GBQ

2020 Financial Reporting Updates for Restaurants

October 22, 2020

Presenters

Dustin Minton
Director,
Restaurant Services
(513) 744-5073
dminton@gbq.com

Jeff Harden
Director, Assurance &
Business Advisory Services
(614) 947-5299
jharden@gbq.com

Agenda Overview

- PPP Loan Accounting
- Asset impairments
- Exit or disposal activities
- Debt restructuring and covenants
- Going concern assessment and disclosure
- Lease concessions
- Gift card accounting

Recent News

- SBA began approving PPP forgiveness applications on October 2, 2020
- SBA released FAQ #52 on October 7th related to deferral period of loan payments
- SBA announces guidance for PPP borrowers and M&A transactions
- PPP Loans less than $50,000 can utilize simplified forgiveness application
- FASB issued a proposed ASU allowing private entity franchisors to use a practical expedient under ASC 606 and account for certain pre-opening services as a single performance obligation

Accounting for PPP Loans as Debt

- Day 1 - Recorded as debt on balance sheet
    - P&I payments are deferred until the earlier of:
        - Forgiveness has been determined by SBA
        - 10 months after the end of the covered period
    - Monthly interest should be accrued from day 1

- Capitalize and amortize related debt issuance costs
    - Accounting and legal fees
    - Documentation prep costs
    - External, incremental costs to advisors

Accounting for PPP Loans as Debt

- Qualified expenses accounting
  - Includes payroll costs, rent, utilities and mortgage debt interest
    - Related party rent caveat – limited to related debt interest
  - Recorded as expense (<u>NOT</u> a reduction of the loan)
  - Presentation and disclosure remains the same

- Forgiveness accounting
  - Apply for forgiveness with banker
  - Provide banker requested documentation
  - Extinguishment only after being legally released
    - Occurs once the SBA has approved forgiveness (bank has 60 days to submit decision and SBA thereafter has 90 days to approve forgiveness)
    - Removal from balance sheet
  - CARES Act considers it canceled indebtedness
  - “SBA audit” risk and exposure is accounted for separately from forgiveness (i.e. record reserve once probable and estimable under ASC 450, *Contingencies*)

Accounting for PPP Loans as Debt

Forgiveness accounting in practice

- Measured based on net carrying value related to forgiveness
  - Loan balance
  - Accrued interest (if eligible)
  - Deferred finance costs

- Journal entry to record forgiveness
  - Dr. PPP Loan
  - Dr. Accrued interest
    - Cr. Deferred finance costs
    - Cr. Gain on forgiveness

Accounting for PPP Loans as Debt

- Income statement presentation of forgiveness
    - Separate line item
    - Waiting on forthcoming guidance

- EIDL emergency grant
    - $10,000 reduces your forgiveness amount
    - Becomes part of the loan under PPP

Accounting for PPP Loans as Debt

Example of accounting for EIDL emergency grant when PPP loan received

- Assume the following:
  - $10,000 Emergency Grant received and recognized as income
  - $250,000 PPP loan received
  - PPP loan was used 60% for payroll and 40% for non payroll making it all eligible for forgiveness
- Upon requesting forgiveness from the bank:
  - $250,000 of supporting documentation provided and approved
  - $10,000 Emergency Grant is subtracted from forgiveness amount
  - Results in $240,000 loan forgiveness
  - Results in net PPP loan of $10,000 @ 1% with a X year term
- Journal entry to record forgiveness with Emergency Grant reduction:
  - Dr. PPP Loan $240,000
  - Cr. Gain on forgiveness $240,000
- P&L impact would still recognize $250,000 of “income”
- Net tax impact would be zero for EIDL grant (income offset by expenses)

Accounting for PPP Loans as a Gov't Grant

- Authoritative Guidance
  - ASC 105 – allows application of nonauthoritative guidance by analogy when guidance not specified
  - AICPA TQA 3200.18 – allows election to treat as a grant if it is probable that it will meet both:
    - Eligibility criteria for a PPP loan
    - Loan forgiveness criteria for all or substantially all of PPP loan
- Continual assessment of whether criteria is met
- How to account for it:
  - Day 1 – recorded as deferred income liability (not debt)
  - Ongoing – relieved on a systematic basis over covered period for which expenses were incurred for intended purpose
  - Income statement presentation options
    - Presented separately
    - Offset against related expense
  - If less than 100% forgiveness expected, treated as change in estimate

Big Picture: Debt vs. Grant

Which method should you choose?

Accounting Impact	Debt	Grant
Balance sheet presentation	Recorded as debt	Recorded as deferred income liability
P&L presentation of forgiveness	Gain on Cancellation of Debt	Option of separate line item or offset to related expense
Recognition of forgiveness timing	Extinguishment only after being legally released	Recognized as related expenses occur – no delay
Pros	-Simpler accounting -Less judgment -Most commonly used	Conceptual alignment of forgiveness and expenditures
Cons	-Leverage ratio impact -Forgiveness may occur next year -Tax provision impact	Comparability issues if netting with expenses

PPP Loan Accounting – Best Practices

- Know what your bank expects for documentation
  - Connect the dots
- Take the time to understand the safe harbors around FTEs and wage reduction penalties
- Use payroll records when possible to substantiate loan proceeds used
  - Makes the application process easier
  - Less documentation to pull together
- Leverage third party payroll PPP reports for FTE calculations
  - Owners may need to be manually pulled out
- Related party rents limited to the related mortgage interest
- Are you using the right application form?

PPP Loan Accounting – Future Reporting Implications

- Debt covenants – discuss with your bank expectations around EBITDA/similar calculations and whether forgiveness income should be included or excluded

- Income tax provision will be unusual YOY for C corps electing debt instrument accounting with forgiveness in subsequent year, for example:
    - 2020: expenditures under PPP loan proceeds are non-deductible (higher effective tax rate for financial reporting)
    - 2021: forgiveness income is excluded from taxable income (lower effective tax rate for financial reporting)
    - Above are considered permanent items (affect income tax expense) as opposed to temporary items (recorded through the balance sheet)

Asset Impairments

- Numerous "impairment" models under GAAP depending on the nature and type of account subject to assessment

- Most models incorporate a triggering event mechanism or otherwise require consideration of indicators of impairment arising during a period

- Hierarchy and sequence of impairment assessments is important
    1. Other accounts (A/R, inventory, investments, etc.)
    2. Indefinite lived intangible assets
    3. Long-lived assets held and used
    4. Goodwill

Long-Lived Assets, Goodwill and Intangible Assets

- Negative triggers (indicators of impairment) likely exist, even within models based on annual assessments
- Long-lived assets assessed for recoverability first prior to fair value measurement (undiscounted cash flows relative to carrying value)
- Goodwill and indefinite lived intangible assets have no recoverability step
- Unit of account (primary asset, reporting unit, etc.)
- Non-recurring fair value disclosures

Evaluation for Impairment

- When developing your projections, consider all of the following:
  - Historical P&L projections
  - Current year P&L pre and post-COVID
    - Identify non-recurring re-opening/PPE costs in a separate GL account to easily "add back"
    - 2020 trends – sales went down, then back up
    - How did sales recover throughout the pandemic?
  - Future P&L projections
    - Calculate multiple scenarios – worst case, best case, middle of the road based on 2020 trends and expected recovery

- Key questions to ask:
  - Was this store underperforming prior to COVID and at risk?
  - For well performing stores that experienced a dip in sales, was this directly related to COVID?
  - Although sales may have dipped, did EBITDA dip?
  - How did PPP loan proceeds impact EBITDA?

Exit or Disposal Activities

- Relates to restructuring initiatives, business closures and similar reorganizations
- Long-lived assets held for sale – suspend depreciation and mark to lower of carrying or fair value if certain conditions are met
- One-time employee termination benefits
  - Recognize when communicated under most instances
  - Amount recognized depends on whether future services are required
- Contract terminations (including leases) – consideration of sub-lease rentals
  - For lease obligations, recognize on date of restaurant closure

Debt Restructurings and Covenants

- Three ways to account for debt restructurings:
    - Modification – substantially similar terms
    - Extinguishment – substantially different terms
    - Troubled debt restructurings (TDRs) – experiencing financial difficulty and concession granted

- Short-term loan modifications (e.g., deferral of payments) made to help borrowers that are current on existing loans and experiencing issues as a result of COVID-19, generally would not be considered TDRs

- Different accounting for unamortized deferred finance costs, fees paid to creditors and costs with third-parties

- Covenants
    - Violations subsequent to period end and before financial statements are issued are recognized subsequent events
    - Implications to balance sheet presentation (current liability) and going concern assumptions

Going Concern

- Required of management and auditors
- Preparation of financial statements on a going concern basis until liquidation becomes imminent (at that time, apply liquidation basis accounting)
- One year look-forward period on its ability to meets its obligations
    - One year from date of financial statement issuance (not one-year from year-end date)
- Substantial doubt – conditions and events, in the aggregate, indicate that it is *probable* that the entity will be unable to meet its obligations within the one-year look forward period
- Consideration of management plans to mitigate going concern issues
    - Capital infusion
    - Debt restructuring
    - Securing new debt
    - Financial projections
    - Member pledge to support operations

Going Concern

- Two sets of disclosure requirements depending on whether substantial doubt is alleviated by management plans.

- Disclose the following irrespective of whether substantial doubt is alleviated by management plans:
  - Principal conditions/events that raise substantial doubt
  - Management's evaluation of the significance in relation to ability to meet its obligations
  - Management plans that are intended to mitigate (or have alleviated) the conditions/events that raised substantial doubt

- If substantial doubt is not alleviated by management plans:
  - Must include statement in notes that "substantial doubt" exists
  - Emphasis of matter paragraph in audit report required

Lease Concessions

- In response to COVID, the FASB allowed companies not to treat lease concessions provided by in CARES Act as lease modifications.

- Important to note in regards to lease concession:
  - It has to be a direct result of COVID
  - It should not result in a substantial increase in the right of lessor or obligations of the lessee

Lease Concessions Accounting Methods

- Two acceptable methods follow for lease concession accounting

- Example: Assume the following:
  - Company A received a lease concession for six month deferral
  - Pre-COVID straight-line debit monthly rent and debit deferred rent, with credit to cash.

- Method 1
  - Account for the concession as if no changes to the contract were made:

    Dr. Straight-line rent expense

    Dr./Cr. Deferred rent

    Cr. Accounts payable
  - No change to the P&L, rent expense is recognized, and AP increases until payments commence
  - Lower bottom-line in year of impact - debt covenants compliance considerations

Lease Concessions Accounting Methods

- Method 2
  - Account for the deferred payment as variable lease payments
    - No entry is recorded
    - Rent is expensed when paid
  - Better bottom-line for the year of the impact and additional rent will be recognized in the years when paid
  - The Company will have to adjust the deferred rent schedule for lack of rent
- Disclosure considerations:
  - Lessors/ Lessees should provide disclosures about material concessions granted/received

Gift card and Loyalty Program Accounting

- Revenue recognition, including breakage, is in accordance with ASC 606
- Gift card sale options: sale without promotion, with $XX promotional value, or a bulk sale to warehouse retailer
- Net gift card liability reflects the cash received from customer
- Unredeemed or redeemed, but not for a full amount gift cards trigger "breakage rules‟
- Proper tracking from the POS for each promotion to ensure breakage only relates to cash amount received
- Escheatment state law considerations

Gift Card Accounting – Promotional Value

- Assume the following:
  - Restaurant A sells gift cards with a face value of \$25 for \$20. Upon sale, the restaurant records the following entry:

Dr. Cash	\$20	
Dr. Gift Card Liability Contra	\$5	
Cr. Gift Card Liability		\$25

  - If a gift card is redeemed fully, then restaurant recognizes revenue with the sale discount for promotional amount:

Dr. Gift Card Liability	\$25	
Dr. Sale discounts	\$5	
Cr. Sales		\$25
Cr. Gift Card Liability Contra		\$5

Gift Card Accounting – Bulk Sale

- Assume the following:
  - Bulk sale to warehouse retailer
  - Restaurant B sells 100 gift cards in bulk to SAM's club
    - Face value of $50
    - Sam’s Club buys for $30 from Restaurant B
    - SAM’s club sells it for $40 to end customer
  - At the time of the transaction, the Company would record:

Dr. Cash	$3,000	
Dr. Gift Card Liability Contra	$2,000	
Cr. Gift Card Liability		$5,000

- Once the gift card is redeemed, the Restaurant records entry similar promotional value proportionate to value redeemed.

Additional Resources

- Accounting for Gift Cards (NEW – October 22, 2020)
- SBA Releases New PPP Forgiveness Form 3508S for Loans $50,000 or Less (October 12, 2020)
- SBA Announces Guidance for PPP Borrowers and M&A Transactions (October 8, 2020)
- COVID-19: Accounting for Lease Concessions (September 8, 2020)
- SBA PPP: Can a Restaurant File The EZ Forgiveness Application (July 16, 2020)
- Accounting For PPP Loans And Forgiveness (April 17, 2020)
- AICPA TQA 3200.18 – PPP Loan as a Grant
- Paycheck Protection Program Loans FAQs (last updated October 7, 2020)

Questions

Contact Information

Dustin Minton
Director,
Restaurant Services
(513) 744-5073
dminton@gbq.com

Jeff Harden
Director, Assurance &
Business Advisory Services
(614) 947-5299
jharden@gbq.com