Accounting and Reporting for the Employee Retention Credit

By Michelle Haerr, Audit Manager and Timothy J. Sims, Partner

The Employee Retention Credit (ERC), a credit against certain payroll taxes allowed to an eligible employer for qualifying wages, was established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act and further amended by the Consolidated Appropriations Act (CAA) and the American Rescue Plan (ARP). While these provisions brought relief to nonprofit organizations affected by COVID-19, they also brought questions about accounting and reporting for this credit.

Here are answers to help organizations that claim the credit.

Accounting for the Employee Retention Credit

The 2020 and 2021 ERCs act as fully refundable credits against the employer portion of Social Security taxes based on the amount of qualified wages that an eligible employer has incurred. The maximum credit is based on a qualified-wages ceiling for each employee. To account correctly for the ERC, there are a few items to consider.

Application of Professional Guidance

If your organization qualifies for the ERC, it is important to consider which accounting standard governs the recognition of the revenue. We believe it is appropriate to apply Accounting Standards Update (ASU) Subtopic 958-605, *Contributions Received and Contributions Made,* to the recording of this income. The ERC is considered a conditional grant, as an organization only qualifies for the transfer of assets if it has overcome the barrier of eligibility.

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Timing of Recognition

Per ASU 958-10-75-2:

> … conditional promises to give, which contain donor-imposed conditions that represent a barrier that must be overcome as well as a right of release from obligation shall be recognized when the condition or conditions on which they depend are substantially met, that is, when a conditional promise becomes unconditional. Imposing a condition creates a barrier that must be overcome before the recipient is entitled to the assets promised.

As we note in our video on the Tax Implications of the Employee Retention Credit, there are two pathways to qualification for the ERC: a significant decline in gross receipts from the reference quarter in 2019, or full or partial suspension of services due to a governmental order related to COVID-19. Under both the suspension-of-services test and the gross-receipts test, the contribution should be recognized as the barriers are met.

The timing of overcoming the barriers varies depending on which qualifying route your organization takes:

- Suspension-of-services test: The ERC would be earned as the wages are paid throughout the time period of the suspended services. The contribution and related receivable can be recorded as those wages are accrued.
- Gross-receipts test: The barrier to revenue recognition is not met until the end of the quarter, as the test depends on a quarter-end revenue comparison with the same quarter of 2019. The receivable and related contribution income should be recorded at the end of each quarter in which the organization experiences the qualifying decrease in revenue.

If the barriers have been met as indicated above, a receivable should be recognized for the portion that has not been received, even if the forms have not been filed.

Filing the forms is an administrative function and is not considered a barrier to revenue recognition. However, to accurately record the revenue and related receivable, it is important to have determined eligibility, calculated the credit, and, ideally, be in the process of filing the forms prior to recording the receivable.

If your organization qualifies for advance ERC payments, any payments received prior to overcoming barriers of eligibility should be considered a refundable advance until the conditions have been substantially met (ASU 958-10-65-2).

Posting the Debits and Credits

In keeping with proper accounting treatment for nonprofits, expenses and contributions should be recorded gross. The payroll tax liability will be accrued for the entire amount prior to the application of the ERC. The ERC is recorded as either a debit to cash or accounts receivable and a credit to contribution or grant income, according to the timeline noted above. In the case of an organization receiving advance ERC payments, cash is debited and a refundable advance liability is credited. That liability reverses as the barriers are overcome.

When the income is recorded, it is unrestricted, as any implied time restriction would have been met upon the due date of the receivable. Additionally, there is no purpose restriction attached to the ERC. Thus, once the conditions are met and the revenue is recognized, it is unrestricted.

Reporting the Employee Retention Credit

The ERC will be reflected in several ways on the financial statements:

- Statement of Activities – The transaction should be reflected gross, in the unrestricted operating revenues as either contribution, grant, or other income.
- Statement of Financial Position – A current receivable should be recorded for the ERC amount that was not taken as a credit on payroll tax reporting forms. (You can claim a credit that is higher than the taxes due on Form 941, *Employer's Quarterly Federal Tax Return*.)
- Notes – Disclose more details about the nature of the ERC in either revenues or the A/R footnote, like this example:

  Laws and regulations concerning government programs, including the Employee Retention Credit established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, are complex and subject to varying interpretations. Claims made under the CARES Act may also be subject to retroactive audit and review. There can be no assurance that regulatory authorities will not challenge the Organization's claim to the ERC, and it is not possible to determine the impact (if any) this would have upon the Organization.

Hopefully, these considerations help you as you determine how to account for the ERC in your organization and reflect the credit in your reports. If you have further questions, please contact us. We are always happy to help!

Additional Resources:

Tax Implications of the Employee Retention Credit – Video

Employee Retention Credit Frequently Asked Questions – Article

Assistance with the Employee Retention Credit – Video

The Employee Retention Credit and Nonprofit Organizations – Recorded webcast and handout

IRS Notice 2021-49 – Guidance on claiming the ERC for qualified wages paid after June 30, 2021, and before January 1, 2022

IRS Notice 2021-20 – Guidance on claiming the ERC for qualified wages paid from March 13, 2020, through December 31, 2020

IRS Notice 2021-23 – Guidance on claiming the ERC for qualified wages paid after December 31, 2020 and before July 1, 2021

Accounting for Paycheck Protection Program Proceeds – Overview of the proper accounting for Paycheck Protection Program loan proceeds

The ERC will be reflected in several ways on the financial statements, including in the Statement of Activities, Statement of Financial Position, and Notes.

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