

COVID-19 Accounting Tutorials



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PAYCHECK PROTECTION PROGRAM REVENUE RECOGNITION

BACKGROUND

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provided budgetary relief to businesses and higher education institutions through numerous provisions, including the [Paycheck Protection Program](#) (PPP), administered by the Small Business Administration (SBA).

Not-for-profit (NFP) higher education institutions and auxiliary NFP entities are eligible for PPP loans if they have less than 500 employees (excluding Federal Work Study student employees and including other employees who happen to be students). Under the original program, at least 75% of the funds were to be used for up to eight weeks on employee compensation (payroll and benefits), and 25% could be used on rent, utilities and eligible mortgage interest.

On June 5 the PPP Flexibility Act was signed into law. The Flexibility Act amends the original PPP by changing the percentages between payroll and non-payroll costs from the original 75% - 25% split to a 60% - 40% split, extends the funds use period from eight weeks to 24 weeks, and allows employers to defer social security tax payments during the extended compliance period. Whether an employer follows the original or revised Flexibility Act terms, the amount eligible for forgiveness decreases if the percentage used / spent on payroll decreases. **There can be full or partial forgiveness based on payroll spending percentages.**

Borrowers and lenders may rely on the laws, rules, and guidance available at the time of the relevant application (Question 17, [SBA and Treasury Q&A](#)). Colleges and universities that received PPP loans have the option to continue under the original eight-week covered period with original payroll and other expense spending requirements or take advantage of the revised forgiveness criteria under the Flexibility Act.

A previous tutorial on this topic (May 1, 2020) dealt with a PPP loan at the balance sheet date for which compliance requirements were still in progress.

ISSUE: WHEN CAN NFPs RECOGNIZE REVENUE?

This tutorial clarifies that for NFP institutions, PPP loans can be viewed as a conditional contribution under Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2018-08 – permitting revenue to be recognized as the barriers to entitlement are satisfied (limited discretion spending).

ACCOUNTING FOR PPP LOANS

The intention of the PPP loan program is to provide support to businesses and qualifying NFP entities. Compensation retention formulas allow at least partial revenue recognition up to full revenue recognition depending upon the level of employer compliance with percentage splits between payroll and non-payroll spending requirements.

The lack of credit verification and collateral requirements, below market interest rates, payment deferral period, and allowable revenue recognition combined with intent to recognize grant revenue means that NFPs can consider PPP loans to be non-exchange grants *and* use conditional contribution guidance in FASB ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, (codified under Topic 958 in the FASB Accounting Standards Codification (ASC)). [This interpretation has been](#)

[reinforced by the AICPA.](#)

Sequence of Events

Following PPP loan application submission and notification, the institution:

1. Receives loan proceeds from the lender
2. Incurs allowable expenses over the eight week (or alternate coverage period) following receipt of funds
3. Substantiates allowable expenses using payroll and accounts payable systems, employer tax filings, and related supporting paperwork where appropriate
4. Following program completion, submits documentation of expenses to the lender to request loan relief
5. If all or a portion of the loan is not forgiven, the institution begins repayment six months after receiving the loan.

Conditional Contribution Requirements

Conditional contributions have both:

1. A right of return of the assets transferred or a right of release of a promise to transfer assets
2. At least one barrier that must be overcome before the recipient is entitled to the assets

Right of Return

The right of return in the PPP program is that there will be a loan obligation, rather than grant income, if the reporting entity does not fulfill the compliance requirements. A loan obligation requires repayment and as such would be a return of funds.

Barriers to Entitlement

FASB ASU 2018-08 provides several types of barriers:

- Measurable performance related barriers, such as producing a measurable quantity of something or achieving a specified level of service
- A recipient's limited discretion to conduct an activity, such as incurring qualifying allowable expenses or adhering to a specific protocol.
- Stipulations related to the purpose of an agreement that are more than mere administrative or trivial tasks.

With PPP loans, the barrier to entitlement is limited discretion on spending (second bullet above). The NFP must spend funds on compensation (to maintain employee headcount) and other qualifying expenses (mortgage interest, rent and utilities).

Revenue recognition and timing

Since eligible colleges and universities received PPP loans between mid-April and June 30, 2020, questions have arisen concerning the timing of revenue recognition. Most institutions with PPP loans received before the June 5 Flexibility Act have proceeded under the assumption of an eight-week coverage period and spending at least 75 percent on payroll to retain employees.

Analysis of IPEDS data indicates that close to 94 percent of NFP colleges and universities have May 31 and June 30 fiscal year-ends, consequently institutions will have completed or be close to fulfilling program requirements by their reporting year-end.

1. Can institutions recognize revenue – either partial or total depending on the fiscal year-end date and the coverage period – in their FY20 audited financial statements?
2. Is granting of loan forgiveness by the SBA a barrier to entitlement or an administrative function?

These questions are answered on the next page citing Department of Education and FASB guidance and recapped in a *Summary and Conclusions* paragraph.

Department of Education (ED)

[A May 15 Announcement](#) indicated that institutions receiving PPP loans under Section 1102 of the CARES Act can recognize revenue in the year the loan was received, based on an estimate of the amount of loan forgiveness as long as the amount is identified on the audited financial statements and attested to by the auditor. Further, **ED will exclude that portion of the PPP loan from total liabilities and increase the institution's net assets by that amount in calculating the institution's composite score** (emphasis added). Accordingly, there will be no reconciling differences between ED's required supplemental schedule and the audited financial statements.

FASB

FASB ASC 958-10-65-2 indicates that (1) a transfer of assets that is a conditional contribution shall be accounted for as **a refundable advance until the conditions have been substantially met** or explicitly waived by the donor and (2) certain *promises* are conditioned on incurring certain qualifying expenses (or costs) and **a portion of those contributions should be recognized as revenue as qualifying expenses occur** (emphasis added).

Whether donors or grantors promise funds or provide grant funds in advance, ASC Topic 958 indicates that revenue can be recognized as barriers to entitlement are met. Colleges and universities have a long-standing practice of recognizing revenue on federal grants as limited discretion spending occurs. These institutions do not wait for final compliance notification or agency desk audits. For funds received in advance, explicit waiver by the donor / grantor does not stand in the way of revenue recognition if conditions (barriers to entitlement) have been met.

Partial Loan Forgiveness

The original PPP and now the Flexibility Act allow *partial* loan forgiveness depending on a threshold of payroll spending. Considering [FASB's Staff Q&A related to ASU 2018-08](#), guaranteed partial forgiveness means no revenue would be at risk if institutions with May 31 and June 30 fiscal year ends recognize an amount of revenue based on fulfillment of required program spending thresholds.

The above approach is consistent with the Department of Education allowing revenue recognition in the reporting year, based on an estimate of the amount of loan forgiveness, for the purpose of calculating financial responsibility ratios and the composite score. Additionally, an institution's program documentation would be subject to audit review.

SUMMARY AND CONCLUSION

Based on FASB's guidance (funds received are refundable advances until conditions have been substantially met), ED's guidance on revenue recognition for composite score calculation, allowable partial loan forgiveness in the statute, and higher education's prevailing practice of recognizing grant revenue as qualifying expenses are incurred, colleges and universities can recognize revenue as limited discretion spending occurs. Although it's a judgment call, it would be extremely unusual for NFPs to wait for final federal agency approval or donor / grantor waivers to recognize revenue for nonexchange grants. These considerations combined with ED's auditor attestation requirement (an opinion on the financial statements and related schedules, such as ED's required supplemental schedule for financial responsibility), support NACUBO's conclusion.

DEBITS AND CREDITS

When the cash is received from the lender, the institution records deferred revenue or a refundable advance. As the barriers to entitlement are met (eligible spending), the institution removes the liability and records grant/contribution revenue. The revenue is recorded in net assets without donor restrictions, there are no specific purpose or time restrictions after conditions are met.

Although it's highly unlikely that the loan will not be forgiven, in the event that all or a portion of the loan remains as an obligation that must be repaid, the liability should be classified as a note payable and an amortization schedule should be created. Installment payments are then recorded as a reduction of the note payable and interest expense, based on the amortization schedule.

During the period from the time the loan is received until it is forgiven or repayment begins (the deferral period), interest will accrue at a rate of 1 percent per annum or .08 percent per month. In the unlikely event that the loan is not forgiven, interest expense incurred during the deferral period for the portion of the loan that is not forgiven can be “caught up” and recorded when the amount to be repaid is known.

DOCUMENTATION

Institutions should have documentation that substantiates employee compensation expenses and covered mortgage, lease and utility obligations. At a minimum, the following is recommended:

- Documentation that substantiates the number of employees and rates of pay.
 - Payroll system reports indicating qualifying employees and compensation paid
 - Hourly inputs for nonexempt employees
- IRS payroll tax filings
- State income and payroll tax filings
- Unemployment insurance filings
- Accounts payable documentation verifying payments for mortgages, leases, or utilities.
 - Accounts payable system reports that tie to expenses claimed
 - Original invoices or contractual agreements that substantiate payments

FINANCIAL STATEMENT DISCLOSURES

For institutions that issue financial statements prior to satisfying all conditions and / or before receiving notice that the loan has been forgiven, an inclusion in the note on contingencies is appropriate, if material.

A suggested is provided here.

The [institution] received a Paycheck Protection Program (PPP) loan of \$XXX,XXX granted by the Small Business Administration under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). PPP loans are considered conditional contributions, with a right-of return in the form of an obligation to be repaid if a barrier to entitlement is not met. The barrier is that PPP loan funds must be used to maintain compensation costs and employee headcount, and other qualifying expenses (mortgage interest, rent and utilities) incurred following receipt of the funds. The institution recognized the amount received as grant revenue as qualified expenses occurred / barriers to entitlement were met. Application for forgiveness of the loan will be made / was made on [date], with inclusion of compliance substantiation and certification therein. However, at the time of issuance of the financial statements, notice of forgiveness had not been received from the lender. All documentation supporting program compliance has been made available for the financial statement audit. All indications are that the loan will be forgiven. However, if a portion of the loan must be repaid, the terms (1% per annum, repayable over a maximum of five years with a six-month deferral period) are such that the institution has sufficient liquidity to repay the unforgiven portion.

Related FARM Chapters

¶462 Contributions