DHG

VIEWS

Accounting for Paycheck Protection Program Loans Received Under the CARES Act

In the immediate aftermath of the economic shutdown, small businesses across America struggled to make ends meet and were most concerned about liquidity and the survival of their business. Now that the initial shock has passed and the economy is beginning the process of reopening, many are asking questions regarding how loans under the Paycheck Protection Program (PPP) should be accounted for.

ACCOUNTING MODELS

The AICPA, in consultation with the SEC and FASB, has issued guidance on accounting for PPP loans by adding *Question .18 to Technical Q&A Section 3200, Long-Term Debt* (TQA). There are four models that may be appropriate when accounting for PPP loans. These four models differ in their treatment of the proceeds when initially received as well as the timing of when the liability is derecognized, and income is recognized. Management will need to consider their eligibility for forgiveness, their ability to meet the forgiveness conditions, as well as whether they intend to seek forgiveness of PPP loans when determining which model is preferable.

A Background on the Paycheck Protection Program

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was enacted on March 27, 2020. The CARES Act includes a variety of relief provisions for businesses and individuals struggling with the ramifications of the pandemic, including the establishment of the Paycheck Protection Program (PPP). The PPP provided loans to certain eligible businesses in an effort to stabilize the economy during the pandemic. Under the program, businesses applied for loans and, if the funds are used for eligible expenditures and certain other requirements are met, businesses that received these loans may apply to have the loans fully or partially forgiven.

Figure 1: Accounting for PPP Loan Models

Debt (ASC 470)	Grant (IAS 20)	Conditional Grant (ASC 958-605)	Gain Contingency (ASC 450-30)
• Recognize funds received as debt. • Accrue interest at one percent rate. • De-recognized when either of the conditions in ASC 405-20-40-1 are met.	• Appropriate if business entity expects to meet eligibility requirements and expects to receive forgiveness. • Recognize funds received as a deferred income liability. • Recognize income once there is reasonable assurance conditions will be met. • Income is recognized on a systematic basis as the related expenses are incurred.	• Appropriate if business entity expects to meet eligibility requirements and expects to receive forgiveness. • Recognize funds received as a refundable advance. • Recognize income once the conditions are substantially met or have been waived.	• Recognize funds received as a liability. • Recognize income when the funds are realized or realizable.

Debt

The legal form of PPP loans is debt and it would be appropriate to account for them as such by recognizing a liability when the funds are received and accruing interest at the one percent interest rate in accordance with the interest method prescribed in ASC 835-30. While the one percent interest rate on these loans is below market, businesses do not need to impute interest at market rates because the interest rate was prescribed by a governmental agency (see ASC 835-30 for guidance on imputation of interest).

Under the debt model, the PPP loan liability may only be derecognized if either of the following conditions have been met as outlined in ASC 405-20-40-1:

a. The loan has been paid back and the debtor is relieved of their obligation for the liability

b. The loan is forgiven, and the debtor is legally released from being the primary obligor under the liability

Once forgiven, a gain on extinguishment would be recognized in the financial statements for the outstanding balance of the loan and accrued interest that was forgiven. The extinguishment gain should be identified as a separate item in the income statement and the amount forgiven should be reflected as a noncash financing activity in the statement of cash flows.

Business entities who received PPP loans and do not expect to meet the eligibility requirements to have received those funds or who do not expect to meet the conditions for forgiveness would account for the loan using the debt model.

Government Grant – Analogy to International Accounting Standards

U.S. GAAP provides for entities to analogize first to other sources of authoritative U.S. GAAP for similar transactions when guidance for a particular transaction or event is not specified in a source of authoritative U.S. GAAP, and then to consider other nonauthoritative guidance from other sources. Given there is no authoritative U.S. GAAP prescribing the accounting for government grants to business entities, the TQA notes that nongovernmental entities that are not non-profit entities may analogize to IAS 20, Accounting for Government Grants and Disclosure of Government Assistance if they expect to meet the eligibility requirements for PPP loan forgiveness and they conclude that the loan is in substance a government grant that will be forgiven.

Under IAS 20, a government grant is recognized when there is reasonable assurance that the entity will comply with any conditions attached to the grant and the grant will be received. Reasonable assurance is not defined but is to be interpreted similar to the probable threshold in U.S. GAAP (i.e. the event is likely to occur). Once these conditions have been met, the grant income will be recognized in the income statement on a systematic basis over the period in which the business entity incurs the expenses for which the grant is intended to compensate.

When analogizing to IAS 20, funds received from PPP loans would be recognized as a deferred income liability when received. Business entities would then derecognize the liability and recognize the grant in the income statement as the related expenses are incurred, so long as it is probable that the specific conditions prescribing forgiveness eligibility have been met. The grant may be recognized in the income statement as either a reduction of the expenses for which the grant is intended to compensate, a separate line item, or combined with other income.

This method would not be appropriate for a business entity that does not expect to meet the eligibility requirement for the loan or those who meet the loan eligibility requirements, but do not expect to meet the conditions to have the loan forgiven.

Government Grant – Analogy to Non-Profit Guidance

ASC 958-605 provides authoritative guidance for non-profit entities with respect to accounting for contributions received. However, business entities receiving transfers of assets from governmental units are specifically scoped out of this guidance. Nevertheless, business entities may analogize to this guidance and account for the PPP loans similar to a conditional contribution. Under ASC 958-605, cash received for conditional contributions is initially accounted for as a refundable advance in the balance sheet and is only recognized in income once the conditions have been substantially met or waived.

This method would not be appropriate for a business entity who does not expect to meet the eligibility requirement for the loan or those who meet the loan eligibility requirements, but do not expect to meet the conditions to have the loan forgiven.

Gain Contingency – By Analogy

ASC 450-30 provides guidance on accounting for gain contingencies. Under this model, a contingency that might result in a gain should not be recognized as a gain in the financial statements until all contingencies related to the receipt of the assistance have been met and the gain is realized or realizable. PPP funds received should be reflected as a liability and only reflected in the income statement once realized or realizable.

Accounting by Non-Profit Entities

While business entities have four available models when accounting for PPP loans, non-profit entities receiving PPP loans are limited to the debt model (ASC 470) and the conditional contribution model (ASC 958-605). If a non-profit entity received a PPP loan and does not expect to meet the conditions to have the loan forgiven, it should account for the loan using the debt model. If a non-profit entity chooses not to follow the debt model and expects to meet the conditions necessary to receive forgiveness and concludes that the PPP loan represents, in substance, a grant that is expected to be forgiven, it should account for the loan as a conditional contribution under ASC 958-605.

Additional information can be found at dhg.com/emergingstrong.com. For questions, contact your DHG advisor or assurance@dhg.com.

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