# Accounting & Audit Update

2021 Annual Year-End Update

# Accounting for Employee Retention Credits

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# Presenter

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# ERC - In General

+ The Employee Retention Credit (ERC) was introduced in 2020 as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act; further expanded/extended in December 2020 and March 2021
+ Incentivizes employers to retain employees during COVID-19 by offering a refundable tax credit against the employer's share of certain payroll taxes
+ Structured as a refundable payroll tax credit if certain expenses are incurred by an eligible employer
+ While ERCs in 2020 and 2021 could have been obtained as an advance by filing Form 7200, most 2020 ERCs were reported by filing an amended Form 941-X (as part of an employer's quarterly payroll tax return), while most 2021 ERCs were captured via a timely filed Form 941 or an amended Form 941-X
+ Similar to a Paycheck Protection Program (PPP) loan in that the ERC is another form of government assistance

# ERC - Business Entities

- For commercial for-profit business entities, there is **no** specific guidance under accounting principles generally accepted in the United States of America (U.S. GAAP) on how to account for ERCs (and other similar government support)
- For commercial for-profit business entities, there is **no** specific Financial Accounting Standards Board (FASB) standard
- Thus, there is some flexibility
- Which accounting treatment is most appropriate for the entity’s unique circumstances and/or to the users of the financial statements
- **As applicable**, the framework used to account for ETCs **should be consistent** with the framework previously used with respect to **accounting for a PPP loan**

# ERC - Business Entities (Continued)

- **FASB Accounting Standards Codification (ASC) Topic 470, *Debt***
  - Not applicable with respect to ERC since ERC is a refundable tax credit
  - Entities that accounted for their PPP loans under ASC Topic 470 will have to determine which framework is appropriate from three other models/options

# ERC - Business Entities (Continued)

- **A grant by analogy to International Accounting Standard (IAS) 20, *Accounting for Government Grants & Disclosure of Government Assistance***
  - If the entity expects to meet the eligibility criteria and concludes the ERC represents, in substance, a grant that is expected to be forgiven, the recipient may analogize to IAS 20
  - Under this model, government assistance is not recognized until there is **reasonable assurance** (**reasonable assurance is not defined; is similar to the "probable" threshold in U.S. GAAP; generally interpreted as "likely" / 75% or greater likelihood of occurrence**) that [1] any conditions attached to the assistance will be met and [2] the assistance will be received
  - Once there is reasonable assurance 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**
  - The offset through earnings (presented as either **[1] a credit in the income statement, either separately or under a general heading such as "other income,"** or [2] a reduction of the related expenses) **(expense off-set is however contrary to U.S. GAAP)**, is recognized as the entity recognizes the related costs to which the loan relates

# ERC - Business Entities (Continued)

- **A grant by analogy to FASB ASC 958-605, *Not-for-Profit Entities: Revenue Recognition***
  - FASB ASC 958-605 addresses the accounting for contributions by not-for-profit entities
  - Although the scope of FASB ASC 958-605 excludes contributions made by governmental entities to business (for-profit) entities, FASB has acknowledged that entities scoped out of this guidance are not precluded from applying it by analogy when appropriate
  - The timing of recognition for a contribution received depends on whether the contribution is **conditional** or not
  - If conditional, the contribution is not recognized until the conditions are **substantially met (substantially met is not defined; is somewhat vague)** or explicitly waived
  - The entity would defer any recognition of the ERC, whether received in cash or as an off-set to current or future payroll taxes, in the income statement until the conditions of release (the related barriers) have been **substantially met** or explicitly waived, at which time the earnings impact would be recognized
  - The entity will need to consider whether preparing and submitting the payroll tax filing is "more than an administrative task" that would defer recognition until such filing with the IRS is made

# ERC - Business Entities (Continued)

- **A grant by analogy to FASB ASC 450-30, *Contingencies: Gain Contingencies***
  - FASB ASC 450-30 outlines a model for gain contingency recognition
  - The earnings impact of a gain contingency is recognized **when all of the contingencies related to receipt of the assistance have been met and the gain is realized or realizable**
  - The entity would defer any recognition of the ERC, whether received in cash or as an off-set to current or future payroll taxes, in the income statement until all uncertainties are resolved and the income is **realized or realizable**, at which time the earnings impact would be recognized
  - FASB ASC 450-30 generally provides less specificity on measurement and recognition requirements as compared to the other two models/options
  - FASB ASC 450-30 will likely result in later recognition as compared to the other two models/options
  - Likely the least used of the three models/options

# ERC - Business Entities (Continued)

+ **Summary**
  - IAS 20 - develop a pattern to recognize the ERC that approximates the pattern by which the entity incurs the necessary costs that allowed the entity to qualify for the credit
  - FASB ASC 958-605 - account for the ERC as a conditional contribution, recognizing the revenue as the entity substantially meets the program requirements (i.e., as the qualifying expenditures are incurred and any barriers to entitlement are overcome)
  - FASB ASC 450-30 - account for the ERC only when all uncertainties regarding its realization have been resolved; typically, this will result in entities deferring recognition of income until their payroll tax filing has been processed and they are entitled to the funds
  - The U.S. GAAP/book and tax considerations should not be independently considered; potential deferred tax considerations (C-corporations)

# ERC - Note Disclosures

+ Disclose the accounting policy and the related impact to the financial statements, including an identification of the relevant financial statement line items and amounts
+ Disclosures should include the relevant terms of the ERC program
+ When amounts have not been recognized because the related conditions (the barriers) have not yet been substantially met, such conditions should be disclosed

# ERC - Example

+ A calendar year-end commercial for-profit company (XYZ Company), who faced economic hardship as a result of the COVID-19 pandemic, chose to keep their W-2 employees on the payroll; accordingly, the company applied for refundable credits as follows:

| Submission Date of Form 7200 or 941 | Period Covered by the Filing | Amount Claimed |
|---|---|---|
| March 31, 2021 | First quarter 2021 | $200,000 |
| July 1, 2021 | Second quarter 2021 | $175,000 |
| August 31, 2021 | Third quarter 2021 | $150,000 |

# ERC - Example (Continued)

The following is a comparison of how XYZ Company would account for the ERCs for financial statement reporting purposes under each of the three previously discussed approaches:

| 2021 Quarter | IAS 20 | FASB ASC 958-605 | FASB ASC 450-30 |
|---|---|---|---|
| First Quarter | XYZ Company would record $200K of non-operating income (or contra-expense) and a receivable as the qualifying payroll expenditures were incurred in the quarter ended 3.31.21 | XYZ Company would record $200K of non-operating income (or contra-expense) and a receivable as the qualifying payroll expenditures were incurred in the quarter ended 3.31.21 and the company had filed the required forms with the IRS | XYZ Company 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; the company would recognize the income statement impact only upon all uncertainties being lifted (i.e., upon receipt of the funds or formal notice by the IRS that the company is entitled to such funds) |
| Second Quarter | XYZ Company would record $175K 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) the company incurred the qualifying expenditures during the quarter | XYZ Company 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 the company would record $175K of non-operating income and record a receivable; if such filing is considered to be "more than administrative," then there would be no accounting as of 6.30.21 until all barriers to entitlement had been overcome | XYZ Company 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; the company would recognize the income statement impact only upon all uncertainties being lifted (i.e., upon receipt of the funds or formal notice by the IRS that the company is entitled to such funds) |
| Third Quarter | XYZ Company 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 $150K, non-operating income (or contra-expense) of $100K (2/3 of the total as 2 months of qualifying expenditures have been incurred for the quarter as of the filing date) and $50K of deferred income (a liability) | XYZ Company would defer all $150K upon completing the IRS filings as "substantially all" expenditures have not been incurred as of the filing date (not all barriers to entitlement had been overcome); once all qualifying expenditures have been made, XYZ would record the income statement impact of the ERC | XYZ Company 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; the company would recognize the income statement impact only upon all uncertainties being lifted (i.e., upon receipt of the funds or formal notice by the IRS that the company is entitled to such funds) |

# Statement on Auditing Standards No. 134

## December 9, 2021

# SAS 134

- Statement on Auditing Standards No. 134, *Auditor Reporting & Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*
- SASs are issued by the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board
- Effective with 12.31.21 audits
- Will change the format of the standard independent auditor's report
- Benefits users of audited financial statements by placing the auditor's opinion at the front of the independent auditor's report for added visibility
- Provides the necessary transparency into the basis for the auditor's opinion and the responsibilities of both management and the independent auditors
- Introduces the concept of key audit matters; SAS 134 does not require the communication of key audit matters

# Certain Accounting Standards Updates

# December 9, 2021

# ASU 2018-15

- Financial Accounting Standards Board Accounting Standards Update (ASU) 2018-15, *Intangibles-Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*
- Private companies - effective with fiscal years beginning after 12.15.20 (12.31.21 year-end); early adopted permitted
- Aligns the accounting for implementation costs related to a hosting arrangement that is a service contract with the accounting for implementation costs incurred to develop or obtain internal use software that is not a service contract

# ASU 2018-17

+ ASU 2018-17, *Consolidation (Topic 810) - Targeted Improvements to Related Party Guidance for Variable Interest Entities*
+ Supersedes and expands on ASU 2014-07, *Consolidation (Topic 810) - Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements,* to all private company common control arrangements that meet the applicable criteria
+ Private companies - effective with fiscal years beginning after 12.15.20 (12.31.21 year-end); early adopted permitted
+ Retrospective adoption with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented
+ A private company reporting entity may elect not to apply variable interest entities guidance to legal entities under common control, including common control leasing arrangements, if both the reporting entity and the legal entity being evaluated for consolidation are not public business entities
+ Accounting policy election the private company reporting entity will apply to all current and future legal entities under common control that meet the applicable criteria; the accounting alternative cannot be applied to select common control arrangements

# ASU 2018-17 (Continued)

+ The four criteria
  - The reporting entity and the legal entity are under common control
  - The reporting entity and the legal entity are not under common control of a public business entity
  - The legal entity under common control is not a public business entity
  - The reporting entity does not directly or indirectly have a controlling financial interest in the legal entity
+ Requires note disclosures related to the reporting entity's involvement in and exposure to entities under this election

# ASU 2020-04

- ASU 2020-04, *Reference Rate Reform (Topic 848) - Facilitation of the Effects of Reference Rate Reform on Financial Reporting*
- Effective 3.12.20 (issuance date of ASU 2020-04) through 12.31.22
- The London Interbank Offered Rate (LIBOR) is one of the most widely used reference rates in the world when accounting for debt, securities, derivatives, and other financial instruments; the LIBOR rate is being phased out
- Provides optional relief to ease accounting transition due to the replacement of the LIBOR rate as a reference rate in receivables, debt, leases, derivatives, and/or other contracts
- ASU 2021-01, *Reference Rate Reform (Topic 848) - Scope*, subsequently expanded the scope of ASU 2020-04 to include certain other derivative instruments
- General theme is to allow for the carryover of current accounting treatment when changes to the contract are just due to the inclusion of a replacement reference rate
- Such a contract modification does not require contract remeasurement at the modification date or the reassessment of a previous accounting determination
- Debt - prospectively adjust the effective interest rate and account for the modification as if the modification was not substantial

# ASU 2021-03

- ASU 2021-03, *Intangibles-Goodwill and Other (Topic 350): Accounting Alternative For Evaluating Triggering Events*
- Private companies only - effective on a prospective basis with fiscal years beginning after **12.15.19 (12.31.20 year-end)**; early adopted permitted
- Private companies suggested the costs and complexity of monitoring and evaluating triggering events throughout the reporting period outweighs the benefits to the users of the financial statements
- Provides an accounting alternative to perform a goodwill impairment triggering event evaluation as of the end of the reporting period, rather than monitoring for goodwill related triggering events throughout the reporting period
- No longer need to perform an events-driven triggering event assessment and record impairment as of the date of the triggering event

# Questions

# Presenter

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# Thank You

For Your Time!

# Leases 842 Project – New Developments and Implementation Notes (ASU 2016-02)

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# Quick hitters

### Overview

FASB's Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842*) is intended to increase transparency and comparability in financial reporting by requiring balance sheet recognition of leases and enhanced footnote disclosures related to lease arrangements.

### EFFECTIVE DATE

Public business entities, certain not-for-profit entities with conduit financing arrangements, and employee benefit plans – Fiscal years as well as interim periods beginning after **December 15, 2018**.

All other entities – Fiscal years beginning after **December 15, 2021**. Interim periods within fiscal years beginning after **December 15, 2022.**

### WHAT TO DO NOW

Educate your team on the definition of a lease contract as defined under the new standard. Inventory your contracts and ensure communication between your accounting teams and all departments. Consider transition options, practical expedients, and impacts to financial statements including debt covenants. Consider impacts to month-end reporting and future tracking.

# Quick hitters (cont.)

## TRANSITION OPTIONS

**Effective Method** – applied as of the effective date (comparative prior periods presented under ASC 840)

**Comparative Method** – applied as of the earliest comparative period presented

## PRACTICAL EXPEDIENTS

**Package of 3** – applied to entire portfolio

**Hindsight** – applied to entire portfolio

**Land easements** – for leases existing before the adoption date of ASC 842

**Short-term lease exemption** – Elected by class of asset.

## PRACTICAL EXPEDIENTS

**Combining lease and non-lease components** Elected by class of asset.

**Discount rate** – Private company option to use the risk-free rate -election by class of asset.

# CPEA Update

- **Additional Extension Requested………….Denied.**
- **Income statement impact ?**
  - Don't underestimate impact of a lease modification or remeasurement event occurring in the year of transition (i.e. 2022) that could impact year-end expense
  - Discovery of embedded leases with non-level payments or that trip finance thresholds
- **Transition Method**
  - Vast majority continue to use the Effective Date Method (vs. Comparative Method)
  - Effective Date Method
    - Requires 840 and 842 disclosures if elected and presenting comparative statements
      - Future Min. Lease Pmts under 840 required to be listed as of latest balance sheet presented under 840
      - Some public companies got into trouble with compliance on 840 disclosures.

# CPEA Update (continued)

- **<u>Leases of Land</u>**
  - Only applied the transfer of ownership and bargain purchase criteria under 840. They apply all the same criteria as all other leases under 842. This means many could easily trip into finance leases that were previously operating.
- **<u>Leases of Land and Building</u>**
  - Under 840, leases in which FV of land was less than 25% of the total fair value of leased property, the lessee considered the land and the building as a single unit for applying the lease term and fair value tests.
  - Under 842 did not carryforward this exception and leases of land (including implied leases of land) need to be treated as a separate lease component, unless reporting impact of not is insignificant.
    - *Evaluate for land leases over this last month. If wanting to renegotiate or change lease term, do before 1/1/2022.*

# CPEA Update (continued)

- **<u>Lease Liability</u>**
  - **Lease liability** calculated off the remaining minimum rental payments (as defined under 840), plus amounts probable of being owed under a residual value guarantee
  - Use **discount rate** at the "<u>application date</u>" – determined by which transition method is selected
    - Note: Guidance not clear on whether you use the rate applicable to remaining lease term at application date or to the original term of the lease. This is being treated as a policy election now *(note: likely lower rate if using original term covered by lease)*
- **<u>Minimum Rental Payments</u>**
  - Not defined by FASB. 840 is clear that LEASE payments do NOT include increases in rental payments caused by increases in a rate or index (such as those based on the change in CPI).
    - Note: common practice in disclosures have included this for many.

# CPEA Update (continued)

**Example A**

At January 1, 2012, an entity enters into a 20-year operating lease that provides for annual payments of $100,000 with additional payments based on the change in the Consumer Price Index (CPI). At January 1, 2022, the entity adopts FASB ASC 842. At that time, the annual lease payment is comprised of $100,000 plus an additional $50,000 caused by the change in the Consumer Price Index since January 1, 2010. For simplicity, assume a 0% discount rate. Is the FASB ASC 842 operating lease liability at the adoption date (January 1, 2020) $1,000,000 ($100,000 x 10 remaining years) or $1,500,000 ($150,000 x 10 remaining years).

# CPEA Update (continued)

**Answer A**

FASB ASC 842 transition guidance does not address this question. Based on responses to technical inquiries of FASB staff reported by numerous firms, the operating lease liability at the adoption date should NOT include increased lease payments caused by variable lease payments. Thus, the operating lease liability at the adoption date in the example above is $1,000,000. However, the SEC staff has indicated that, if a registrant has previously disclosed increased operating lease payments caused by a change in a rate or index, it is permissible for the registrant to continue its accounting practice and, thus, record the operating lease liability at the adoption date in the example above at $1,500,000.

# CPEA Update (continued)

- Executory costs

**Practice Note**

While FASB ASC 840 is not clear regarding minimum rental payment composition in the aforementioned areas, FASB ASC 842 does provide clarity in these areas. As a result, new and remeasured leases after the effective date adjustment, will apply FASB ASC 842 in full (without respect to transition guidance) and these questions will no longer apply. Fixed lease payments -- including those in gross leases -- are part of the lease right-of-use asset and liability regardless of whether they pertain to executory costs. Payments based on a rate or index are measured as part of the lease right-of-use asset and lease liability at lease commencement (or remeasurement) based on the rate or index at lease commencement (or remeasurement). Subsequent changes in the rate or index (assuming no remeasurement event) are variable lease payments and are not recognized as part of the right-of-use asset or lease liability.

# CPEA Update (continued)

- **Hindsight**
  - **Could be beneficial in long-term land leases**

**Example C**

A land lease has a 30-year initial term with two 20-year renewal options by the lessee. The lease does not contain a bargain purchase option nor does title revert to the lessee. Based on this, the lease is properly classified as an operating lease under FASB ASC 840 at lease inception. The renewal options are not reasonably assured to be exercised at lease inception. The land is located in a key area for the lessee's business. The entity uses the hindsight practical expedient and determines that the two 20-year renewal options now should be included in the lease term based on the key location for the business. The entity also elects the package of three practical expedients.

# CPEA Update (continued)

- **Hindsight – continued**

**Answer C**

While not addressed explicitly in FASB ASC 842, we feel the entity is able to grandfather the existing classification of an operating lease in transition to FASB ASC 842. The lease term now includes the renewal option periods and will not change. If the hindsight practical expedient was not elected, the lease term would not include the renewal option periods. Since the lease term does include the renewal option periods, it is possible that such a lease under FASB ASC 842 would become a finance lease when the renewals are exercised and lease term changes. The lease term change causes reassessment under FASB ASC 842 classification rules including the present value test.

# CPEA Update (continued)

- **Short-term (ST) leases**
  - ST leases are defined as 1 year or less in original lease term (NOT a 5-year lease that has 1 or less years remaining at application date)
- **Practical expedient to combine lease and nonlease (service) components:**
  - If elected, be aware that the combined lease component payments are what will be used for measuring the lease payments for the finance lease present value test
- **Related party leases**
  - Assess the legally enforceable terms and conditions. Oral or expired related party leases may need legal determination.
    - Considerations of likelihood of renewals/extensions

# Software Solution

- Many situations will prompt or require use of a software solution

- Our software solution is here and available for us to help your team

- Similar to depreciation schedules – maintains independence

- Considerations for Candidates
  - If handling more than 10 leases, Excel not likely an effective solution
  - Suited best for those with 5-100 leases
  - Cost-effective solution, particularly after year 1.
  - Provides balances, journal entries, disclosures.

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# IRS Circular 230 Disclosure.

- As a result of perceived abuses, the Treasury has recently promulgated Regulations for practice before the IRS. These Circular 230 regulations require all accountants to provide extensive disclosure when providing certain written tax communications to clients. In order to comply with our obligations under these Regulations, we would like to inform you that any advice given in this presentation, including any attachments, cannot be used to avoid penalties which the IRS might impose, because we have not included all of the information required by Circular 230, nor have we performed services that rise to this level of assurance.