



Alerts

PPP Loan Proceeds Return Date Extended, Tips on Preparing for a PPP Loan Audit

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Hinshaw Alert

PPP Loan Proceeds Return Date Extended

On April 23, 2020, the U.S. Department of the Treasury and Small Business Administration (SBA) announced that public companies receiving Paycheck Protection Program (PPP) loans, who were concerned about the economic uncertainty certification they had made when applying for a PPP loan, had until May 7, 2020 to return all of the loan proceeds. If they did, according to FAQ #31 they would be deemed to have made the certification in good faith. Then, on April 28, the agencies indicated in FAQ #37 that this rule would also apply to private companies.

In their haste to stimulate the economy and keep employees working, the federal government made quick decisions on eligibility and rules. Now, they are changing some of the rules on the fly.

On May 5, these agencies issued FAQ #43, which stated that they were extending the PPP loan proceeds return date to May 14, 2020. This gives PPP borrowers concerned with their economic uncertainty certification—or concerned for any other reason—more time to return all their PPP loan proceeds.

Preparing for an Audit

Recently, the Treasury and the SBA announced that all [PPP loans in excess of \\$2 million would be audited](#) after the forgiveness application was submitted by the borrower. In FAQ #39, they also indicated that smaller PPP loans could be subject to review.

Due to this increased scrutiny, businesses which received PPP loans in excess of \$2 million that intend to retain the loan proceeds should anticipate and prepare for an audit of their loan and forgiveness applications at some future date. Businesses that received smaller loans may also face scrutiny in the future, and should also consider preparing for an audit. Companies that elect to return the proceeds on or before May 14, 2020 should consider whether they need to prepare for a loan application audit as well.

Attorneys

James W. Keeling
Timothy M. Sullivan

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In light of this, management should prepare a COVID-19 memo addressing conditions facing the business at the time the PPP application was submitted. This memo should be prepared as soon as possible, as it will be much more difficult to try and prepare it at some future date when management is under audit pressure from the Treasury, SBA, or a bank lender.

Initially, the memo would be prepared for the business' internal files. At this time it is not required to provide the bank with the memo, but it could be necessary when preparing the loan forgiveness application. By documenting this now, when the facts are fresh in everyone's mind, a business will be in a better position to defend itself if the SBA asks questions and seeks documentation during the loan forgiveness phase—or two years later during the audit phase.

This memo should be continually updated with the information needed to prepare the loan forgiveness application, documenting how the loan proceeds were used in the business. While every situation differs, we have outlined points that the memo could address below.

(1) A quantitative and qualitative summary of the situation the business faced (at the time of the PPP loan application) should form the basis for the memo. This could include a narrative and financial forecasts showing *pro forma* financial results for the next 6 – 12 months using various scenarios. The memo should also document what motivated management to seek the loan. Some examples of what should be considered include:

- Have operations been closed or restricted by local government orders?
- Has the marketing pipeline been affected?
 - If so, provide the % it has declined, if known.
- Has revenue declined or is it projected to decline?
 - If so, provide the amount or percentage it has gone down.
- Has profitability declined or is it projected to decline?
- Has backlog declined?
- Are customers delaying orders?
- Are there concerns that major customers or vendors might not survive the COVID-19 crisis?
- Are accounts receivable (and delinquencies) increasing?
- Has, or will, cash flow decline because customers cannot pay?
- Are there supply chain issues?
- Have contracts been cancelled?
- Has the company laid off employees, or considered laying them off?
- Do the projections indicate whether the business will return to pre-COVID-19 levels after the crisis has ended?
- Due to the demand for PPP loans, was management concerned that if the COVID-19 crisis continued for an extended period, that the business would burn through all of its resources (e.g., lines of credit) and then be unable to secure a PPP loan?
- If the business has existing debt, would it be able to service it, and cover payroll and other expenses?
- Could the business' assets—such as real property and machinery—face a significant reduction in value if the crisis continued for an extended period or if the business was required to cease some or all of its operations during the crisis?
- What would be the operating costs for things like safety and sanitation in a post-COVID-19 environment?

(2) Consider what access, if any, the business has to liquidity—debt or capital. In this regard, simply having a line of credit does not address whether it will be available at a later date if the COVID-19 crisis persists for an extended period of time. Theoretically, many companies may be able to raise capital from others, but it takes time to make a case for investment by third parties. Even friends and family expect substantial returns on their investment in exchange for making what could be a risky illiquid investment.

(3) Be sure that the memo gives a general overview of the business' use of funds and general strategy related to the PPP loan. Note, in accordance with the SBA rules, at least 75% or more of the funds from the PPP loan should be used for payroll costs.



(4) As part of the loan forgiveness process—which will be considered in any audit by the regulators—you need to prepare detailed records of how the proceeds were spent. Not only will this be required by the lender when you request that some or all of the loan be forgiven, but it will also help you in the audit process.