

Audit and Accounting Update for Financial Institutions Webinar Responses to Unanswered Questions November 12, 2020

During Wipfli's 2020 Audit and Accounting Update for Financial Institutions, we were unable to respond to all of the questions asked during the timeframe. Following are responses to those questions.

PPP loan accounting

Related questions:

- *How would you include the SBA guarantee in estimating credit losses?*
- *Would [our institution] remove the balance of the PPP loans that we think have 100% PPP guarantee?*

Answer: Similar to other government-guaranteed loans, it is appropriate to consider the SBA guarantee when estimating the allowance for loan losses by looking at the net unguaranteed portion of the loan to determine whether and how much of an allowance for loan losses should be recognized for these loans. If the loan is 100% guaranteed by the SBA, the institution may determine no reserve is necessary for that loan.

Related questions:

- *We've been leaving [a PPP loan that has been forgiven by the SBA] as a loan and waiving the interest until payment is received (one day). Does that seem appropriate?*
- *If you have a remaining balance [after a PPP loan is partially forgiven], does it still get reported as a loan (vs. an other receivable)?*

Answer: We believe institutions can recognize loan forgiveness when communication from the SBA provides details of the amount that will be received from the SBA. If the institution chooses to wait and recognize loan forgiveness when the SBA payment is received, we believe that would also be an appropriate accounting policy. If loan forgiveness is not recognized until the SBA payment is received, any interest related to the loan not included in the SBA payment should be reversed.

If a PPP loan is partially forgiven, any remaining balance would continue to be reported as a loan.

Question: *[Has there been] any discussion about [whether] EIDL, if received as well, will be forgiven and not netted against PPP which would remain as a loan?*

Answer: If a borrower received an Economic Injury Disaster Loan (EIDL) grant under Section 1110(e) of the CARES Act, the maximum amount of PPP loan forgiveness is reduced by the amount of the EIDL grant. We are not aware of any discussion by Congress about changing this rule.

Related Questions:

- *When a loan is forgiven, do we recognize deferred loan fees immediately or continue to amortize?*

- *Under the interest method of amortization of deferred PPP fees, wouldn't you recognize income to maintain a constant yield?*
- *Would the forgiveness be considered a paydown and a corresponding amount of the deferred fee be recognized?*

Answer: If a loan is fully paid off or forgiven, any remaining net deferred loan fees would be immediately recognized in earnings.

If a loan is partially paid down or forgiven, the institution should recalculate the effective yield used to amortize the related deferred loan fees using the updated cash flow information that includes the prepayment. Using the updated effective yield, the institution can then calculate a new unamortized deferred loan fee balance as if the new effective yield had been applied since loan origination. The difference between the existing unamortized deferred loan fees and the new unamortized amount should be recognized in earnings in the period the prepayment was recognized. This “true up” of the unamortized net deferred loan fee amount results in recognizing an amount of deferred loan fees in earnings similar to — but not exactly the same as — the proportionate amount of prepayment received.

If the institution estimates prepayments in the calculation of effective yield for a pool of PPP loans in accordance with ASC 310-20-35-26, the institution should evaluate whether differences arise between the prepayments anticipated and the actual prepayments received. If so, the institution should recalculate the effective yield to reflect actual payments to date and anticipated future payments and adjust the unamortized deferred loan fee balance as if the new effective yield had been applied since origination of the loans.

Loan modifications and restructurings

Related questions:

- *NCUA has the new [call report] section for COVID. Do you have information on what we should be reporting? For example, a member deferred a payment, but now they are current. Do you still include the loan in the NCUA COVID section?*
- *[Is it correct that] reporting for the call report for COVID loans is only for loans that still have a deferral through the call report date?*

Answer: The reporting institution should report the number and outstanding balance of eligible loan modifications under Section 4013 held as of the report date. This would include only loan modifications related to COVID-19 that are still deferred through the call report date. Therefore, in the situation identified, once a Section 4013 loan modification or deferral period has expired and the loan is back on its original terms, the loan would no longer be included as a Section 4013 loan modification for call report purposes.

Other

Question: *Please explain the difference between a nonpublic entity and a PBE that is not an SEC filer.*

Answer: A public business entity (PBE) is a business entity meeting any one of the criteria below.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or it does file or furnish financial statements (including voluntary filers) with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the "Act"), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

As you can see, criterion "a." is the only one related to an SEC filer. An institution that is not an SEC filer may still be considered a public business entity under US GAAP if it meets any of the criteria in "b." through "e." For help with determining whether your institution may be a public business entity, please contact your Wipfli relationship executive.

Question: *Please comment on the effect of PPP onboarding fees received on the taxable income of Subchapter S cash-basis taxpayer banks ... and the related regulatory capital hit if those banks are forced to exclude PPP onboarding fees from GAAP income and capital due to ASC310-20 deferral but must distribute to Subchapter S pass-through shareholders.*

Answer: For information about the impact of PPP loans on income taxes and tax strategies to consider, tune in to <https://www.wipfli.com/events/fi-tax-covid-tax-update-for-financial-institutions>.