

Center for Plain English Accounting

AICPA's National A&A Resource Center

Accounting for Termination Benefits **Other Accounting Impacts of COVID-19**

By: Mike Austin

As the COVID-19 pandemic continues to impact our personal and professional lives, many of our members are using the resources provided by both the [AICPA](#) and the [CPEA](#) to help clients first navigate the initial financial reporting considerations related to closing out calendar year-end 2019 audits and, then, navigating the CARES Act and the resulting PPP loans and other government assistance obtained by many businesses.

While these issues rightfully demanded the most attention to date, an event as impactful as the pandemic also will have a ripple effect through many other areas of an entity's operations, which may result in the need to consider less frequently used accounting guidance. As a result, we are beginning a series of reports to provide an overview of accounting guidance that may be more relevant in this environment.

To begin, many entities have needed to reduce employee headcount to remain in business either through furloughing employees or via outright termination of employment. In this report, we'll summarize the relevant accounting considerations for both new or modified benefits that are being provided to employees, as well as benefits provided to employees upon termination.

New and Modified Benefits for Employees

While the CARES Act rightfully receives the majority of attention from an accounting perspective, the previous piece of pandemic related legislation, the Families First Coronavirus Response Act (FFCRA), brought many changes for entities which were required to be implemented by April 2, 2020. Among the changes, with potential accounting impacts, are requirements to expand family and medical leave, establish an emergency two week paid sick leave requirement as well as providing several payroll tax credits for qualifying employers (less than 500 employees).

Of the changes made by the FFCRA, the accounting for the required sick leave requirement may be most unfamiliar to entities. Generally, in considering the accounting, entities only would be required to accrue for sick pay if the benefits provided could be carried forward into the next period (if the benefits accumulate) or if the benefits must be paid out upon termination (if the benefits vest). In most cases, sick pay benefits do not meet either of those criteria, which results in their being expensed as incurred. The FFCRA does not require the two-week sick pay period to either accumulate or vest, so the determination would be based on how individual entities chose to provide that benefit to their employees.

If an entity chose to make the sick pay benefit vest, then it would be accounted for in the same manner as other compensated absences and recognized when the criteria in FASB ASC 710-10-25-1 are met:

FASB ASC 710-10-25-1



Compensated Absences

An employer shall accrue a liability for employees' compensation for future absences if all of the following conditions are met:

- a. The employer's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered.
- b. The obligation relates to rights that vest or accumulate. Vested rights are those for which the employer has an obligation to make payment even if an employee terminates; thus, they are not contingent on an employee's future service. Accumulate means that earned but unused rights to compensated absences may be carried forward to one or more periods subsequent to that in which they are earned, even though there may be a limit to the amount that can be carried forward.
- c. Payment of the compensation is probable.
- d. The amount can be reasonably estimated.

Employers may also extend the benefits provided by the FFCRA to employees who have been furloughed or those on other forms of temporary leave. If furloughed employees still are receiving either full or partial salary (salary continuation), an accrual should be made when it is probable that the benefits will be paid and the amount can be reasonably estimated, with updates to the liability to be made at each financial reporting date. Other benefits provided to employees to help them while they are working from home such as reimbursements for home internet and phone, home office equipment, and childcare benefits generally are expensed as incurred since they are benefiting employees in the period they are received.

Termination and Other Postemployment Benefits

The appropriate authoritative guidance for benefits provided after employment ends that is not tied to a pension or other postemployment benefits (OPEB) plan generally falls into one of four groups:

- Contractual termination benefits
- Special termination benefits
- Other postemployment benefits
- One-time termination benefits

Contractual termination benefits [FASB ASC 712-10-25-2:3]

Benefits which are in the scope of this category are provided in accordance with the terms of an existing plan or arrangement, such as a labor contract, and the benefits paid are tied to specific events in the contract, such as closures of operations at certain locations. Terminations related to the pandemic are unlikely to fall into this category for most organizations, so will not be covered in this report in greater detail.

Special termination benefits [FASB ASC 712-10-25-1]

Benefits which are provided to an employee as an incentive for them to elect a voluntary termination fall under this type of benefit arrangement. The additional benefits provided may vary and include items ranging from additional salary continuation to extended health insurance coverage. In response to the pandemic, some entities may choose to offer benefits of this type to employees in exchange for their accepting a voluntary termination. The timing of recognition of these benefits is straightforward; generally, an accrual and expense is recognized in the period in which the employee irrevocably accepts the offer and the amount of the liability is reasonably estimable. Given those conditions, it would be highly unlikely for an employee to accept the offer without knowing what they are receiving for doing so, which would result in the amount being reasonably estimable.

Some questions may arise related to timing of recognition if the offers are made across the reporting period. If offers are made prior to year-end but not accepted by the employee until the following year, they would not be recorded as of year-end since the employee had not accepted the offer. This still would be the case if the employee accepted the offer after year-end but prior to the issuance of the year-end financial statements, as the expense generally is recognized when the offer is accepted by the employee.

The timing of recognition can be impacted in situations where the employee is required to provide services for an additional period after acceptance of the offer. For example, if an employee accepts an offer on August 1, 2020 to voluntarily terminate employment as of January 31, 2021, then the expense related to the special termination benefits would

be recognized over the 6-month service period the employee is required to work to earn the benefit.

Other postemployment benefits [FASB ASC 712-10-25-4:5]

Benefits in the scope of this category are provided in accordance with a mutually agreed upon plan between the employees and the employer for benefits which are not either contractual termination benefits or special termination benefits -- essentially a catchall category. These benefits are provided under a plan established by the company and communicated to employees either in writing, orally, or via past action. In many cases, the benefits an entity will extend to an employee who is involuntarily terminated is outlined in benefit handbooks provided to employees at the time they are hired. Typically, benefits covered in this category include salary continuation, severance benefits, job training/counseling services, and continuation of benefits such as health, disability, and life insurance.

Accounting for benefits provided under this category depends on whether the benefits meet the four criteria discussed earlier for compensated absences. If the benefits do not meet those criteria, they are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated (the loss contingency model). The timing of when an expense is recognized likely will be much different under each model so ensuring that an entity is following the correct guidance is critical, but not always simple.

When Do You Record an Expense?



MJ Inc. communicates to employees when they are hired that if they are terminated involuntarily they will receive two-weeks severance pay. If employees elect to leave the company voluntary they will not receive the benefit.

Would MJ record the two-weeks severance using the compensated absences model or the loss contingency model?

By communicating the plan to employees when they are hired, MJ has committed to making the two-weeks severance payment if an employee is involuntarily terminated; however, the payment of the compensation would not be probable at the time, nor would the amount to be paid be reasonably estimated. As a result, a liability would not be recorded until those two conditions are met (the loss contingency model).

One-time termination benefits [FASB ASC 420-10-25-4:10]

Given that the previous category of benefits was described as a catchall for benefits which did not fall into the first two categories, it may be surprising to see a fourth category. As

the name indicates, this category includes involuntary termination benefits that are provided as a one-time benefit. The key difference between these benefits and the other category benefits is that these benefits are not part of an ongoing, or other, plan the entity already had in place. That small difference is critical since the timing of recognition of expenses for one-time benefits can be significantly different than for the other category benefits.

As discussed previously, the general criteria for recognition of a benefit that falls into the first three groups is that the liability is probable, and the amount is reasonably determinable. The obligation to provide one-time benefits does not occur until the promise to provide the benefits is communicated to the affected employees and the following criteria have been met:

FASB ASC 420-10-25-4



An arrangement for one-time employee termination benefits exists at the date the plan of termination meets all of the following criteria and has been communicated to employees (referred to as the communication date):

- a) Management, having the authority to approve the action, commits to a plan of termination.
- b) The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.
- c) The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.
- d) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Due to the nature of the criteria above, all are likely to have been met prior to the plan being communicated to employees, which, typically, makes the communication date the key factor in determining the timing of recognition. Once that communication is made, the expense is recognized either immediately, if the employee is not required to provide any additional service (beyond any minimal retention period) or, if relevant, over the additional required service term to obtain the benefit. With respect to one-time benefits provided to employees in relation to the pandemic, the expectation would be that no additional service time would be required and, therefore, the expense would be recognized when communicated.

The default assumption related to termination benefits is, if entities have a preexisting written plan or a consistent history of providing severance payments to employees without a plan, the benefits would be accounted for under those plans, even if the benefits provided are an enhancement of what was included in those plans. To be accounted for under the guidance for one-time benefits, the employer would need to communicate to employees that the benefit is a one-time benefit that is tied to a specified termination event (such as the pandemic) and would not be available for future terminations.

A Combination of Approaches

When employers make the decision to reduce their workforce, the benefits provided to employees may include elements that are accounted for under multiple areas of guidance. For example, consider the following situation:

What is the Correct Guidance?



Pip Co. determines that, to maintain a strong operating position, they need to reduce their workforce by 100 employees. They do not have any history of postemployment benefits being paid and they have no written agreements with employees. Their plan offers any employees who voluntarily terminate their employment within 30 days a termination benefit of \$10,000, to be paid on the separation date. If enough employees do not accept the voluntary offer, they will involuntarily terminate employees to reach the 100-employee target. Any involuntarily terminated employees will receive a \$6,000 payment at their termination date. All employees are expected to leave within the minimum retention period.

What type of benefit(s) are offered, and when would the expense be recorded?

There are two types of benefits offered by Pip Co. First, Pip Co. has offered an involuntary termination benefit of \$6,000 for 100 employees that would be considered a one-time termination benefit. They would record a liability (\$600,000) at the communication date. Pip Co also has offered an incremental voluntary termination benefit (\$4,000 per employee) which would be accounted for as a special termination benefit. The expense would be recognized when the employee accepts the offer.

The CPEA provides non-authoritative guidance on accounting, auditing, attestation, and SSARS standards. Official AICPA positions are determined through certain specific committee procedures, due process and extensive deliberation. The views expressed by CPEA staff in this report are expressed for the purposes of providing member services and other purposes, but not for the purposes of providing accounting services or practicing public accounting. The CPEA makes no warranties or representations concerning the accuracy of any reports issued.

© 2020 Association of International Certified Professional Accountants. All rights reserved. For information about the procedure for requesting permission to make copies of any part of this work, please e-mail cpea@aicpa.org with your request. Otherwise, requests should be written and mailed to the Center for Plain English Accounting, AICPA, 220 Leigh Farm Road, Durham, NC 27707-8110.