New Guidance for Banks – PPP Loans & Restructurings

On June 30, 2020, the American Institute of CPAs (AICPA) released a Technical Questions and Answers (TQA) covering financial institutions' accounting for the U.S. Small Business Administration's (SBA) Paycheck Protection Program (PPP) loans. The TQA also addresses interest income recognition on COVID-19-related loan restructurings that are not considered troubled debt restructurings (TDR) or new loans.

Classification of PPP Advances

The PPP advance should be treated as a loan and not a facilitation of a government grant.

SBA Guarantee

The AICPA has concluded that the SBA guarantee embedded in the PPP loan does not meet the definition of a freestanding contract and should be considered when estimating credit losses. Under the new CECL model, which is in effect for large public companies, enhancements that mitigate credit losses—other than freestanding contracts—must be considered in estimating credit losses. Entities that have not adopted Accounting Standards Update 2016-13 should follow guidance in Accounting Standards Codification (ASC) 450, *Contingencies*, or ASC 310, *Receivables*.

Loan Origination Fee & Clawback Provision

Upon funding of the loan, the fee should be accounted for as a nonrefundable loan origination fee under ASC 310-20, *Receivables—Nonrefundable Fees and Other Costs*. The fee should be offset against loan origination costs, deferred, and amortized over the life of the loan (or estimated life if certain prepayment conditions are met) as an adjustment to yield.

The origination fee may be subject to clawback (or if the SBA has not yet paid the fee, the fee may not be paid), after full disbursement of the PPP loan if:

- The PPP loan is canceled or voluntarily terminated and repaid after disbursement but before the borrower certification safe harbor date
- The PPP loan is canceled, terminated, or repaid after disbursement (and after the borrower certification safe harbor date) because the SBA conducted a loan review and determined the borrower was ineligible for a PPP loan
- The lender has not fulfilled its obligations under the PPP regulations

The AICPA believes these clawback provisions would not cause the fee to be considered refundable and, as a result, would be subject to FASB ASC 310-20.

> *Lenders should consider the guidance in FASB ASC 450,* Contingencies*, related to fees that may be subject to clawback or not received. A lender should establish a loss contingency when it is probable that events or conditions precedent to a loss have occurred, and the resulting amount of the loss is estimable.*

Effective Interest Rate (EIR)

Interest income on loans is recognized using the interest method described in ASC 310-20, which excludes revolving loans or those with no scheduled payment terms. The interest method arrives at periodic interest income at a constant EIR on the net investment in the receivable. The EIR is the rate that equates the amortized cost basis of the loan to the loan's future contractual payments.

When a loan is restructured by a creditor, and the restructured loan is neither a TDR nor required to be accounted for as a new loan, a creditor should determine a new EIR. This is subject to a cap—an entity may not recognize interest income that results in a creditor's net loan investment increasing above the amount at which the borrower could settle the obligation (including prepayment penalties if they are imposed throughout the loan term).

At an April 8, 2020, meeting, FASB staff discussed a fact pattern in which a loan was restructured in response to COVID-19, that restructuring was neither a TDR nor accounted for as a new loan, and the restructured terms included a period with reduced payments. FASB staff concluded creditors may elect to apply or not apply the guidance in ASC 310-20-35-18(a). Because this loan did not have any unamortized discounts or premiums, applying ASC 310 guidance would result in recognizing interest at the contractual rate in effect during the period of reduced payments, *e.g.*, the cap does not apply.

The AICPA TAQ addresses a restructured loan with an unamortized discount that could be subject to the cap.

- ASC 310-20-35-18(a) **not elected** – The EIR on the restructured loan would be the rate that equates the new contractual cash flows over the restructured contractual term with the amortized cost basis of the loan at the restructuring date.
- ASC 310-20-35-18(a) **elected** – The EIR on the restructured loan would be the rate that equates the new contractual cash flows over the restructured contractual term with the amortized cost basis of the loan at the restructuring date. The interest income recognized is limited to the amount that would not cause a creditor's net investment in the loan to exceed the amount for which the borrower could settle the obligation. At the end of the period of reduced payments, the creditor would determine a new EIR that equates the remaining contractual cash flows to the amortized cost basis of the loan.

Creditors that have elected to estimate prepayments should consider the effect of that guidance on their determination of the EIR.

Conclusion

BKD will continue to follow this developing situation. As with most topics related to COVID-19, changes are being made rapidly. Please note that this information is current as of the date of publication. Visit BKD's COVID-19 Resource Center to learn more. If you have questions about these changes, contact your **BKD Trusted Advisor™** today.

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