Snapshot

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Snapshot 2020-23

Accounting for PPP loans received by businesses

Note: Certain web browsers do not support the SBA's website.

The CARES Act, including subsequent amendments, earmarked over $600 million through the Paycheck Protection Program (PPP), administered by the Small Business Administration (SBA), for potentially forgivable loans to support eligible small businesses impacted by COVID-19. The loans, which have a two- or five-year term (depending upon when they were issued) and bear interest at 1 percent, are provided through SBA-approved lenders to an eligible entity. The PPP was closed to additional small business applicants on August 8, 2020.

A business that received a PPP loan should take care to document its basis both for certifying the need for the loan and for determining that it has sufficient qualifying expenses to request forgiveness, as well as the accounting policies related to the loan.

Eligibility for PPP loans

Entities that may have been eligible for PPP loans include

- A "small business" that meets the SBA's size standards
- Any business or nonprofit organization that has fewer than 500 employees
- Any business in the accommodation and food service industry (that is, any NAICS Code that begins with 72) with fewer than 500 employees per location
- Sole proprietors, independent contractors, and self-employed persons

Additionally, a borrower is required to certify that the "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."

Certification of need

To assert the necessity of a PPP loan, as noted in Questions 31 and 37 of the SBA's PPP FAQs, an entity must take into account its ability to access other sources of liquidity sufficient to support its ongoing operations in a manner that is not significantly detrimental to its business. The FAQs note that a public company with substantial market value and access to capital markets, as well as a private company with adequate sources of liquidity, will unlikely be able to make the required certification in good faith.

As noted in FAQ 46, a borrower (together with any affiliates) that receives a PPP loan of less than $2 million will be deemed to have made the required certification in good faith. In addition, all PPP loans in excess of $2 million will be subject to review by the SBA for compliance with PPP requirements, including the applicant's initial eligibility. However, the SBA retains the right to review the eligibility of any borrower, regardless of the size of the loan.

Forgiveness of PPP loans

A portion of the borrower's PPP loan (and related interest) will be forgiven, equal to eligible expenses, including payroll costs, interest payments on mortgages, and rent and utility payments, made during the loan's qualifying period, provided that the borrower meets all of the loan's employee-retention criteria.

According to the SBA's rule regarding lender and SBA responsibilities, a borrower, in order to receive forgiveness on a PPP loan, must submit an application for forgiveness to the creditor. The creditor, in turn, issues a recommendation to the SBA within 60 days on whether the borrower is entitled to full, partial, or no forgiveness of the PPP loan, and requests payment from the SBA equivalent to the amount for which it recommends forgiveness (including accrued interest). The SBA then has 90 days to review the request for payment from the creditor. If the SBA concurs with the creditor's recommendation, the SBA pays the creditor for the amount forgiven, plus any interest that accrues through the date of payment. The borrower must then remit any amount not forgiven by the SBA to the creditor in accordance with the terms of the PPP loan. If the SBA subsequently determines that the borrower was ineligible for the PPP loan, the borrower must immediately repay the loan to the creditor.

Accounting for PPP loans

The accounting and disclosure requirements for government assistance provided to businesses depends on whether the assistance is considered a loan, payment for a good or service, an income tax credit, or a grant. Each borrower under the PPP program should carefully analyze its unique facts and circumstances in determining the appropriate accounting. However, generally, most businesses will account for PPP loans as either debt or government grants.

Accounting for PPP loans as debt

Because PPP loans are a legal form of debt, it is appropriate for a borrower to account for these loans as debt under the guidance in ASC 470, *Debt*, even if the borrower believes that it may be eligible to apply the guidance on government grants and assistance in IAS 20 by analogy. Under the guidance in ASC 835, *Interest*, a borrower accrues interest over the term of the loan at the effective interest rate. Borrowers are not required to impute a market rate of interest to government-guaranteed obligations, such as PPP loans, under the guidance in ASC 835-30, *Imputation of Interest*.

Under ASC 470, debt should be derecognized when the debt is extinguished, in accordance with the guidance in ASC 405-20, *Liabilities: Extinguishments of Liabilities*. Under this guidance, debt is extinguished when either of the following conditions is met:

- The debtor pays the creditor.
- The debtor is legally released from being the primary obligor, either judicially or by the creditor.

A PPP loan is forgiven in total or in part only after the SBA has paid the lender the amount of the PPP loan the SBA has determined is eligible for forgiveness, at which point, the lender should notify the borrower of the forgiveness of the PPP loan. The SBA's criteria for forgiveness may change, so borrowers should carefully monitor the SBA's website for new developments.

When the debt is extinguished, any amount that is forgiven (including accrued but unpaid interest) is recognized in the income statement as a gain upon debt extinguishment.

Under ASC 230, *Statement of Cash Flows*, the amount borrowed under a PPP loan is shown as a cash inflow from financing activities, principal repayments as cash outflows from financing activities, and interest payments as outflows from operating activities. Any gain recognized as a result of amounts of principal and interest forgiven is shown as a noncash reconciling item to net income in the cash flows from operations.

Classification of PPP loans

Following the issuance of the Paycheck Protection Program Flexibility Act of 2020, signed into law in June, borrowers under PPP loans are required to begin repaying any amounts not forgiven at the later of (a) 10 months following the borrower's covered period, or (b) when the SBA remits any amounts forgiven to the lender.

Borrowers that present a classified balance sheet should determine the appropriate classification of a PPP loan according to the classification guidance in ASC 210-10-45 (with those entities accounting for PPP loans under ASC 470 also considering the guidance in ASC 470-10-45) based on the loan's contractual terms. In other words, an entity that has submitted or plans to submit a request for forgiveness to the SBA should determine the appropriate classification of the PPP loan without considering the amounts that it anticipates will be forgiven. Accordingly, the classification guidance in ASC 210-10-45 (and, if applicable, ASC 470-10-45) should be applied as though (a) no amounts will be repaid by the SBA, and (b) the payment deferral will cease 10 months after the end of the borrower's covered period.

Accounting for PPP loans as government grants

U.S. GAAP does not have specific guidance on accounting for government grants made to business entities if the grants are not in the form of a tax credit. Under the guidance in ASC 105, *Generally Accepted Accounting Principles,* an entity may apply nonauthoritative guidance by analogy when guidance for a transaction is not specified within U.S. GAAP. Accordingly, as noted in AICPA TQA 3200.18 and based on discussions with the SEC Office of the Chief Accountant, a borrower may elect to account for a PPP loan as a government grant in substance by applying the guidance in IAS 20 by analogy if it is probable that it will meet both (a) the eligibility criteria for a PPP loan, and (b) the loan forgiveness criteria for all or substantially all of the PPP loan. If the borrower cannot support that it will probably meet both the eligibility and the forgiveness criteria, the PPP loan should be accounted for as debt. The assessment of whether it is probable that a borrower will meet the eligibility and forgiveness criteria is an ongoing one, and the borrower should therefore monitor developments regarding the SBA's continued evaluation of the eligibility and forgiveness criteria.

As discussed in TQA 3200.18, IAS 20 is not the only source of nonauthoritative guidance that a borrower may use by analogy to account for government grants. If a borrower has previously established a policy to account for government grants, it should first consider whether that accounting policy can be applied to PPP loans (for instance, a healthcare entity that previously applied the guidance in ASC 450-30 to account for payments received for electronic health-record technology under the American Recovery and Reinvestment Act of 2009).

However, many businesses do not have an established policy for accounting for government grants or might conclude that PPP loans are not similar to the government grants received in the past, so they will need to establish a new accounting policy.

Under IAS 20, a borrower should account for a PPP loan as an income-related grant and initially recognize the loan as a deferred income liability. The borrower should then relieve the loan through income on a systematic and rational basis in those periods over which the entity recognizes the expenses that the grant is intended to offset. The income statement impact of any loan forgiveness under IAS 20 may either be presented separately or be offset against the related expenses. A borrower applying IAS 20 by analogy should not present the income statement impact of any PPP loan forgiveness as revenue.

Under IAS 20, if a borrower initially concludes that it is probable it will meet the criteria for loan forgiveness and therefore accounts for the PPP loan as an in-substance government grant, but then subsequently discovers that a portion or all of the PPP loan is repayable, it should account for the change in expectation as a change in estimate.

In addition, a borrower that elects to account for the PPP loans as an in-substance government grant under IAS 20 may make an accounting policy election to account for the proceeds received, paid, and forgiven on those loans within the same section of the statement of cash flows where the loan's related expenses are presented. However, a borrower may also make an accounting policy election to present the PPP loan as a traditional borrowing.

Disclosures

Regardless of the accounting approach followed by a borrower, if the PPP loan is material to the financial statements, the borrower should disclose in the footnotes how the PPP loan was accounted for and where the related amounts are presented in the financial statements, including the statement of cash flows. Additionally, the borrower should consider the disclosure requirements of the specific accounting guidance applied to the PPP loan (that is, ASC 470, IAS 20, ASC 450-30, or other guidance).

Public companies should consider other disclosure requirements outlined in Regulation S-X, including risk factor disclosures related to meeting the eligibility and forgiveness requirements as well as liquidity disclosures regarding the potential for repaying the amounts borrowed. In addition, all entities should consider whether conclusions regarding their ability to remain a going concern are premised upon receiving debt forgiveness for the PPP loan.

Tax treatment of PPP loans

Regardless of the financial accounting classification, PPP loans are treated as debt for federal income tax purposes.

If a PPP loan is forgiven, Section 1106(i) of the CARES Act specifically requires taxpayers to exclude canceled indebtedness from gross income, and, accordingly, the debt forgiveness amount is nontaxable. The accrued interest forgiven is potentially taxable, depending on the circumstances. Subsequent to the passage of the CARES Act, the IRS issued Notice 2020-32, which precludes a deduction for an expense that would otherwise be deductible if the payment results in the forgiveness of a loan, thereby preventing entities from claiming a double tax benefit on the qualifying expenses for PPP loans. On December 27, 2020, the Consolidated Appropriations Act (CAA) was signed into law, which reverses existing IRS guidance provided in Notice 2020-32 by allowing taxpayers to fully deduct any business expenses, regardless of whether the expense was paid for using forgiven PPP loan proceeds. The loan forgiveness is still excluded from federal taxable income, while state income tax treatment varies.

Determining the appropriate timing of when expenses are deductible and when the loan is forgiven, along with the correct accounting treatment, can be challenging if more than one tax year is involved, such as when expenses are incurred and the application for forgiveness is filed in tax year 2020, but that forgiveness is not granted until tax year 2021. Borrowers should consult their tax advisors for guidance regarding the appropriate tax and accounting treatment for their specific facts and circumstances.

Deferred taxes

For entities that account for PPP loans as loans under ASC 470, interest is accrued on the loan for financial statement purposes. However, there may be diversity in practice regarding how entities treat contractual interest on PPP loans for income tax purposes. Any book-to-tax differences should be accounted for as a temporary difference in the financial statements and should then be reversed when the forgiveness of the accrued interest is recorded in the financial statements.

However, a borrower that does not account for its PPP loan as debt (for instance, if the borrower applies IAS 20 by analogy) is likely to recognize additional deferred taxes in accordance with ASC 740. As discussed above, determining when items are included as income or expenses for tax purposes can be complex, and borrowers should carefully examine their unique facts and circumstances.

For more information on borrower accounting for PPP loans as well as the overall impact of COVID-19 on estimates of credit losses, see NDS 2020-04, "COVID-19: Accounting and financial reporting considerations."

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