Q&A Section 2130

Loan Restructurings Resulting in Periods With Reduced Payments

Creditors may restructure loans in response to COVID-19 that result in restructurings that are not troubled debt restructurings and include periods of reduced payments, including payment deferrals, fee waivers, extension of repayment terms, or delays in payment. The following question and answer addresses the recognition of interest income on such loans following the restructuring, provided the restructuring is not accounted for as a new loan.

.41 Determination of the Effective Interest Rate

Inquiry—If a creditor restructures a loan due to COVID-19 to include a period of reduced payments, and the restructuring is neither a troubled debt restructuring (TDR), nor required to be accounted for as a new loan, how should a creditor recognize interest income on the restructured loan?[1]

Reply—FASB *Accounting Standards Codification* (ASC) 310-20, *Receivables—Nonrefundable Fees and Other Costs*, requires creditors to recognize interest income on loans[2] in accordance with the interest method. For loans other than those with no scheduled payment terms or revolving lines of credit, the objective of the interest method is to arrive at periodic interest income at a constant effective interest rate (EIR) on the net investment in the receivable. That is, for such loans the EIR is the rate that equates the amortized cost basis of the loan[3] 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 in accordance with the interest method, as described in FASB ASC 310-20.

[1] The guidance in this question and answer is not applicable to the accounting by borrowers and should not be applied by borrowers by analogy.

[2] For loans classified as held-for-sale, creditors should consider the guidance in FASB *Accounting Standards Codification* (ASC) 948-310-25-3.

[3] For entities that have adopted FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, for purchased financial assets with credit deterioration, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition.

For restructured loans that include a period with reduced payments (including temporary payment holidays), the application of the interest method may result in a creditor's net investment in a loan increasing above the amount at which the borrower could settle the obligation. For loans structured at origination with increasing interest rates, FASB ASC 310-20-35-18(a) prohibits the recognition of interest income that would result in a creditor's net investment in a loan increasing above the amount at which the borrower could settle the obligation. Prepayment penalties are considered in determining the amount at which the borrower could settle the obligation only to the extent that such penalties are imposed throughout the loan term.

At its [April 8, 2020 board 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 a reduced payments. FASB staff noted that, for such a restructuring, creditors may elect to apply or not apply the guidance in FASB ASC 310-20-35-18(a) to loans that have a period with reduced payments following a restructuring. In the fact pattern discussed by FASB staff, the loan did not have any unamortized discounts or premiums and, as a result, the application of the guidance in FASB ASC 310-20-35-18(a) would result in recognizing interest at the contractual rate in effect during the period of reduced payments. However, for loans with unamortized discounts, interest income would be recognized at the EIR determined upon restructuring, subject to the cap in FASB ASC 310-20-35-18(a). AICPA staff believes that the election regarding whether to apply or not apply FASB ASC 310-20-35-18(a) to restructured loans with periods of reduced payments is an entity-wide accounting policy election.

If a creditor elects to not apply the guidance in FASB ASC 310-20-35-18(a) to its restructured loans, 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.

If a creditor elects to apply the guidance in FASB ASC 310-20-35-18(a) to its restructured loans, 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. However, the amount recognized in interest income 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. The limitation on interest income described in FASB ASC 310-20-35-18(a) is illustrated in Example 6 in paragraphs 35–37 of FASB ASC 310-20-55. 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.

While not specifically addressed by this question and answer (Q&A), whichever policy a creditor elects, creditors that have elected to estimate prepayments in accordance with paragraphs 26–32 of FASB ASC 310-20-35 should consider the impact of that guidance on their determination of the EIR.

Additionally, while also not specifically addressed by this Q&A, whichever policy a creditor elects, creditors should apply appropriate accounting policies regarding the recognition of interest income to restructured loans in the scope of this Q&A when concerns about the realization of loan principal or interest on a restructured loan exist.

Q&A Section 2130

Paycheck Protection Program (PPP)

The CARES Act, as amended, established the Paycheck Protection Program (PPP). The PPP involves a loan designed to provide a direct incentive for small businesses to keep their workers on the payroll. The following questions and answers address certain accounting matters for that program for lenders. Please refer to the SBA website for detailed information regarding the PPP.

.42 Classification of Advances Under the Paycheck Protection Program

Inquiry—Should the lending institution account for an advance under this program as a loan or as a facilitation of a government grant?

Reply—The instrument is legally a loan with a stated principal, interest, and maturity date. The institution is expected to collect amounts due from either the borrower or the Small Business Administration (SBA) as guarantor. The institution should account for this instrument as a loan.

.43 Consideration of the SBA Guarantee Under the Paycheck Protection Program

Inquiry—Is the guarantee from the SBA considered "embedded" as opposed to a "freestanding contract" and, thus, can it be considered in estimating credit losses on the loan?

Reply—The SBA guarantee exists at the inception of the loan and throughout its life and was not entered into separately and apart from the loan. If the loan is transferred, the guarantee transfers with it. The arrangement does not contemplate the loan existing without the guarantee unless it is ultimately determined the lender violated an obligation under the agreement. The guarantee was not entered into in conjunction with some other transaction and is not legally detachable. As a result, for institutions that have adopted FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, the guarantee would not meet the definition of a *freestanding contract* as defined by FASB *Accounting Standards Codification* (ASC) 326-20-20.

FASB ASC 326-20-30-12 requires credit enhancements that mitigate credit losses (other than those that are considered freestanding contracts) to be considered in estimating credit losses. The guarantee is considered "embedded" and would, therefore, be considered when estimating credit losses on the loan.

For institutions that have not yet adopted ASU No. 2016-13, SBA guarantees would similarly be considered embedded guarantees (contracts that are not freestanding financial instruments) in determining the allowance for credit losses under FASB ASC 450, *Contingencies*, or FASB ASC 310, *Receivables*.

.44 Accounting for the Loan Origination Fee Received From the SBA

Inquiry— What is the accounting for the fee received or receivable from the SBA for originating the loan and the potential clawback of the fee?

Reply—Upon funding of the loan, the fee should be accounted for as a nonrefundable loan origination fee under FASB ASC 310-20, *Receivables—Nonrefundable Fees and Other Costs*. As a result, it should be offset against loan origination costs and deferred in accordance with FASB ASC 310-20-25-2 and amortized over the life of the loan (or estimated life if prepayments are probable and the timing and amount of prepayments can be reasonably estimated and the entity qualifies and elects to apply the guidance in paragraphs 26–32 of FASB ASC 310-20-35) as an adjustment to yield in accordance with FASB ASC 310-20-35-2.

As noted in question .43, the loan guarantee is embedded in the loan and is part of the same "unit of account." As a single unit of account, the arrangement involves multiple counterparties, which are (1) the lending institution, (2) the borrower, and (3) the SBA as guarantor, which through that role could be looked to for payment if the borrower either (*a*) provides the institution/SBA with documentation it has met the conditions to have the loan forgiven or (*b*) defaults on its obligation. The loan origination fee is paid to the institution by one of the counterparties, the SBA. In effect, the SBA is paying a loan origination fee that would have ordinarily been paid by the borrower. In certain program documents, the fee may be referred to as a *processing fee*, but the labelling of the fee is not determinative.

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

AICPA staff believes that these clawback provisions are distinguished from refund provisions because they are designed to operate similar to cancellation or penalty provisions in the event it is ultimately determined that one of the counterparties to the arrangement violated a representation, warranty, or in the case of the lender, an obligation under the agreement. This would include repayments that occur before the borrower certification safe harbor date as that provision was designed to allow borrowers to repay their loans to avoid the potential of being deemed ineligible. As a result, AICPA staff believes that these clawback provisions would not cause the fee to be considered refundable and, as a result, would be subject to FASB ASC 310-20.

AICPA staff also believes that 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.

Q&A Section 2130

Paycheck Protection Program (PPP)

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.45 Accounting for Loan Repayment or Forgiveness by the SBA

Background

To receive loan forgiveness under the Paycheck Protection Program (PPP), a borrower must complete a loan forgiveness application and submit the required documentation to its lender. The lender must then issue a decision to the SBA on the loan forgiveness application not later than 60 days after receipt of a complete loan forgiveness application from the borrower. If the lender determines that the borrower is entitled to forgiveness of some or all of the borrowed funds, the lender must request payment from the SBA at the time the lender issues its decision to the SBA. The SBA will, subject to any SBA review of the loan or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision to the SBA. Upon receipt of the SBA payment, the lender will notify the borrower that the loan (or a portion of the loan) has been forgiven.

If the SBA determines in the course of its review that the borrower was ineligible for the PPP loan, the loan will not be eligible for forgiveness, and immediate payment will be required.

If a borrower does not submit a loan forgiveness application in accordance with the requirements of the PPP after a period of time following the end of the loan forgiveness covered period for all or a portion of the loan, the borrower must begin paying principal and interest after that period through the maturity of the loan for the amount of the loan that was not forgiven.

Inquiry — How should a lender account for the portion of the loan that is eligible for forgiveness during the settlement process, including the time period subsequent to the lender's determination that the borrower is eligible for forgiveness and through the receipt of payment from the SBA?

Reply — The loan should continue to be accounted for as an interest-bearing loan (including amortization of loan origination fees — see section 2130.44) through receipt of payment from the borrower or the SBA. Payments received from the borrower or the SBA prior to maturity of the loan (other than required payments of principal and interest) are considered prepayments of the loan.

The SBA is considered one of the counterparties to the loan agreement that will repay the principal and accrued interest on the loan if the borrower provides the institution and SBA with documentation that it has met the conditions to have the loan forgiven. As a result, AICPA staff believe that payments received from the SBA should be treated similar to payments received from the borrower. When payment is received from the borrower or the SBA (either in full or in part) prior to the loan's maturity, amounts received should be accounted for as a prepayment, and unamortized loan origination fees should be accounted for in accordance with FASB ASC 310-20, *Receivables—Nonrefundable Fees and Other Costs*.

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