

Borrower's accounting for Paycheck Protection Program loans

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December 2021

Program overview

The Coronavirus Aid, Relief, and Economic Security (CARES) Act established the Paycheck Protection Program (PPP), which is administered by the U.S. Small Business Administration (SBA), to provide loans to qualifying entities. Under this program, a qualifying entity could apply to an SBA-approved lender for a federally guaranteed loan to help offset certain payroll and other operating costs (e.g., rent and utility costs). The loan and accrued interest, or a portion thereof, is eligible for forgiveness by the SBA if the qualifying entity meets certain conditions. The Consolidated Appropriations Act, 2021 (the 2021 CA Act), which was signed into law on December 27, 2020, provided additional funding to the program and changed certain of its provisions. A summary of these changes can be found in our publication, [A business guide to the December coronavirus relief package](#). Among the changes made were allowing a qualifying entity to apply for a second PPP loan, and prohibiting publicly traded companies from being able to obtain a PPP loan.

The SBA has issued an [Interim Final Rule](#) that provides information about the loan forgiveness requirements and review procedures applicable to PPP loans. Section V(1)(c) of the Interim Final Rule indicates that the SBA may audit any PPP loan at its discretion until the end of the required document retention period for the loan. For PPP loans of more than \$150,000, the required document retention period ends six years after the date the SBA forgave the PPP loan or the borrower repaid the PPP loan in full. For PPP loans of \$150,000 or less, the required document retention period for certain PPP loan requirements is three years, and for other requirements is four years, measured from the date the borrower submitted its loan forgiveness application. As explained in Section V(1)(b) of the Interim Final Rule, the SBA may review any or all of the following when auditing a PPP loan:

- Whether the borrower qualified for the PPP loan
- Whether the PPP loan amount was appropriately calculated and the proceeds used for allowable purposes
- Whether the loan forgiveness amount was appropriately determined

It is important to note that the SBA has the right to audit a PPP loan up to the end of the required document retention period for that loan even if it previously forgave the loan. In other words, the SBA's forgiveness of a PPP loan does not eliminate the possibility of it auditing the loan during the document retention period.

The SBA's [FAQ for PPP Borrowers and Lenders](#) provides guidance to address borrower and lender questions concerning the implementation of the PPP. This FAQ is updated on a periodic basis, including on July 29, 2021 to reflect the SBA's discontinuance of the use of the Loan Necessity Questionnaire for purposes of determining whether the borrower was eligible for a PPP loan (for additional information, see our article, [Withdrawal of SBA loan necessity questionnaire for PPP loans](#)). After the July 29, 2021 update, Question 39 in the [FAQ for PPP Borrowers and Lenders](#) indicates that a [First Draw PPP loan](#) of any size may be subject to audit to determine whether the borrower was eligible for the loan.¹ Prior to the July 29, 2021 update, Question 46 in the [FAQ for PPP Borrowers and Lenders](#) indicated that when evaluating loan eligibility, any entity that together with its affiliates received First Draw PPP loans of less than \$2 million would have been deemed to have made the required certification concerning the necessity of the loan request in good faith for purposes of being approved for the loan, except for self-employed individuals that report more than \$150,000 in gross income on Schedule C of their Form 1040 when that income was used to calculate the PPP loan amount. (This safe harbor for certain loans only applied to the certification concerning the necessity of the loan request in good faith for purposes of being approved for the loan and not to whether the necessary conditions for forgiveness of the loan have been met.) With the July 29, 2021 update to the [FAQ for PPP Borrowers and Lenders](#), Question 46 was removed. The scrutiny of an audit for First Draw PPP loans creates an incremental degree of uncertainty with respect to whether those loans will have to be repaid. In addition, the change in the 2021 CA Act that prohibits publicly traded companies from being able to obtain a First Draw PPP loan may be indicative of the heightened level of scrutiny publicly traded companies that already received a loan (from the original funding of the program) may experience if an audit is conducted to determine whether they truly qualified for the loan. Recipients of First Draw PPP loans must carefully consider all of the guidance published by the SBA in the context of their own facts and circumstances when assessing whether they qualified for the loan and whether they meet the necessary conditions for forgiveness of the loan by the SBA.

With respect to whether a borrower qualified for a [Second Draw PPP loan](#), prior to issuance of the July 29, 2021 update to the [FAQ for PPP Borrowers and Lenders](#), Question 46, as updated on March 3, 2021, indicated a borrower would have been deemed to have made the required certification concerning the necessity of the loan in good faith given that they must demonstrate that they have had a 25% reduction in gross revenues to obtain the loan. As explained earlier, Question 46 was removed from the [FAQ for PPP Borrowers and Lenders](#) with the July 29, 2021 update due to the discontinuance of the use of the Loan Necessity Questionnaire.

With respect to whether a borrower meets the conditions for loan forgiveness, the SBA provides guidance in its [FAQ About PPP Loan Forgiveness](#), including (but not limited to) guidance about completing the loan forgiveness application, determining whether payroll and nonpayroll costs are eligible for loan forgiveness and assessing how the forgiveness amount may be affected by workforce reductions.

Based on all of the information provided by the SBA about PPP loans, it is clear that whether an entity qualifies for a PPP loan, and whether it meets the necessary conditions for forgiveness, requires careful consideration of the PPP requirements and the individual entity's facts and circumstances.

Accounting models

There is currently no specific guidance in U.S. generally accepted accounting principles (GAAP) that addresses the accounting when a business entity obtains a loan that is forgivable by a government entity. Based on the discussion in the remainder of this section, we believe the following accounting models should be considered by business entities and not-for-profit entities (as appropriate):

¹ See Questions 31 and 37 of the SBA's [FAQ for PPP Borrowers and Lenders](#) for liquidity considerations related to whether an entity qualifies for the loan.

Fact pattern	Business entities	Not-for-profit entities
When the entity determines it did not qualify for the loan	Topic 470, "Debt," of the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC)	ASC 470
When the entity does not expect to meet the conditions for some or all of the forgiveness of the loan	ASC 470 for the portion of the loan for which the entity does not expect to meet the forgiveness conditions (see next row for the portion for which the entity expects to meet the forgiveness conditions)	ASC 470 for the portion of the loan for which the entity does not expect to meet the forgiveness conditions (see next row for the portion for which the entity expects to meet the forgiveness conditions)
When the entity determines that it does qualify for the loan and expects to meet the conditions for forgiveness of the loan	ASC 470 or one of the following by analogy ^{2,3} : <ul style="list-style-type: none"> • International Accounting Standards (IAS) 20, <i>Accounting for Government Grants and Disclosure of Government Assistance</i> • ASC 958-605, "Not-for-Profit Entities – Revenue" • ASC 450-30, "Contingencies – Gain Contingencies" 	ASC 470 or ASC 958-605

We believe that accounting for a PPP loan as debt is acceptable for both business and not-for-profit entities, and certainly warranted when they expect to repay the loan or do not expect the loan to be forgiven. In addition, when an entity is considering whether a model other than ASC 470 may be appropriate, it should carefully consider whether it qualifies for the loan and meets the necessary conditions for forgiveness of the loan by the SBA. This would include consideration of the possibility that PPP loans may be audited at the SBA's discretion to determine whether the borrower qualified for the loan or met the conditions for forgiveness of the loan. The subjective nature of the necessity determination may make it difficult for the borrower to determine if, upon audit, they will be required to repay the loan. In addition, the borrower needs to determine whether they met all eligibility requirements and the conditions for loan forgiveness even after the SBA has forgiven the loan given the period of time over which the SBA has the right to audit a PPP loan.

Because there is currently no specific guidance in U.S. GAAP that addresses the accounting when a business entity obtains a loan that is forgivable by a government entity, the SEC staff in the Office of the Chief Accountant were asked to specifically comment on whether they would accept a registrant's use of either of the following models to account for a PPP loan: (a) ASC 470 or (b) IAS 20 by analogy. Additional discussion of both of these approaches is provided later in this section. We understand that when considering these two models, the SEC staff made it clear that by providing their views, they were not commenting on whether a registrant is or is not eligible to receive a PPP loan. The SEC staff indicated

² In determining the appropriate guidance to apply, a business entity should consider its previous accounting policy for similar transactions (if any).

³ The Securities and Exchange Commission (SEC) staff's views are provided later in this section.

they would not object to a registrant accounting for the loan as debt under ASC 470, nor would they object to a registrant concluding that a PPP loan is akin to a government grant and accounting for it by analogy to IAS 20, provided the registrant qualifies for the loan, and there is *reasonable assurance* that it will meet the conditions necessary for forgiveness of the loan by the SBA. For this purpose, the concept of *reasonable assurance* equates to *probable* as used in ASC 450, "Contingencies." The SEC staff did not comment on other guidance that may or may not be appropriate for a registrant to apply when accounting for PPP loans.

The American Institute of Certified Public Accountants (AICPA) issued [Q&A Section 3200.18](#), *Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program*, to address accounting for PPP loans by borrowers that are nongovernmental entities. The guidance in the AICPA Q&A related to the accounting model(s) that should or may be applied in certain facts and circumstances is consistent with the discussion herein.

While there is no specific guidance in U.S. GAAP with respect to how business entities should account for forgivable loans, there is specific guidance for how not-for-profit entities should account for contributions (which include the forgiveness of liabilities) in ASC 958-605. Despite ASC 958-605 specifically excluding from its scope transfers of assets from government entities to business entities, at a meeting of the Private Company Council on [April 17, 2020](#), the FASB staff noted that business entities are not precluded from applying ASC 958-605 by analogy when appropriate. As such, this guidance could potentially be applied by a business entity by analogy if the entity believes the liability will be forgiven. If that is not the case, the entity would account for the loan as debt under ASC 470. Additional information about ASC 958-605 is provided later in this section.

In addition to accounting for a PPP loan in accordance with ASC 470 or by analogy to IAS 20 or ASC 958-605, we believe it may also be acceptable for business entities to account for the forgiveness of the loan in accordance with the guidance in ASC 450-30, for which additional information is provided next.

Following is additional information about each of the accounting models discussed herein (refer to the preceding table for a summary of our thoughts on which entities may apply each model and under which circumstances):

- **ASC 470.** The amounts received under the loan are recognized as debt. Interest expense should be accrued and recognized on the loan in accordance with ASC 835-30, "Interest – Imputation of Interest." However, an entity should not impute interest based on a higher market rate (as otherwise required), because an exception to doing so is provided in ASC 835-30-15-3(e) when the interest rate is prescribed by a government agency. For derecognition purposes, ASC 470-50-40-1 refers to ASC 405-20-40-1, which indicates that a financial liability is not derecognized until it is either paid off by the debtor or the debtor is legally released as the primary obligor. For this purpose, a financial liability includes debt and any accrued interest. We believe the borrower has been legally released as the primary obligor for all or a portion of the PPP loan when amounts are remitted to the lender by the SBA in forgiveness of the PPP loan. (The lender is responsible for notifying the borrower of any remittances.) Any gain that should be recognized upon being legally released (because the loan and any accrued interest is forgiven in whole or in part) is presented in the income statement as a gain on the extinguishment of debt. For purposes of the cash flow statement, when the loan proceeds are received, they should be classified as a financing cash inflow. In addition, any portion of the loan forgiven should be deducted from net income when arriving at cash flows from operating activities using the indirect method. If the PPP loan forgiveness is not included as a separate line item in the operating activities section of the cash flow statement because it is aggregated with other line items, separate disclosure of that noncash financing activity would be necessary. Any portion of the loan repaid should be classified as a financing cash outflow, and any interest paid should be classified as an operating cash outflow.

- *IAS 20*. The loan is accounted for as a government grant by analogy to IAS 20, provided the business entity qualifies for the loan and there is *reasonable assurance* that it will meet the conditions necessary for forgiveness of the loan by the SBA. Under IAS 20, the forgivable loan would be considered an income grant. As an income grant, the amounts received under the loan should be reflected as a deferred income liability on the balance sheet and derecognized into income as the entity is incurring and recognizing the qualifying payroll and other operating costs. The income statement effects of an income grant are presented as either a separate line item, within other income (or a similar general line item) or net within the related expense line item (e.g., payroll expense). For purposes of the cash flow statement, a business entity should classify the loan proceeds that are probable of forgiveness as either a financing or operating cash inflow, depending on its interpretation of the guidance in ASC 230, "Statement of Cash Flows."
- *ASC 958-605*. Proceeds from the PPP loan should be accounted for as a conditional contribution and recognized as a refundable advance until the conditions for forgiveness have been substantially met or explicitly waived. The derecognition of the liability is reflected as contribution revenue (or other income, if appropriate) for a not-for-profit entity. When analogizing to ASC 958-605, we believe the derecognition of the liability for a business entity should generally be reflected in other income.
- *ASC 450-30*. Proceeds from the PPP loan should be recognized as a liability. A contingent gain is usually not recognized until all uncertainty is removed.

Given the lack of guidance that is directly on point, as well as the subjectivity and complexities in determining if an entity is eligible for a loan and if the relevant criteria are met to release the liability into the income statement, we recommend an entity discuss the model selected and its application of that model with its advisers and auditors.

The accounting considerations related to a PPP loan do not end upon forgiveness of the loan by the SBA, because whether a borrower truly qualified for a PPP loan and met the conditions necessary for forgiveness of the loan could be audited by the SBA up to six years after it forgave the loan (depending on the amount of the loan and the requirements being audited). As such, even after a PPP loan has been forgiven by the SBA, consideration should be given to the loss contingencies guidance in ASC 450 (both from a disclosure and recognition perspective) during the period of time the PPP loan is still subject to audit by the SBA. From a recognition perspective, if it is probable at the balance-sheet date that the borrower will have to repay any amount previously forgiven by the SBA, and the amount of the repayment is reasonably estimable, the borrower should recognize a contingent liability and provide the necessary disclosures about that liability. If it is probable at the balance-sheet date that the borrower will have to repay a PPP loan amount previously forgiven or otherwise derecognized, but the amount of the repayment is not reasonably estimable, or if it is only reasonably possible at the balance-sheet date that the borrower will have to repay an amount previously forgiven by the SBA, the borrower should provide the necessary disclosures about that loss contingency. Unless the possibility of repayment after forgiveness of a PPP loan by the SBA is clearly remote, we strongly recommend a borrower consult with its advisers and auditors to discuss whether the recognition or disclosure of a loss contingency related to its forgiven PPP loan is necessary.

Deductibility of expenses paid with proceeds from PPP loans

The 2021 CA Act (in addition to providing various economic stimulus measures) grants companies a tax deduction for expenses paid with proceeds from forgiven PPP loans. Under previous law, the forgiveness feature of the PPP loans meant that any expenses funded through forgiven PPP loans were nondeductible for federal income tax purposes.

The effect of any change in tax law is required to be reflected in a corporation's tax provision in the period of enactment. As a result, for calendar year-end corporations, the tax law change from the 2021 CA Act (i.e., granting deductibility for the expenses) should have been reflected in the fourth quarter of 2020. Calendar-year corporations that had not recognized the debt forgiveness for financial reporting purposes

in 2020 could take the expense deduction in 2020 for expenses incurred in that year and have a permanent tax difference (related to debt forgiveness income on the PPP loan) in 2021 when the loan forgiveness income is recognized.

However, fiscal year-end corporations (for example, September 30, 2020 fiscal year ends) had a somewhat more complicated tax provision than calendar year-end corporations. The additional complexity resulted from the covered expenses being incurred in a different accounting period (i.e., fiscal year 2020) than the enactment of the tax law change (fiscal year 2021). Because of the direct link between the nondeductible expenses, prior to the 2021 CA Act change, and the nontaxable income from the debt forgiveness (i.e., the amount of nondeductible expenses was equal to the amount of the debt forgiveness), we believe that the resulting difference should have been accounted for as a deductible timing difference in situations where the expenses were incurred in periods prior to recognition of the debt forgiveness income. Therefore, fiscal year-end corporations with expenses funded by forgivable PPP loans that had not yet been forgiven had a deductible timing difference related to those expenses, which resulted in the recognition of a deferred tax asset.

Disclosures

Any entity that obtains a PPP loan should provide clear and complete disclosure about the loan, including its terms, how the entity determined it was qualified to receive the loan, how the entity determined it met the conditions for forgiveness of the loan, and how the entity is accounting for the loan and presenting it in its financial statements. In addition, in November 2021, the FASB issued Accounting Standards Update 2021-10, [Government Assistance \(Topic 832\): Disclosures by Business Entities about Government Assistance](#), which requires business entities to make certain annual disclosures about transactions with a government that are accounted for by applying a grant or contribution accounting model by analogy to other accounting guidance such as ASC 958-605 or IAS 20. The required disclosures include:


- The nature of the government assistance received
- The accounting policy applied to the government assistance
- The recognized amounts of government assistance and where those amounts are reflected in the balance sheet and income statement
- The significant terms and conditions of the government assistance, including any related commitments and contingencies

These disclosures are not required for in-scope entities until financial statements for annual periods beginning after December 15, 2021. However, early application is permitted.

SEC registrants should consider the effects of obtaining a PPP loan on other aspects of its filings with the SEC, including its risk factor and liquidity disclosures. For example, the SEC staff in the Office of the Chief Accountant indicated that if an SEC registrant would not have had the necessary cash flows to continue its operations without the PPP loan, it should disclose that fact. In addition, on June 23, 2020, the SEC staff in the Division of Corporation Finance issued Disclosure Guidance: Topic No. 9A, [Coronavirus \(COVID-19\) – Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources \(CF Disclosure Guidance Topic No. 9A\)](#), to provide the staff's current views regarding disclosures about operations, liquidity and capital resources that SEC registrants should consider with respect to the business and market disruptions related to COVID-19, including disclosure considerations related to governmental financial assistance in the form of loans.

Conclusion

Because the administration of the PPP by the SBA is fluid, and its terms potentially subject to change as a result of future legislation, entities should monitor developments by referring to the [Paycheck Protection Program](#) page of the SBA's website and the SBA's [FAQ for PPP Borrowers and Lenders](#) and [FAQ About PPP Loan Forgiveness](#).



For information about other financial reporting issues related to the coronavirus pandemic, refer to our white paper, [Coronavirus: Financial reporting considerations](#). For additional resources related to the coronavirus pandemic, visit our [Coronavirus Resource Center](#).

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