CNM LLP
Technical Advisory Firm

Practice Tips: Accounting for Concessions Received During COVID-19

by

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Accounting for Concessions Received During COVID-19

Many vendors, landlords, lenders, and government agencies have been encouraged to grant customers, borrowers, and small businesses temporary financial relief to help them survive business closures or significantly reduced revenues as a result of mandates by several state governments to shelter-in-place and enforce social distancing.

While there has been accounting guidance issued to address how to record such financial relief by the grantors, there has not been as much accounting guidance offered to the recipients of such relief.

So, for businesses that have received temporary relief from contractual loan or lease payments or Paycheck Protection Program loans guaranteed by the Small Business Administration (SBA PPP loans), here are some accounting issues that you should be considering along with some tips on how to think about those issues.

Rent Concessions

Some businesses have successfully negotiated temporary relief from contractual lease payments due while their operations are closed due to government prohibitions on conducting nonessential business operations. Such relief could be in the form of deferral of the payments to a later date or an outright forgiveness of the payments due altogether. Questions have been raised regarding how to record such rent concessions granted by a lessor to a lessee.

Regardless of whether you have adopted the new lease accounting standard (ASC 842), the FASB staff issued FAQs in April to address the accounting for rent concessions received by lessees in an operating lease. Under that guidance, the FASB staff indicated that a lessee could elect to account for rent concessions in one of two ways:

1. As a concession that is considered to be granted under the original terms of the lease, or
2. As a lease modification.

For rent payment deferrals (forbearance), you can elect to account for the rent concession as a variable rent adjustment granted under the original terms of the lease. In that case, you would record the related rent expense in the period it is incurred but would not reduce the lease liability (or accrued rent payable) until the payment was made later (after the forbearance period). You would continue to increase the lease liability for imputed interest cost and amortize the right-of-use asset during the concession period.

If the lease payment is waived (forgiven), then no rent expense would be recorded during the concession period. If ASC 842 has been adopted, both the lease liability and right-of-use asset would be reduced by the amount of the forgiven rent payments.

If you elect to account for the forbearance or waiver of rent payments as a lease modification of the original lease terms, you would remeasure the lease liability based on the modified terms and adjust the carrying amount of the right-of-use asset accordingly.

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SBA Paycheck Protection Programs (PPP) Loans

Currently, for recipients of SBA PPP loans, there is no clear guidance on how a borrower should account for these loans. Until such guidance is forthcoming (e.g., from the FASB or the SEC staff), the accounting for such loans will need to be based on interpretation of existing accounting guidance and likely will result in some diversity in practice.

While the FASB staff is considering the accounting for such loans from the lender side, it is not clear whether they also will provide guidance to the borrowers. Although no official conclusions have been reached, there are indications that lenders likely will record the SBA PPP loans as receivables in accordance with ASC 310-10.

For borrowers, there currently seems to be two possible accounting alternatives:

1. Account for the PPP loans as debt, or
2. As a grant from the government if the loan balance is expected to be forgiven.

As the legal form of the transaction is a loan to the borrower and the ultimate settlement of the loan is uncertain, the borrower probably should record and account for the loan obligation initially as debt. There are certain requirements that must be met in order for a PPP loan to be forgiven by the SBA, and those requirements are still being determined. So, forgiveness of the loan by the SBA is not guaranteed. Also, some borrowers may choose to repay all or a portion of the loan.

Unless and until it is certain that all or a portion of the PPP loan will be forgiven by the SBA, it will be difficult to support recording the loan as a government grant (e.g., as income over the term of the loan). In that case, the prudent course of action would be to record the PPP loan as debt and then wait to see how the PPP loan will be settled and whether any new accounting guidance on the matter is issued by that time.

If all or a portion of the PPP loan is forgiven by the SBA, a gain would be recognized either as an extinguishment of debt or income from a government grant.

Forbearance Received on Non-SBA PPP Loans

Companies that have been adversely impacted by COVID-19 may negotiate with lenders for temporary payment relief related to outstanding loans or other debt. For example, banks have been encouraged by regulators and Congress to grant temporary relief from loan payments to borrowers who were current prior to the coronavirus breakout.

When a lender grants temporary payment relief to a borrower, how should the borrower account for such forbearance?

Currently, the primary accounting alternatives to consider are to record the relief as a:

1. Debt modification
2. Troubled debt restructuring
3. Temporary forbearance

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Debt Modification

Under existing GAAP, a change to the original terms of a debt represents a modification. The accounting for a debt modification is addressed in ASC 470-50. If the modified terms are substantially different from the remaining original terms at the time of the change, the transaction is recorded as an extinguishment of the original debt and the issuance of a new debt in its place. If not, then the debt is recorded under the modified terms as if they were part of the original debt.

Generally, a debt modification is considered to be substantially different if the present value of the cash flows under the terms of the modified debt is at least 10 percent different from the present value of the remaining cash flows under the terms of the original debt.

Troubled Debt Restructuring

A troubled debt restructuring (TDR) occurs when a lender grants a concession to a borrower experiencing financial difficulties that it would not otherwise consider.

In a troubled debt restructuring related solely to a modification of the terms of the debt, the carrying value of the debt is not adjusted unless the total future cash payments specified by the new terms, including both interest and principal, are lower than the carrying value. In that case, the carrying value of the debt is reduced to equal the total future cash payments, and a gain is recognized. The effective interest rate must be recalculated to recognize interest expense going forward based on the difference, if any, between the carrying amount of the debt and total future cash payments specified by the new terms. A troubled debt restructuring must be disclosed in the financial statements.

A lender is deemed to have granted a concession if the borrower's effective interest rate based on the new terms is lower than the original debt immediately before the restructuring.

The CARES Act and the banking regulators have issued guidance to insured depository institutions to encourage granting temporary relief by not requiring temporary forbearance granted to current borrowers related to COVID-19 to be recorded or reported as TDRs. While that guidance is not directed towards the related borrowers, it may be possible to apply that guidance by analogy. In addition, temporary payment deferrals or waivers for a short period (e.g., three months), may not result in a significant decrease in the effective interest rate on the debt.

Temporary Forbearance

On the lender side, the FASB staff has issued guidance on how to account for temporary forbearance granted to borrowers in good standing. For interest payments that are just deferred until later and are expected to be collected eventually, the accounting would not change for the lender. The uncollected amount due either would be added to the principal balance if it will accrue interest until paid or would be recorded as an interest receivable until collected if the deferred payment is noninterest bearing.

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If the interest payments are waived and forgiven entirely, the lender can choose from two alternatives:

1. Record no interest income during the forbearance period, or
2. Recalculate the effective yield based on the cash flows expected to be collected and recognize interest income based on the revised (lower) yield.

Although that guidance is addressed to lenders, it may be possible for borrowers to apply similar accounting for the forbearance by analogy.

In that case, if the interest payments are deferred but not forgiven, the borrower would record a liability for the interest payable. If the deferred payment is interest bearing, the liability should be added to the outstanding balance of the debt. If the deferred payment is noninterest bearing, it should be recorded as a separate accrued interest payable.

If the interest payments are waived or forgiven entirely, the borrower could account for the waived payments in one of two ways:

1. Record no interest expense during the forbearance period, or
2. Recalculate the effective yield based on the cash flows expected to be collected and recognize interest expense based on the revised (lower) effective interest rate.

Summary

As some of the accounting alternatives outlined above are subject to interpretation in the absence of specific authoritative accounting guidance or in light of guidance that has been issued for lenders, you should discuss any proposed accounting for debt concessions with your independent auditors.

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Our extensive knowledge of US GAAP, ICFR and SEC reporting skills has given us the ability to assist our clients with transactions that are not only multifaceted, but the capability to implement new or complex accounting standards. We have over 130 partners and employees in our Los Angeles, Orange County, San Diego, and New York City offices. Many of our clients are developed from direct referrals from the Big 4 accounting firms, speaking to the level of quality services we provide.

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