled to recover amounts previously paid in 2020 via the ERC, then the entity should recognize a receivable for amounts to be received for the amounts paid in 2020 to be recovered via the ERC. Any uncertainties related to qualifying for the ERC should be assessed as to whether the claim for the credit is probable.

As for income statement presentation, we believe that either classifying the amounts as a reduction to payroll tax expense or as other income would be acceptable with appropriate disclosure of the election made by management. Our review of recent public entity filings indicates that more public entities are crediting the associated expense rather than recognizing the amounts on a separate line item.

Practice Note: FASB ASC 410-30-25 addresses environmental obligations and subsequent recoveries. However, given the lack of explicit guidance in the FASB ASC regarding other loss recoveries, FASB 410-30-25 is widely utilized for other types of loss recoveries by analogy.

Prospective Accounting for the ERC - Applying the FASB ASC 958-605 Model

Entities applying the FASB ASC 958-605 model would consider the ERC as a nonexchange transaction that is accounted for as a conditional contribution. This is based on the guidance in FASB ASC 958-605-25-5A, which indicates that a conditional contribution must have both:

- One or more barriers that must be overcome before a recipient is entitled to the assets transferred or promised
- A right of return to the contributor for assets transferred (or for a reduction, settlement, or cancellation of liabilities) or a right of release of the promisor from its obligation to transfer assets (or reduce, settle, or cancel liabilities)

Given the eligibility requirements connected to the ERC, barriers and a right of return exist. Barriers (or conditions) could include the various eligibility requirements such as meeting the rules for a decline in gross receipts and incurring qualifying expenses (payroll costs).

Conditions (barriers) should be substantially met (overcome) by the entity before the ERC is recognized (see FASB ASC 958-605-25-11). Therefore, a refund receivable and income would be recognized in the period the entity determines the conditions have been substantially met. In cases where conditions are met over time or in stages, the ERC should be recognized as the qualifying expenses (payroll costs) are incurred, and other conditions (e.g., eligibility) are met. An ERC received before the conditions have been substantially met to earn the ERC should be accounted for as a refundable advance (liability) (FASB ASC 958-605-25-5F) until the conditions are substantially met.

Filing for the ERC. Entities will need to determine whether preparing the related ERC form and filing it with the government represents a barrier that needs to be overcome. As indicated in FASB ASC 958-605-25-5D, administrative and trivial stipulations are not indicative of a barrier.

Financial Statement Classification

A refundable advance related to the ERC would be classified as a current liability, assuming the entity expects to meet the remaining conditions. When conditions are met, a for-profit entity would recognize the ERC as grant revenue or other income; an NFP entity is required to record the ERC as revenue. Under FASB ASC 958-605, entities should not net grants (ERC) with related expenses on the income statement.

Disclosure

Entities following the FASB ASC 958-605 model to account for the ERC should comply with the disclosure requirements in FASB ASC 958-310*, Not-for-Profit Entities: Receivables*. Based on the disclosure requirements in FASB ASC 958-310-50-4 for conditional contributions, an entity should disclose adequate information about the amounts of the ERC, a description of the ERC, and the related conditions.

The FASB recently issued ASU 2021-10, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*, requiring disclosures by business entities related to the receipt of government assistance. See below for a description of that ASU. ASU 2021-10 is not effective for calendar year 2021 entities, but can be early adopted.

<u>Prospective Accounting for the ERC - Applying the IAS 20 Model</u>

As indicated earlier, the IAS 20 model is an accounting option for for-profit entities and would not apply to NFP entities. IAS 20 provides guidance on government grants for business entities but is considered nonauthoritative in the FASB ASC. While it is not a part of the FASB ASC, FASB ASC 105, *Generally Accepted Accounting Principles,* and more specifically, FASB ASC 105-10-05-2, does permit considering a nonauthoritative source (such as IAS) when the accounting for the transaction is not specified in the FASB ASC or the accounting for a similar transaction is not specified in the FASB ASC.

Under the IAS 20 model, government assistance is not recognized until there is reasonable assurance (similar to the “probable” threshold in U.S. GAAP) that (1) any conditions attached to the assistance will be met and (2) the assistance will be received. Once there is reasonable assurance that the conditions will be met, the earnings impact of government grants is recorded on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate. Therefore, an entity will need to estimate the amount of the ERC it expects to retain.

IAS 20 has presentation flexibility regarding amounts recognized in the income statement, indicating that government grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'other income;' alternatively, they are deducted in reporting the related expense. Thus, in the case of ERC, the entity could choose to present the amounts as other income or as an offset to the expenses for which the ERC is intended to compensate (e.g., payroll expenses).

Disclosure

Disclosure requirements under IAS 20 for government grants are:

- The accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements
- The nature and extent of government grants recognized in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited and
- Unfulfilled conditions and other contingencies attaching to government assistance that has been recognized

As indicated above, the FASB recently issued ASU 2021-10, requiring disclosures by business entities related to the receipt of government assistance. The disclosure requirements in ASU 2021-10 are similar to those in IAS 20. See below for a description of that ASU.

<u>Prospective Accounting for the ERC - Applying the FASB ASC 450-30 Model</u>

Since some business entities in the past have followed the guidance in FASB ASC 450-30 when accounting for certain grants, a gain contingency model may be applied by business entities to account for the ERC. FASB ASC 450-30-25-1 indicates that a contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization. Therefore, amounts related to the ERC would not be recognized until all uncertainties regarding the disposition of the ERC are resolved. The FASB ASC 450-30 gain contingency model provides less specificity on disclosure, measurement, and recognition requirements as compared to other models. As a result, we generally do not feel the FASB ASC 450-30 gain contingency model is a preferred accounting policy for the ERC.

<u>Recent Issuance of ASU 2021-10: Disclosures Related to Government Assistance</u>

On November 18, 2021, the FASB issued Accounting Standards Update (ASU) 2021-10. ASU 2021-10 requires business entities to disclose, in notes to their financial statements, information about certain types of government assistance they receive.

The amendments in ASU 2021-10 are effective for all entities within their scope for financial statements issued for annual periods beginning after December 15, 2021. Early application of the amendments is permitted.

ASU 2021-10 adds Topic 832, *Government Assistance*, to the FASB ASC. The guidance in FASB ASC 832 applies to all entities except NFP entities and employee benefit plans within the scope of FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*, FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*, and FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*. FASB ASC 832 applies to entities that have accounted for transactions with a government by analogizing to a grant or contribution accounting model (for example, the IAS 20 model or the contribution model in FASB ASC 958-605).

FASB ASC 832 requires an entity to disclose the following about transactions with a government within its scope:

- The nature of the transactions, including a general description of the transactions and the form in which the assistance has been received (for example, cash or other assets)
- The accounting policies used to account for the transactions
- The line items on the balance sheet and income statement that are affected by the transactions, and the amounts applicable to each financial statement line item in the current reporting period

In addition, FASB ASC 832 requires an entity to disclose information about the significant terms and conditions of transactions with a government within its scope. Terms and conditions that might be appropriate to disclose include, but are not limited to, any of the following:

- The duration or period of the agreement
- Commitments made by both the reporting entity and the government
- Provisions, if any, for recapture (for example, when the government can recapture amounts awarded), including the conditions under which recapture is allowed
- Other contingencies

An entity should provide the disclosures required by FASB ASC 832 for annual periods.

Consistency of Accounting Policies Among Government Assistance Programs

While most for-profit entities likely do not have an existing policy for accounting for government assistance, entities in the healthcare, bioresearch, and other industries already may have policies in place to account for government assistance. If an entity already has a policy for accounting for government assistance, they should consider if the ERC is sufficiently similar to assistance received in the past (as prescribed by FASB ASC 250, *Accounting Changes and Error Corrections*) and would fall under that policy or if they differ enough to necessitate the creation of a new accounting policy. That determination will require judgment.

Is Consistency Required Between the Accounting Policies Applied to PPP Loans and the ERC?

Consistency between the accounting model used for a PPP loan and the accounting model used for the ERC is a matter of judgment. The CPEA believes that the ERC and the PPP are different programs and as such would not necessarily need to have the same accounting treatment.

Appendix: ERC Disclosure Examples

Presented below are excerpts from recent financial statement issuances that contain disclosures about the ERC. The disclosure excerpts below may not reflect legislation and regulations passed subsequent to the issuance of the related financial statements. Practitioners are cautioned to stay abreast of the latest ERC-related regulations. Also, the CPEA makes no assertions that the disclosure excerpts comply with relevant U.S. GAAP disclosure requirements. These excerpts are provided as a resource to help practitioners prepare and audit ERC disclosures.

Excerpt 1: Houston Ballet Foundation and Houston Ballet Guild, Inc (June 30, 2021)

The Foundation is eligible for the Employee Retention Credit ("ERC") under the CARES Act. $2,007,027 was received prior to June 30, 2021 in a combination of unpaid employment taxes for the quarters ending March 31, 2021 and June 30, 2021 and 2021 Form 941 Employer Quarterly Federal Tax Return refund payments for the quarter ending March 31, 2021. Grants receivable for the ERC at June 30, 2021 are $1,074,589 which represents refunds due on the 2021 Form 941 Employer Quarterly Federal Tax Return for the quarter ended June 30, 2021 and 2020 Form 941-X Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund for the quarters ended June 30, 2020, September 30, 2020 and December 31, 2020.

Excerpt 2: Aramark (October 01, 2021)[1]

The CARES Act provides an employee retention credit ("CARES Employee Retention credit"), which is a refundable tax credit against certain employment taxes of up to $5,000 per employee for eligible employers. The tax credit is equal to 50% of qualified wages paid to employees during a quarter, capped at $10,000 of qualified wages per employee through December 31, 2020. Additional relief provisions were passed by the United States government, which extend and slightly expand the qualified wage caps on these credits through December 31, 2021. Based on these additional provisions, the tax credit is now equal to 70% of qualified wages paid to employees during a quarter, and the limit on qualified wages per employee has been increased to $10,000 of qualified wages per quarter. The Company qualifies for the tax credit under the CARES Act and expects to continue to receive additional tax credits under the additional relief provisions for qualified wages through December 31, 2021. During the fiscal year ended October 1, 2021 and October 2, 2020, the Company recorded $15.1 million and $18.7 million related to the CARES Employee Retention credit in "Cost of services provided (exclusive of depreciation and amortization)" on the Company's Consolidated Statements of (Loss) Income. As of October 1, 2021, the Company has a $23.8 million receivable balance

[1] This disclosure excerpt does not reflect recent legislation that terminated the ERC as of 09/30/21.

from the United States government related to the CARES Act, which is recorded in "Receivables" on the Company's Consolidated Balance Sheet.

Excerpt 3: Great Elm Group (June 30, 2021)

…As modified, the ERC provides eligible employers with less than 500 employees a refundable tax credit against the employer's share of social security taxes. The ERC is equal to 70% of qualified wages paid to employees during calendar 2021 for a maximum credit per employee of $7,000 per employee for each calendar quarter through June 30, 2021. During the year ended June 30, 2021, the Company claimed ERCs of $5.0 million, consisting of $4.8 million recognized as a reduction to operating expenses and $0.2 million acquired in purchase accounting. Such claimed ERCs not settled prior to year-end in the amount of $2.8 million are expected to be settled shortly thereafter and are disclosed within prepaid and other current assets on our consolidated balance sheet.

Excerpt 4: Kura Sushi USA, Inc. (August 21, 2021)

Under the provisions of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") signed into law on March 27, 2020 and the subsequent extension of the CARES Act, the Company was eligible for a refundable employee retention credit subject to certain criteria. The Company recognized a $10.3 million employee retention credit and a $1.8 million employee retention credit during the fiscal years 2021 and 2020, respectively. For fiscal year 2021, $9.3 million is included in labor and related costs and $1.0 million is included in general and administrative expenses in the statements of operations. For fiscal year 2020, $1.7 million is included in labor and related costs and $0.1 million is included in general and administrative expenses in the statements of operations. The Company has filed for refunds of the employee retention credits and subsequent to August 31, 2021 and as of the date of this Annual Report on Form 10-K, has received $8.0 million in refunds and cannot reasonably estimate when it will receive any or all of the remaining refunds. As of August 31, 2021, the Company is no longer eligible to receive refundable employee retention credits.