HERTZBACH
certified public accountants · consultants

ASSURANCE COMMENT

Mark Steinberg

August 4, 2020

Borrower Accounting for PPP Loans

Although the legal form of the PPP loan is debt, some believe the loan is, in substance, a government grant. This has caused confusion on how borrowers should account for the loans under Generally Accepted Accounting Principles (GAAP).

There is no guidance in existing GAAP that specifically addresses the accounting for forgivable loans obtained from, or guaranteed by, a government entity. As a result, the AICPA released TQA 3200.18 which provides nonauthoritative guidance on how nongovernmental entities (business entities and not-for-profits) should account for the forgivable PPP loans. Under the TQA there are two possible approaches to accounting for PPP loans. The loans can be accounted for as either debt or government grants.

Debt

Regardless of whether an entity expects to repay the PPP loan, the loan may always be accounted for as a financial liability in accordance with ASC 470, *Debt.*

Under ASC 470, the borrower would recognize the loan amount as a liability on the balance sheet, with the applicable interest accrued and expensed over the term of the loan. The borrower would not impute additional interest at a market rate because the interest rates are prescribed by government agencies.

The full amount of the loan would remain on the balance sheet until either of the following criteria have been met:

a) The borrower has been legally released from being the obligor under the liability

b) The borrower pays the lender

Under criteria "a", income from extinguishment of debt would only be recognized once the borrower's application for forgiveness is approved. At which time, any amount forgiven would be recognized in the income statement as a gain on extinguishment.

The gain that results from forgiveness will be measured based on the net carrying value of the PPP loan, which should include accrued interest and deferred financing costs relating to the forgivable portion of the loan.

Under the debt approach, receipt of the funds will be presented as cash inflows from financing activities. Any interest paid will be presented as a cash outflow from operating activities, and any principal repaid will be presented as a cash outflow from financing activities. Any loan amount that is forgiven, will be disclosed as a non-cash financing activity.

Origination costs paid to the third parties in conjunction with securing the debt, such as document preparation costs or advisor fees, should be considered debt issuance costs and reflected as a direct reduction from the carrying amount of the debt. These costs are deferred and amortized into interest expense over the term of the debt.

Government Grants

To account for the forgivable loan as a government grant, borrowers must conclude based on their particular facts and circumstances that they meet the PPP eligibility criteria and the borrower is able to demonstrate it is probable they will meet the loan forgiveness requirement under the PPP. Absent meeting the probability threshold, ASC 470 *Debt* guidance would be applied. There is no definition of "probable", but some would say it means a 75% or greater chance of forgiveness.

The TQA states that if a business entity concludes they qualify to recognize the loan as a grant that is expected to be forgiven, it may analogize to the guidance contained in any of the following:

a) International Accounting Standards IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

b) NFP guidance in ASC 958-605, *Revenue Recognition*

c) ASC 450-30, *Gain Contingencies*

International Accounting Standards IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

IAS 20 provides the most comprehensive accounting model for government grants, and it has been widely applied to government grants received by business entities. IAS 20 addresses forgivable loans, and an entity may conclude that the application of IAS 20 to PPP would best reflect the substance of the forgivable loan.

Under IAS 20, government assistance is not recognized until there's a reasonable assurance that: 1) any conditions attached to the assistance will be met, and 2) the assistance will be received.

The proceeds from the loan would be initially recognized as a deferred income liability. Subsequently, the entity would reduce the liability and recognize income on a systematic basis over the period in which the entity recognizes the related costs for which the PPP loan is intended to compensate, for example, payroll costs.

Income would be reflected on the income statement as a separate line item such as other income.

NFP guidance in ASC 958-605, *Revenue Recognition*

A not-for-profit that chooses not to account for the loan under ASC 470 and meets the PPP eligibility criteria, and the borrower is able to demonstrate it is probable they will meet the loan forgiveness requirement under the PPP, should account for the PPP loan in accordance with ASC 958-605. A for-profit may also choose to recognize the PPP loan under ASC 958-605.

Under ASC 958-605 the PPP loan would be considered a conditional contribution. Conditional contributions are not recognized until the conditions are substantially met or explicitly waived. In cases where conditions are met over time or in stages, contributions should be recognized as qualifying expenses are incurred.

Under this model, the proceeds from a PPP loan would initially be recognized as a refundable advance – liability until the conditions for forgiveness are substantially met. The borrower would subsequently recognize contribution revenue as it incurs qualifying expenses, assuming all other conditions are substantially met.

Disclosure

All entities should disclose their accounting policy for PPP loans and the related impact on the financial statements.