

A woman with blonde hair, wearing a light blue button-down shirt, is seated at a desk in an office. She is looking down at a document. On the desk, there is a calculator and several papers, one of which features a colorful pie chart. The background is a blurred office environment with shelves containing binders and papers. A vertical red bar is positioned on the left side of the image.

BDO KNOWS ACCOUNTING AND REPORTING SERVICES:

PAYCHECK PROTECTION PROGRAM LOAN AND FORGIVENESS BEST PRACTICES

BACKGROUND

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020, and authorized more than \$2 Trillion in aid to battle COVID-19 and the economic effects it was having on the U.S. This provided for immediate cash payments to individual citizens, loan programs for small businesses, support for the medical industry and providers directly impacted, and various other economic relief packages for impacted businesses.

The first part of this bill outlined the SBA's Paycheck Protection Program ("PPP") which provided \$349 Billion in emergency funding for small businesses to help keep their workforce employed during the COVID-19 crisis. PPP fund was subsequently increased a few weeks later with an additional \$310 Billion. The purpose of the PPP program is to help small business cover their operating costs, for an 8-week period, due to the financial burden they have encountered as a result of the pandemic. These loans to small businesses have the ability to be forgiven if the funds are used for approved purposes.

Eligibility

The Treasury Department and SBA have stipulated that in order to be eligible to apply for a PPP loan, a business must:

- ▶ Have 500 employees or less,
- ▶ Be a 501(c)(3) non-profit organization, 501(c)(19) veterans organization, or Tribal business concern (sec. 31(b)(2)(C) of the Small Business Act) with the greater of: (a) 500 employees, or (b) meets the SBA industry size standard if more than 500,
- ▶ Have an NAICS Code that begins with 72 (Accommodations and Food Services) that has more than one physical location and employs less than 500 per location, or
- ▶ Be an eligible self-employed individual, independent contractor or sole proprietorship.

These eligibility requirements were enacted to help ensure that only small businesses that rely heavily on cash flow to help fund operating expenses can continue as a going concern.

Forgiveness

In order to be eligible for loan forgiveness, the business or covered person must comply with the approved uses of funds, put the funds to work within the required 8-week period, and adhere to the 75/25 allocation thresholds (at least 75% must be used for payroll / 25% can be applied to the other approved uses). The approved uses of the PPP funds are as follows:

- ▶ Payroll – which may include salaries, wages, commissions, vacation, family, sick and medical leave
- ▶ Mortgage interest – as long as the mortgage was signed prior to February 15, 2020 (which shall not include any prepayment of or payment of principal)
- ▶ Rent – for any lease agreement entered into prior to February 15, 2020
- ▶ Utilities – incurred after February 15, 2020
- ▶ Interest on any other debt obligations that were incurred prior to February 15, 2020

If the aforementioned criteria are met, your business will be eligible to apply for forgiveness through your financial institution who approved the PPP assistance. If the funds are used for other purposes, or do not meet the approved criteria, they will be not be eligible for forgiveness. Instead, the assistance will be loan with a two-year maturity bearing 1% interest. Therefore, developing a plan upfront as to how you intend on using the funds and sticking to it will help ensure a favorable forgiveness application outcome.

INTERNAL TRACKING & ACCOUNTING

As you may remember from the PPP application process, there are a bevy of documents and supporting materials that are required to be presented for your financial institution to determine eligibility. There will be an equal amount of scrutiny placed on the usage of these funds if forgiveness is applied for.

Therefore, businesses should ensure they not only have the proper documentation in place to support their eligibility, but they are also able to present supporting schedules detailing how these funds were received, what amount and percentage of the total funds were applied towards approved payroll costs, what amount and percentage of the funds were applied towards the other approved items, and when these PPP funds used. The ability to provide evidence of these items, through a detailed tracking process, will be crucial to support the desired outcome for the business (forgiveness or a loan).

Applying the appropriate accounting treatment for your books and records will be vital to ensure you have recorded the receipt and use of the PPP funds in accordance with U.S. GAAP. Creating separate GL accounts, journal entries, financial statement disclosures, and internal whitepapers outlining the accounting considerations identified and accounting treatment applied will go a long way in ensuring a smooth audit process with the SBA and / or your external financial statement auditors.

WILL THE RECIPIENTS OF PPP FUNDS BE REVIEWED BY THE SBA OR TREASURY DEPARTMENT?

As part of the PPP application, all borrowers are required to certify in good faith that current economic uncertainty makes the PPP loan request necessary to support the ongoing operations of the applicant. The Treasury Department and SBA are still evaluating the review and / or audit requirements for the PPP program, however, they have outlined in their [Paycheck Protection Program Loans FAQ's](#) who will be subjected to a review. In FAQ #39, the SBA and Treasury Department announced they will be reviewing all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender's submission of the borrower's loan forgiveness application. However, this was later clarified in FAQ #46, "Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith."

I WAS APPROVED FOR AND RECEIVED PPP ASSISTANCE BUT HAVE LAID OFF EMPLOYEES AND CAN'T MEET THE 75% TEST, WHAT HAPPENS NEXT?

A business must first determine why they are unable to meet the 75% test. The most common two scenarios are 1) that a company has laid off a large number of employees, post loan approval, or 2) management has reduced employees pay such that their total payroll costs are now less than 75% of their loan application amount. First, the Paycheck Protection Program Loans FAQ Question #40 was presented to address the scenario of attempting to rehire an employee where they have rejected your offer, and whether or not this would eliminate your ability to receive approval for PPP forgiveness:

- ▶ *"Question: Will a borrower's PPP loan forgiveness amount (pursuant to section 1106 of the CARES Act and SBA's implementing rules and guidance) be reduced if the borrower laid off an employee, offered to rehire the same employee, but the employee declined the offer?"*
- ▶ *Answer: No. As an exercise of the Administrator's and the Secretary's authority under Section 1106(d)(6) of the CARES Act to prescribe regulations granting de minimis exemptions from the Act's limits on loan forgiveness, SBA and Treasury intend to issue an interim final rule excluding laid-off employees whom the borrower offered to rehire (for the same salary/wages and same number of hours) from the CARES Act's loan forgiveness reduction calculation. The interim final rule will specify that, to qualify for this exception, the borrower must have made a good faith, written offer of rehire, and the employee's rejection of that offer must be documented by the borrower. Employees and employers should be aware that employees who reject offers of re-employment may forfeit eligibility for continued unemployment compensation."*

Second, a business must evaluate the funding applied toward payroll-related cost on an individual employee basis. Therefore, when a business is calculating their anticipated forgivable amount, they must evaluate each individual employee's compensation and use of PPP funds toward the individual payroll costs during the covered period. Lastly, if a business cannot meet the 75% test because they have had a reduction in FTE headcount or applied a reduction in pay to their employees, and have applied the remainder of the PPP funds to the other approved purposes, the amounts not spent on payroll related costs will be limited to 25% of the total PPP amount received, for forgiveness purposes, and the remainder will be treated as a loan.

EVOLVING ENVIRONMENT

Since the PPP program was first enacted into law¹, there have been numerous updates to the rules and regulations surrounding the receipt, usage, and subsequent tracking of the funds made available via the Treasury Departments FAQ's. The Treasury Department has made it clear that the laws, rules, and guidance applied to businesses will be based on the rules in effect at the time of their relevant application. Therefore, we encourage businesses that are currently undergoing their application process or who have submitted their application but have not yet been processed to stay up to date on the FAQ's and interpretations that are released as those will impact their PPP loan.

BDO will continue to monitor any updates arising from the Treasury Department, as well as interpretations from the FASB, and will release updates to these materials as appropriate. For further details on this discussion, or to find out more on how BDO can assist your company through the PPP process, please contact one of our team members.

¹ On May 28, 2020 The U.S. House of Representatives passed legislation to ease restrictions regarding the use of PPP funds and the timing of use which would alter forgiveness criteria to be met. As of the time of this publication the easing of those restrictions has not yet been passed by the Senate. Borrowers under the PPP should closely follow future developments to insure they are properly adhering to the most up to date requirements under the Program.

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