UPDATES TO THE ACCOUNTING METHODS FOR THE PAYCHECK PROTECTION PROGRAM LOAN

AS THE U.S. SMALL BUSINESS ADMINISTRATION (SBA) CONTINUES to issue interim final rulings with clarifications and illustrations regarding the various aspects of the Paycheck Protection Program (PPP), the accounting methods for the PPP loan and loan forgiveness may offer complexities and confusion to business entities attempting to address these changes. Companies can greatly benefit from the financial offerings that Congress continuously works on, and as your accounting professionals, we are here to help you understand these programs.

Below is an overview regarding the appropriate accounting methods to conform with the accounting principles generally accepted in the United States of America (USGAAP) and how they affect business entities.

BUSINESS ENTITIES

USGAAP has limited guidance on the accounting for government assistance, or grants, to business entities. Hence, companies may look to International Accounting Standards (IAS) 20 to determine the appropriate accounting. Alternatively, some borrowers may consider the PPP loan forgiveness to be a non-exchange transaction, in which case Accounting Standards Codification (ASC) 606 would not apply.

ACCOUNTING MODELS

In early June, the American Institute of Certified Public Accountants (AICPA) issued Technical Questions and Answers (TQA) 3200.18 related to the borrower accounting for a forgivable loan received under the PPP loan. The TQA included four different accounting methods, any of which the borrower could adopt to account for the PPP loan forgiveness and conform with USGAAP.

The four different accounting models are:

- **Debt (Liability) model (ASC 470)** – Recognizing the PPP loan as a Note Payable
- **Government Grant model** (analogize to International Accounting Standards "IAS" 20) – Recognizing the PPP loan as a Deferred Income Liability
- **Contributions model** (analogize to FASB ASC 958-605) – Recognizing the PPP loan as a Refundable Advance
- **Gain Contingency model (ASC 450-30)** – Recognizing the PPP loan as a Note Payable

"DEBT" MODEL (ASC 470):

The borrower recognizes the PPP loan as a Note Payable (long-term liability) upon receipt. Subsequently, to derecognize the liability, the following guidance (in FASB ASC 405-20-40-1) would apply. The PPP loan would remain recorded as a liability until either:

1. The PPP loan is forgiven by the lender, in part or wholly, and the borrower is **"legally released"** of the debt; or
2. The borrower **pays off** the PPP loan to the lender

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When the events noted in the above first item occur, the borrower could recognize a gain on extinguishment of debt with a corresponding offset to Note Payable.

"GOVERNMENT GRANT" MODEL (ANALOGIZE TO IAS 20):

Consistent with the provisions of IAS 20, after initial recognition of the loan proceeds, government grants are recognized in the statement of income on a systematic basis. This basis corresponds with the manner that the business entity recognizes the underlying expenses that the government grant intends to compensate.

IAS 20 generally recognizes government grants in the statement of income either on a "gross" or "net" basis. A gross basis recognizes the forgiven portion of the loan amount as "other income" in the statement of income. A net basis recognizes the forgiven portion of the loan amount as an offset against the related eligible expenses.

The borrower recognizes the PPP loan as a Deferred Income (long-term liability) upon receipt of the PPP loan. The PPP loan forgiveness is not recognized until the borrower meets the "**probable**" threshold in USGAAP, that:

1. Any and all of the conditions attached to the PPP loan forgiveness will be met; and
2. The lender approves the loan forgiveness

Once it's probable that the two conditions will be met, the PPP loan forgiveness income can be recognized with a corresponding offset to "Deferred Income."

"CONTRIBUTIONS" MODEL (ANALOGIZE TO FASB ASC 958-605):

The borrower recognizes the PPP loan as a Refundable Advance (long-term liability) upon receipt. Subsequently, the PPP loan forgiveness is not recognized until all of the loan forgiveness conditions are **substantially met or explicitly waived** by the lender.

Once the conditions are substantially met or explicitly waived, the PPP loan forgiveness income can be recognized with a corresponding offset to "Refundable Advance."

"GAIN CONTINGENCY" MODEL (FASB ASC 450-30):

Similar to the Debt model, the borrower recognizes the PPP loan as a Note Payable (long-term liability) upon receipt of the loan.

Subsequently, the PPP loan forgiveness is not recognized until all of the **contingencies** related to the PPP loan forgiveness are met (including the approval of the loan forgiveness by the lender), with a corresponding offset to "Note Payable."

If a borrower adopts the Government Grant or Contributions model, the PPP loan forgiveness income can be recognized when the borrower meets the "probability" threshold and "substantially met" criteria, respectively.

If the borrower adopts the Debt or Gain Contingency model, it is appropriate for the borrower to wait until at least the lender approves the loan forgiveness, either in part or wholly, to recognize the loan forgiveness income.

The PPP loan forgiveness income can be recognized in the Statement of Income either:

1. As "Other Income" (Gross Basis Presentation); or
2. As a reduction of the related expenses (Net Basis Presentation)

See below for an illustration of the journal entries.

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ON RECEIPT OF THE LOAN PROCEEDS:

Debit – Cash

Credit – Note Payable/Deferred Income Liability/Advance Payable (long-term)

Recognize Interest Expense:

Debit – Interest Expense

Credit – Interest Payable

Borrowers can recognize interest expense at an interest rate of one percent (1%), in accordance with the interest method. The borrower would not impute additional interest at a market rate because transactions where interest rates are prescribed by government agencies are excluded from the scope of the guidance on imputing interest.

WHEN EXPENSES ARE INCURRED OR PAID DURING THE 8-WEEK OR 24-WEEK "COVERED" PERIODS:

Debit – Related expense accounts

Credit – Cash

UPON MEETING THE "PROBABLE" THRESHOLD OR "SUBSTANTIALLY MET" CRITERIA, OR APPROVAL OF THE LOAN FORGIVENESS:

The borrower would reduce the Note Payable/Deferred Income/Refundable Advance by the amount forgiven and record a gain on extinguishment of the debt/Income.

As noted above, the journal entries can be recorded either on a gross or net basis presentation, as follows:

For **Gross** Presentation:

Debit – Note Payable/Deferred Income Liability/Advance Payable (long-term)

Credit – Other Income

(or)

For **Net** Presentation:

Debit – Note Payable/Deferred Income Liability/Advance Payable (long-term)

Credit – Payroll, Rent, Utilities, Mortgage Interest (as applicable)

DISCLOSURES

Disclosures in business entities' notes to financial statements are required regarding the nature, terms and conditions of the assistance (grants), amounts, a description of the accounting policy selected (i.e. gross or net presentation) and how the amount is reflected in the statement of income/statement of activities.

Our accounting experts are constantly monitoring changes in legislation to find solutions for your business. Please contact us for insight and assistance navigating this business climate.

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