

Technical Line

How to account for proceeds from Paycheck Protection Program loans

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What you need to know

- ▶ The CARES Act created the Paycheck Protection Program (PPP) to provide certain small businesses with liquidity to support their operations during the COVID-19 pandemic.
- ▶ Entities have to meet certain eligibility requirements to receive PPP loans, and they must maintain specified levels of payroll and employment to have the loans forgiven. The conditions are subject to audit by the US government, but entities that borrow less than \$2 million will be deemed to have met the initial eligibility requirements.
- ▶ The accounting for PPP proceeds, as either debt or a government grant, may depend on whether an entity expects to meet the eligibility and loan forgiveness criteria.
- ▶ Entities that receive PPP loans should monitor developments because the US Small Business Administration (SBA) is expected to provide more guidance to address questions about the program.

Overview

The Coronavirus Aid, Relief, and Economic Security (CARES) Act provided an estimated \$2.2 trillion to fight the COVID-19 pandemic and stimulate the US economy, including \$349 billion that was earmarked for the PPP to be administered by the SBA. An additional \$310 billion was later authorized for the PPP.

Under the PPP, eligible small businesses can apply to an SBA-approved lender for a loan that doesn't require collateral or personal guarantees. The loans have a 1% fixed interest rate and are due in two years. However, they are eligible for forgiveness (in full or in part, including

any accrued interest) under certain conditions. For loans (or parts of loans) that are forgiven, the lender will collect the forgiven amount from the US government.

PPP loan requirements

To participate, entities need to certify that economic uncertainty related to the COVID-19 pandemic makes the loan necessary to support their current operations, and that they will use the funds to retain workers (e.g., by paying salaries, providing paid sick/medical leave and health insurance benefits) and pay certain debts and expenses. As noted in the [Frequently Asked Questions \(FAQs\)](#) issued by the SBA, in consultation with the Department of the Treasury, it is the responsibility of the borrower to certify that it is eligible to receive a PPP loan (i.e., no independent lender eligibility certification is required).

The FAQs further state that in addition to reviewing the applicable eligibility rules (e.g., certain employee headcount restrictions), all borrowers must assess their economic need for the loan and consider their ability to access other sources of liquidity sufficient to support their operations in a manner that is not significantly detrimental to the business. For example, the FAQs note that it is unlikely that a public entity with substantial market value and access to capital markets will be able to make the required certification in good faith, and that such a company should be prepared to demonstrate to the SBA, upon request, the basis for its certification. This also applies to private entities with other adequate sources of liquidity.

In an FAQ added this week, the SBA provided a safe harbor for any borrower (together with any affiliates) that receives a PPP loan of less than \$2 million. These borrowers will be deemed to have made the required certification concerning the necessity of the loan in good faith.

The loan forgiveness requirements include retaining employees and payroll levels at certain specified levels during a stated period. The amount of loan forgiveness can be up to the full amount of principal and any accrued interest, but it will be reduced in proportion to reductions in the number of employees and in payroll below specified levels. Borrowers will seek loan forgiveness by submitting requests to their lender that include documentation of employee headcounts and payment of eligible expenses. According to the FAQs, all loans that exceed \$2 million are subject to review by the SBA for compliance with program requirements, including eligibility. Further guidance on these audits is expected.

How we see it

Both public and private entities with alternate sources of funding should carefully evaluate whether they meet the eligibility requirements for PPP loans. In particular, entities should assess whether the current economic uncertainty makes the PPP loan necessary to support their operations. Entities that have received PPP loans but have determined they do not meet the eligibility requirements have until 18 May 2020 to return the funds.

Accounting for PPP proceeds

Because the legal form of a PPP loan is debt, it will always be appropriate for an entity that receives such a loan to account for it as debt under Accounting Standards Codification (ASC) 470, regardless of whether the entity expects the loan to be forgiven. However, an entity that expects to meet the PPP's eligibility and loan forgiveness criteria may elect to account for the proceeds as akin to a government grant. An entity that does not expect to meet the PPP eligibility and loan forgiveness criteria must account for the proceeds as debt. Both approaches are discussed below.

Regardless of the accounting model they follow, borrowers should include clear and robust disclosures of the PPP loan in their financial statements. In addition to disclosures specific to the accounting treatments discussed below, SEC registrants should consider including information about their participation in the PPP in their public filings. For example, in its 30 June Form 10-Q, a calendar year-end registrant is required to discuss any material changes in items that were included in management's discussion and analysis of its last Form 10-K. This would include material changes in the registrant's liquidity; capital resources; and any other information the registrant believes necessary for an understanding of its financial condition, changes in financial condition and results of operations in the current period. SEC registrants also are required to disclose any material changes in risk factors since those disclosed in their last Form 10-K.

Debt

Under ASC 470, an entity would recognize a liability for the full amount of PPP proceeds received and accrue interest over the term of the loan. The entity would not impute additional interest at a market rate because the guidance on imputing interest in ASC 835-30 excludes transactions where interest rates are prescribed by a government agency (e.g., government-guaranteed obligations).

If any amount is ultimately forgiven (i.e., the entity is legally released from being the loan's primary obligor in accordance with ASC 405-20), income from the extinguishment of the liability would be recognized in the income statement as a gain on loan extinguishment.

For cash flow statement purposes, the receipt of the PPP loan proceeds accounted for as debt would be presented as a cash inflow from financing activities. Any amounts repaid would be presented as cash outflows from financing activities, and any amounts forgiven should be disclosed as a noncash financing activity.

Entities that account for PPP loans as debt should consider the disclosure requirements in ASC 470-10-50. Public companies will also need to consider the disclosure requirements in Rule 5-02 of Regulation S-X.

Government grant

If an entity expects to comply with the PPP eligibility and loan forgiveness criteria, it may account for the forgivable PPP loan as, in substance, a government grant that is earned through the entity's compliance with the loan forgiveness criteria. If the entity does not expect to comply with the PPP eligibility and loan forgiveness criteria, the proceeds should be accounted for as debt, as discussed above.

There is no US GAAP guidance for for-profit business entities that receive government grants that are not in the form of a tax credit or revenue from a contract with a customer. As such, business entities will need to determine the appropriate accounting treatment by analogy to other guidance. However, an entity that accounts for PPP proceeds as a government grant will need to continually reassess its ability to meet the forgiveness conditions, and it may have to reverse income if it can no longer support a conclusion that it expects to meet the conditions. A not-for-profit entity that receives a government grant should apply ASC 958-605.

We expect many business entities that account for PPP loan proceeds as government grants to analogize to International Accounting Standards (IAS) 20, the IFRS accounting standard on accounting for government grants, because it includes an accounting framework for forgivable loans. However, we believe they could also analogize to ASC 958-605 for contributions received by not-for-profits or ASC 450-30 for gain contingencies.

An entity that expects to meet the PPP's eligibility and loan forgiveness criteria can account for a PPP loan as a government grant instead of debt.

Application of IAS 20

Under IAS 20, PPP proceeds received would be accounted for as an income grant. A deferred income liability would be recognized upon receipt of the forgivable loan, if it determined that there is "reasonable assurance"¹ that it will meet the conditions for forgiveness of the full loan amount. The deferred income liability would be recognized in income on a systematic and rational basis over the periods in which the entity recognizes as expenses the costs the grant is intended to defray.

How we see it

While the criteria for loan forgiveness appear to be objective, entities that receive PPP loans should closely monitor developments because the SBA has said it intends to issue more guidance to address questions from borrowers and lenders. For example, the SBA plans to update the FAQs regularly, and new FAQs may address eligible payroll costs or requirements to rehire furloughed employees.

IAS 20 provides that grants related to income can be presented as (1) a credit in the income statement, either separately or under a general heading, such as "other income," or (2) a reduction to the related expense.

We generally believe that, for cash flow statement reporting purposes, PPP proceeds accounted for based on an analogy to IAS 20 should be classified as cash flows from operating activities because the nature of the expenses for which the loan is to be used (e.g., payroll, rent) are operational in nature. However, we understand there is a diversity in practice under IAS 20, and classification of the proceeds as cash flows from financing activities may also be acceptable.

If the government grant received is material, an entity should disclose the method of accounting for the grant in its significant accounting policies. Disclosure may also include the (1) the amount received, (2) the amount included in income or deferred, (3) the basis for recognizing any deferred amounts, (4) the terms and conditions of receipt and (5) unfulfilled conditions and any contingent liability for repayment.

Endnote:

¹ While "reasonable assurance" is not defined in IAS 20, for a business entity that applies US GAAP, it has generally been applied using the same threshold as "probable," as defined in ASC 450-20 (i.e., likely to occur).