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Accounting and Reporting Considerations for Forgivable Loans Received by Business Entities Under the CARES Act's Paycheck Protection Program

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This publication was updated on May 15, 2020, to reflect additional guidance issued by the Small Business Administration and discussions with the SEC staff. Revisions have been marked with a ***boldface italic date*** in brackets.

Background

On March 27, 2020, the [Coronavirus Aid, Relief, and Economic Security Act](#) (the "CARES Act") was enacted. Sections 1102 and 1106 of the CARES Act amend Section 7(a) of the Small Business Act (SBA) to create a new program that provides for up to \$349 billion in funding to small businesses through federally guaranteed loans. On April 24, 2020, legislation was enacted to add \$310 billion to the program. One of the centerpieces of the CARES Act is the Paycheck Protection Program (PPP). Overseen by the U.S. Treasury Department, the PPP offers cash flow assistance to nonprofit and small business employers through guaranteed loans for expenses incurred between February 15, 2020, and June 30, 2020. Generally, the maximum loan amount per qualified borrower is the lesser of (1) 250 percent of average monthly payroll costs (e.g., salaries and wages up to \$100,000 and benefits) during the previous one-year

period plus the outstanding amount of any existing SBA loan made on or after January 31, 2020, that is being refinanced under the PPP¹ and (2) \$10 million. See Deloitte's [Heads Up](#), "Highlights of the CARES Act," for details regarding entities that may be eligible for the loans provided under the PPP.

To qualify for assistance, borrowers must fill out the [Paycheck Protection Program Borrower Application Form](#) and "certify in good faith," among other things, that all of the following apply:

- "The [borrower] was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors," as reported to the Internal Revenue Service.
- "Current economic uncertainty makes [the] loan request necessary to support the ongoing operations of the [borrower]."
- "The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments" (which are defined in the PPP rule).
- "During the period beginning on February 15, 2020 and ending on December 31, 2020, the [borrower] has not and will not receive another loan under the [PPP]."
- The "information provided in [the loan] application and the information provided in all supporting documents and forms is true and accurate in all material respects."

The U.S. Treasury Department has issued an [information sheet](#), which states that "[a]ll loan terms will be the same for everyone" (emphasis omitted). The significant terms of PPP loans (PPPLs) are as follows:²

- Fixed interest rate of 1 percent per annum.
- Maturity date of two years, with the ability to prepay earlier with no fees.
- First payment deferred for six months, with the potential ability to extend the deferment for six more months.
- Ability to have a substantial portion of the principal amount forgiven.
- Waiver of "credit elsewhere" requirement.³
- No collateral or personal guarantees required.
- No borrower fees charged to obtain such loans.

Under Section 1106 of the CARES Act, borrowers are eligible for forgiveness of principal and accrued interest on PPPLs to the extent that the proceeds are used to cover eligible payroll costs, mortgage interest costs, rent, and utility costs over the eight-week period after the loan is made (i.e., once the borrower receives the loan disbursement, which is made no later than ten calendar days after loan approval) as long as the borrower retains its employees and their compensation levels. However, no more than 25 percent of loan forgiveness may be attributable to nonpayroll costs. Further, the forgiven amount will be reduced proportionally by any reduction in employees or a wage reduction that exceeds 25 percent. However, to encourage entities to rehire employees who were already laid off because of COVID-19, the program does not penalize borrowers for any changes made between February 15, 2020, and April 26, 2020, provided that the number of employees and salary levels are restored by June 30, 2020.

¹ The CARES Act permits borrowers to refinance any existing SBA Economic Injury Disaster Loans made between January 31, 2020, and the date on which loans under the PPP are made available.

² The Small Business Administration has also issued an [interim final rule](#) and an [FAQ document](#) that provide more information on PPPLs.

³ The [requirement](#) that a borrower "[u]se alternative financial resources . . . before seeking financial assistance" is often referred to as the credit elsewhere requirement.

PPPLs will be made by existing lenders approved under the SBA's Section 7(a) loan program⁴ and other lenders as allowed under the CARES Act. The Small Business Administration provides a 100 percent guarantee on such loans, which is an increase to the existing guarantee percentages under current SBA loan programs.

Borrowers can request loan forgiveness by submitting a request to the lender. The request must include documents that verify the number of full-time-equivalent employees and the dollar amounts of payroll costs, as well as covered mortgage interest, rent, and utility payments for the eight-week period after the loan is made.

Lenders will confirm and verify the eligible loan amount by using the required documents submitted by the borrower, including any tax documents. While that information is sent to the Small Business Administration, a lender is not required to conduct any verification regarding loan forgiveness other than to perform a "good faith review, in a reasonable time, of the borrower's calculations and supporting documents."⁵ Further, the lender may rely on the borrower's representations, and it is the borrower's responsibility to submit the appropriate documentation and attest to the accuracy of the calculations provided. The lender will be held harmless if it relies on such documentation.

The lender must make a decision about the loan forgiveness within 60 days. If it determines that the borrower has complied with the conditions required for loan forgiveness ("loan forgiveness conditions") and confirms that the loan will be forgiven by the Small Business Administration, the lender will inform the borrower that the loan has been forgiven. Section 1106 of the CARES Act indicates that any lender or purchaser of PPPLs may report to the Small Business Administration an expected forgiveness amount, and the Small Business Administration will purchase the expected forgiveness amounts, plus any interest accrued to date, within 15 days after such requests are received.⁶



Connecting the Dots

Treasury Secretary Steven Mnuchin has made public statements indicating that entities receiving loans over \$2 million will be audited. He also warned entities that they could be subject to investigation and potential criminal liability.

The Small Business Administration published additional guidance on April 23, 2020, in its [Paycheck Protection Program Loans Frequently Asked Questions \(FAQs\)](#). The answer to Question 31 of the FAQ document states, in part:

Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.

Lenders may rely on a borrower's certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

⁴ As stated on the Small Business Administration's [Web site](#), its Section 7(a) loan program is its "primary program for providing financial assistance to small businesses. The terms and conditions, like the guaranty percentage and loan amount, may vary by the type of loan." The PPP is a new Section 7(a) loan option.

⁵ See the response to Question 1 of the PPPL [FAQ document](#).

⁶ A lender may request an advance purchase at the end of week seven of the covered period if it provides the appropriate documentation to support the claim that the expected forgiveness amount is reasonable.

On April 28, 2020, the Small Business Administration added Question 37 to the FAQ document. That question addresses “businesses owned by private companies with adequate sources of liquidity to support the business’s ongoing operations,” and the answer points readers back to Question 31 (discussed above) for determining whether such entities qualify for a PPPL.

On April 29, 2020, the Small Business Administration added Question 39 to the FAQ document. The answer states, in part:

To further ensure PPP loans are limited to eligible borrowers in need, the SBA has decided, in consultation with the Department of the Treasury, that it will review all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender’s submission of the borrower’s loan forgiveness application. Additional guidance implementing this procedure will be forthcoming.

On May 5, 2020, the Small Business Administration added Question 43 to the FAQ document. The answer states that the repayment date for the safe harbor described in the answer to Question 31 (i.e., repayment of the loan by May 7, 2020) has been extended to May 14, 2020. The Small Business Administration expects to provide additional guidance before that date on how it will review borrowers’ certifications (as described in the answer to Question 39). Further, on May 13, 2020, the Small Business Administration added Question 47, which extends the safe harbor repayment date again to May 18, 2020, “to give borrowers an opportunity to review and consider FAQ #46.” **[Paragraph amended May 15, 2020]**

On May 13, 2020, the Small Business Administration also added Question 46 to the FAQ document. The answer states, in part (footnotes omitted):

When submitting a PPP application, all borrowers must certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA, in consultation with the Department of the Treasury, has determined that the following safe harbor will apply to SBA’s review of PPP loans with respect to this issue: Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith. . . .

Importantly, borrowers with loans greater than \$2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance. SBA has previously stated that all PPP loans in excess of \$2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request. SBA’s determination concerning the certification regarding the necessity of the loan request will not affect SBA’s loan guarantee.

[Paragraph added May 15, 2020]

In light of this recent guidance, some entities that have received a PPPL may repay the loan in full. Accordingly, an entity should carefully evaluate its facts and circumstances (by “taking into account [its] current business activity and [its] ability to access other sources of liquidity sufficient to support [its] ongoing operations in a manner that is not significantly detrimental to the business,” particularly if it is “a public company with substantial market value and access to capital markets” or a “private [company] with adequate sources of liquidity”). **[Paragraph amended May 15, 2020]**

While there are a number of accounting and reporting considerations related to PPPLs for both borrowers and lenders (or investors), this *Heads Up* focuses on the accounting and reporting considerations that apply to borrowers of PPPLs that are business entities.

Borrower Accounting and Reporting Considerations

As discussed in Deloitte's *Heads Up*, "Highlights of the CARES Act," there is no guidance in U.S. GAAP that specifically addresses the accounting by a business entity that obtains a forgivable loan from a government entity. Notwithstanding the absence of specific guidance in U.S. GAAP, we believe that accounting for a PPPL as debt under ASC 470⁷ is acceptable (see Approach 1 below). However, an entity may conclude that it is qualified for the PPPL (taking into consideration the Small Business Administration's FAQ document) and that it is probable that the PPPL it received will be forgiven. In that circumstance, the entity may account for the PPPL it received as an in-substance government grant (see [Approach 2](#)). However, if the entity expects to repay the PPPL or does *not* conclude that (1) it is qualified for the PPPL and (2) it is probable that the entity will comply with the loan forgiveness conditions for all or a portion of the PPPL, it should account for that amount as debt.



Connecting the Dots

On the basis of discussions with the SEC staff, we understand that the staff would not object to an SEC registrant's accounting for the PPPL (1) as debt under ASC 470 or (2) as a government grant under IAS 20⁸ when there is reasonable assurance (i.e., it is probable under U.S. GAAP) that the registrant will meet the loan forgiveness conditions. The SEC staff's views apply solely to registrants that are eligible for the PPPL and that have concluded that the substance of the loan is akin to that of a government grant. Note that the SEC staff did not provide views on any particular registrant's eligibility to receive a loan under the PPP or whether a registrant has met the "probable" threshold for loan forgiveness. **[Paragraph added May 15, 2020]**

Given the Small Business Administration's guidance, we believe that there are significant uncertainties related to whether many entities that have received loans in excess of \$2 million, particularly public entities, are qualified for a PPPL and will meet the conditions for loan forgiveness. Therefore, entities that have received loans in excess of \$2 million should monitor any future developments in this area and consult with their advisers and auditors before applying Approach 2. **[Paragraph amended May 15, 2020]**

Approach 1 — Account for the PPPL as Debt

Under this approach, an entity treats the PPPL as a debt instrument under ASC 470 and applies the interest method in ASC 835-30, which should take into account the payment deferral allowed for the loan. The entity would not, however, impute additional interest on these loans by using a market rate even though the stated interest rate may be considered below market. This is because ASC 835-30-15-3(e)⁹ excludes such loans from the scope of ASC 835-30.

In determining the timing of the derecognition of the financial liability, the entity should follow the guidance on debt extinguishments in ASC 470-50-15-4, which states the following:

The general guidance for the extinguishment of liabilities is contained in Subtopic 405-20 and defines transactions that the debtor shall recognize as an extinguishment of a liability.

⁷ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

⁸ International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

⁹ ASC 835-30-15-3 states, in part, that "[w]ith the exception of guidance in paragraphs 835-30-45-1A through 45-3 addressing the presentation of discount and premium in the financial statements, which is applicable in all circumstances, and the guidance in paragraphs 835-30-55-2 through 55-3 regarding the application of the interest method, the guidance in this Subtopic does not apply to . . . (e) [t]ransactions where interest rates are affected by the tax attributes or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements)."

ASC 405-20-40-1 states the following (emphasis added):

A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
 1. Delivery of cash
 2. Delivery of other financial assets
 3. Delivery of goods or services
 4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.
- b. **The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.** For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

Because the entity would be obligated to repay the loan if the loan forgiveness conditions are not met, the entity would not be legally released from being the primary obligor under the loan until all the loan forgiveness conditions have been met and the entity receives confirmation from the lender or Small Business Administration that the loan is forgiven. Therefore, if an entity has concluded that the PPPL should be accounted for as debt under ASC 470, it should not recognize any income from the extinguishment of its debt until the entity has been legally released as the primary obligor under the loan.



Connecting the Dots

Given the complexity of the PPP as the terms and conditions continue to be clarified, an entity will need to apply judgment in determining when it is legally released from being the primary obligor under a PPPL. An entity may, therefore, consider consulting with its legal advisers in making this determination.

Income Statement and Balance Sheet Presentation

An entity should recognize the entire loan amount as a financial liability (if a classified balance sheet is presented, the liability will be classified as current or noncurrent under ASC 470-10-45), with interest accrued and expensed over the term of the loan. Any amount forgiven when the entity is legally released as the primary obligor under the loan will be recognized in the income statement as a gain from the extinguishment of the loan.

Cash Flow Statement Presentation

For cash flow statement purposes, an entity should present the receipt of the PPPL funds as a cash inflow from financing activities. Any interest paid will be presented as a cash outflow for operating activities, and any principal repaid will be presented as a cash outflow for financing activities. In addition, if any amount is forgiven, that amount would be disclosed as a noncash financing activity.

Approach 2 — Account for the PPPL as an In-Substance Government Grant

As discussed above, an entity that has received a loan in excess of \$2 million should monitor any future developments related to the PPP and consult with its advisers and auditors before accounting for the PPPL as a government grant. **[Paragraph amended May 15, 2020]**

To account for the forgivable loan as a government grant, an entity must conclude on the basis of its particular facts and circumstances that it qualifies for the PPPL and that it is reasonably assured that it will comply with the loan forgiveness conditions. We believe that

IAS 20 provides the most comprehensive accounting model for government grants, and it has been widely applied in practice to government grants received by business entities. IAS 20 addresses forgivable loans, and an entity may conclude that the application of IAS 20 to the PPPL would best reflect the substance of the forgivable loan.



Connecting the Dots

In the absence of explicit guidance in U.S. GAAP for business entities, ASC 105 provides a hierarchy for entities to use in determining the relevant accounting framework for the types of transactions that are not directly addressed in sources of authoritative U.S. GAAP. According to ASC 105-10-05-2, an entity should “first consider [U.S. GAAP] for similar transactions” before considering “nonauthoritative guidance from other sources,” such as IFRS® Standards. When selecting the appropriate accounting model to apply to a government grant, a business entity should consider the specific facts and circumstances of the grant. If the entity has a preexisting accounting policy for accounting for similar government grants, it should generally apply that policy. However, if the entity does not have a preexisting accounting policy or the grant is not similar to grants it has received in the past, it should carefully consider applying a model that would faithfully depict the nature and substance of the government grant. We believe that in many cases, an entity may not have a preexisting accounting policy or the PPPL may not be similar to grants it has previously received. Therefore, the entity may conclude that IAS 20 provides an appropriate model to apply to the PPPL that is expected to be forgiven. In addition, the SEC staff has indicated that it would not object to the application of IAS 20 to the PPPL if certain conditions are met. The SEC staff has not provided any views on whether the application of other U.S. GAAP would be appropriate. **[Paragraph amended May 15, 2020]**

While we believe that IAS 20 has been widely applied in practice by business entities in accounting for government grants, the application of ASC 450-30 may also be acceptable since we are aware that some business entities may have applied a gain contingency model by analogy for certain grants (e.g., the Electronic Healthcare Records program under the American Recovery and Reinvestment Act of 2009). Under this model, income from a conditional grant is viewed as akin to a gain contingency; therefore, recognition of the grant in the income statement is deferred until all uncertainties are resolved and the income is “realized” or “realizable.” That is, an entity must meet all the conditions required for receiving the grant before recognizing income. In applying ASC 450-30 for the PPPL, an entity must meet all of the loan forgiveness conditions before recognizing any income because it would not be appropriate under a gain contingency model for the entity to consider the probability of complying with the requirements of the government grant when considering when to recognize income from the grant. Therefore, in situations in which an entity at the time it receives the PPPL is reasonably assured that it will meet the loan forgiveness conditions, the entity would recognize income under ASC 450-30 later than it would under IAS 20.

In addition, it may be acceptable in practice for an entity to apply other U.S. GAAP for government grants. While government grants to business entities are explicitly excluded from the scope of ASC 958, the FASB staff has noted that such entities are not precluded from applying that guidance by analogy when appropriate. For example, a business entity may conclude that it is acceptable to analogize to that guidance if it receives a grant that is similar to one received by a nonprofit entity (e.g., certain subsidies provided to both nonprofit and for-profit health care providers).

However, as noted above, we believe that IAS 20 provides the most comprehensive accounting model for government grants, and it has been widely applied in practice to government grants received by business entities.

Application of IAS 20

Paragraph 10 of IAS 20 states the following:

A forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.^[10]

In accordance with IAS 20, PPPLs that are deemed to be government grants cannot be recognized until there is reasonable assurance that the entity will (1) comply with the conditions associated with the grant and (2) receive the grant. While “reasonable assurance” is not defined in IAS 20, for a business entity that is subject to U.S. GAAP, we believe that reasonable assurance is generally the same threshold as “probable” as defined in ASC 450-20 (i.e., “likely to occur”).

IAS 20 provides guidance on two broad classes of government grants: (1) grants related to long-lived assets (capital grants) and (2) grants related to income (income grants). Because a PPPL is not related to long-lived assets, the proceeds received from the PPPL are accounted for as an income grant. Therefore, a deferred income liability should be recognized upon receipt of the PPPL if at the time of receiving the loan the entity has determined that it is reasonably assured that it will meet the loan forgiveness conditions. As indicated in paragraph 12 of IAS 20 (ignoring interest cost), the entity would recognize income on a “systematic basis over the periods in which the entity [recognizes] as expenses the related costs for which the grants are intended to compensate.” That is, under this approach, income should be recognized in the income statement as qualified expenses are incurred (i.e., in the same period or periods in which the entity recognizes the corresponding costs in the income statement).

Income Statement and Balance Sheet Presentation

We believe that under IAS 20,¹¹ an entity may present PPPL income as either (1) other income (as part of operating or nonoperating income) or (2) a reduction of the related expenses that the PPPL is intended to defray. In our view, if an entity elects to present the PPPL as operating income, it is acceptable to present it in separate line items adjacent to the related expenses. If the PPPL income is material to the entity's financial statements, it is important for the entity to disclose the financial statement line items that are affected, as discussed in the [Disclosures](#) section.

The deferred income liability would be presented as a current liability if a classified balance sheet is presented.

Cash Flow Statement Presentation

For cash flow statement reporting purposes, any PPPL proceeds received that the entity expects to be forgiven would be classified as cash flows from operating activities or financing activities, depending on how the entity interprets ASC 230. An entity may conclude that the proceeds should be presented as a cash inflow from operating activities since such proceeds are related to the entity's future operating expenses (which will be presented as cash outflows for operating activities when paid). However, an entity may believe that since cash is received before the qualifying operating expenses are incurred, it would be appropriate to present the advance as a cash inflow from financing activities. In such a case, when the entity incurs the operating costs, it would disclose a noncash financing activity resulting from the fulfillment of the grant requirements (i.e., as the loan is “forgiven”). We believe that at the time a loan is legally forgiven (e.g., when the lender collects the amount of the loan from the Small Business Administration and notifies the borrower that the loan is forgiven), the entity may consider that amount to be constructively received, and it would be acceptable for the entity to present

¹⁰ Forgivable loans are defined in paragraph 3 of IAS 20 as “loans which the lender undertakes to waive repayment of under certain prescribed conditions.”

¹¹ See paragraphs 29 through 31 of IAS 20.

the deemed repayment of the loan as a financing cash outflow and a corresponding operating cash inflow for the grant received from the government.

Disclosures

Regardless of which approach is ultimately applied in the accounting for PPPLs (as described above), an entity must determine the appropriate disclosures for the loan, if material. If the PPPL is accounted for as a financial liability, the entity should consider the disclosure requirements in ASC 470-10-50. Although there currently is no authoritative guidance in U.S. GAAP on disclosure requirements for government grants (including forgivable loans from the government) received by business entities, the FASB initiated a project in 2015 to address disclosures that entities should provide for government assistance they receive. In 2015, the Board issued a [proposed ASU](#)¹² that described several disclosures that it considered relevant and useful to stakeholders. Such disclosures included a general description of the significant categories of government assistance and disclosures of (1) the form in which the assistance has been or will be received, (2) the financial statement line items that are affected (noting that such assistance may be presented as a separate line in the statement of operations), (3) significant terms and conditions of the government assistance, and (4) any government assistance received but not recognized directly in the financial statements. While the project continues to be listed on the FASB's active agenda, there is no scheduled date for further redeliberations. In the absence of authoritative guidance, we believe that it is critical for an entity to disclose its accounting policy for the PPPL and the financial line items that are affected if the amounts are material to its financial statements.



Connecting the Dots

On the basis of discussions with the SEC staff, we believe that if the PPPL is material, the staff would expect an SEC registrant to provide disclosures in the footnotes to its financial statements that discuss (1) how the PPPL is accounted for and (2) where the loan is presented in its financial statements. In addition, the SEC staff has indicated that additional disclosures might be warranted in a registrant's filing (e.g., MD&A), including discussions of any risk factors (e.g., risks related to an entity's eligibility for the PPPL and other uncertainties) and how the PPPL affects its liquidity (e.g., potential repayment of the loan or other concerns). Further, a registrant should consider disclosing how the PPPL affects its ability to operate and whether it is at risk for being unable to continue to operate without the PPPL. **[Paragraph added May 15, 2020]**

¹² FASB Proposed Accounting Standards Update, *Disclosures by Business Entities About Government Assistance*.

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