



April 18, 2020

## COVID-19 Update:

### **PPP Loan Application – Done! PPP Loan in limbo or PPP Loan Approved – Whew! Now What?**

The Paycheck Protection Program (PPP loan) was created to provide loans to help businesses keep their workforce employed during the Coronavirus (COVID-19) crisis. What makes a PPP loan so enticing is the potential for it to be forgiven up to 100%<sup>1</sup>. The challenge is that banks and small businesses have not received definitive guidance on how the PPP loan will be forgiven. This adds anxiety to an already difficult situation as business owners are left wondering what will be required in order to get this loan forgiven.

Here is what we know about the PPP loan forgiveness:

After the loan is funded, in order to qualify for the loan forgiveness there is a two-step process.

1. Businesses will need to aggregate the total payments for the 8-week period, after the date of funding (the “8-week post funding period”), for payroll costs (including wages, vacation and medical leave, and health benefits), interest payments, rent payments and certain utilities.
2. Then, compare the organization’s average number of monthly full-time equivalent employees (FTEs) during the 8 week post-funding period to a “comparison period,” defined as:
  - a. Average monthly FTEs from February 15, 2019 through June 30, 2019; or
  - b. Average monthly FTEs from January 1, 2020 through February 29, 2020.

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**Seasonal employers must use a comparison period of February 15, 2019 through June 30, 2019 compared to the 8 week period following the date of funding.**

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<sup>1</sup> There is some question about whether Section 265(a)(1) of the Internal Revenue Code may act to bar the deduction of expenses paid from tax-exempt income. We will monitor this development closely and keep you informed as this key aspect is clarified.

Those receiving a PPP loan, should note that the Small Business Administration (SBA) has stated that no more than 25% of forgiveness can be from non-payroll costs. The SBA has also clarified that any interest that accrues before the loan is forgiven or paid will be charged to the borrower.

Full forgiveness will not be available if you reduce your FTEs during the covered period or reduce the pay of an employee making less than \$100,000 by more than 25%. You will need to apply for loan forgiveness and your lender will determine the loan forgiveness amount. Upon receipt of the forgiveness request and necessary supporting documents, your Lender will have 60 days to approve or deny the forgiveness.

What we don't yet know, is what supporting documentation will be required to demonstrate compliance with the terms and conditions of the PPP loan and what process the banks will use to evaluate how much of the loan proceeds are eligible for forgiveness. Until there is better guidance from the Treasury or the SBA on exactly what information will be needed to determine loan forgiveness, this article strives to give practical suggestions of what to do now based on years of experience working with the government and banks.

Below are ten suggestions to consider now:

1. **Create a PPP Loan File.** This file should contain all correspondence, evidence, receipts and support. Make someone the champion of this overall process and stay on top of it. It may make a world of difference in the weeks ahead to be cognizant of how these rules may change both in scope and time frames as your bank and the government continue to iron out all the compliance aspects of this program.
2. **Track Your Average Monthly FTEs.** PPP loans are eligible for forgiveness if your organization's average monthly FTEs during the 8 week post-funding period is the same or higher than one of the approved comparison periods. If the average monthly FTEs in the 8 week post funding period is less than the average FTEs in the comparison period, plan that the forgiveness amount will be adjusted downward proportionately.

We suggest tracking FTEs for each of your normal pay periods starting from the earliest date of the approved comparison periods through the date the PPP loan forgiveness is approved. Tracking FTEs in this manner will allow for an easier evaluation of what comparison period is more beneficial to your organization and allows you additional flexibility should revised guidance be issued.

If rehiring employees previously furloughed or laid-off as a result of receiving this loan, track the re-hire statistics clearly. Be prepared to produce this documentation when your enterprise gets to the forgiveness phase of this overall process.

3. **Track Payroll Costs.** Payroll costs during the 8-week post funding period must be 75% or more of the comparison period average to be eligible for full forgiveness.

Consistent with #2 above, we suggest tracking payroll for each of your normal pay periods, and payroll reports and filings created in the normal course of business, starting from the earliest date of the approved comparison periods through the date the PPP loan forgiveness is approved.

Tracking payroll costs in this manner will allow for an easier evaluation of what comparison period is more beneficial to your organization and allows you additional flexibility should revised guidance be issued. Ad-hoc analysis and adjustments can be made, if necessary, but the ability to reconcile to your organization's payroll records and filings will be important. Such adjustments may be necessary to the extent you have employees whose wages exceed \$100,000 on annual basis.

**4. Track Qualified Non-Payroll Costs.** The PPP loan allows for up to 25% of the loan proceeds to be spent on non-payroll costs, such as:

- Mortgage interest, on loans originating before February 15, 2020;
- Rent, under lease agreements in force before February 15, 2020; and
- Utilities, for which service began before February 15, 2020.

Keep a detailed log of these payments during the 8-week post funding period, and keep related documentation, including payment remittances, statements, or invoices.

**5. Create a Transaction Log.** Create a detailed log of the uses of the loan proceeds. The log should clearly identify when and how the proceeds were used. Prepare a reconciliation from the day the proceeds were received through the date proceeds were depleted. To support documentation with numbers #3 and #4 above, we advocate setting up a separate bank account to accept all PPP loan funds into and then to use this account to directly disburse funds or use it as a draw account where funds are drawn down with detailed draw requests into your operating and payroll accounts as needed to meet qualified obligations going forward. Others may choose to establish new accounts in the chart of accounts used by the business to track the use and application of the PPP proceeds. Regardless, the objective is to streamline the audit tracking, eliminate commingling of funds and provide transparency during the loan forgiveness process with the bank.

**6. Consider Implications of other CARES Act Provisions.** There likely are other CARES Act provisions that your organization may be eligible for, that could impact the timing and extent of our PPP loan forgiveness. For example:

- If you are receiving both a PPP loan and an Economic Injury Disaster Loan (EIDL), keep detailed records about the uses of each – we recommend you do not pay any payroll costs with EIDL proceeds if you have received a PPP loan.
- If you received the \$10,000 EIDL emergency grant or any other EIDL funds, those funds will reduce the amount of forgiveness you will receive.

**7. Create a PPP Loan Forgiveness Model.** Using the information gathered in steps 1-5 above, create a spreadsheet to estimate what percentage of the PPP loan may and may not be eligible for forgiveness. Consider the impact on projected cash flow if you will need to pay back all or part of your loan. Keep in mind that this will be a moving target as the economy begins to recover.

8. **Create and Update Cash Flow Models.** Critically evaluate your assumptions driving revenue and costs as your organization tries to return to pre-pandemic operating levels. While scenarios will be unique for each organization type, and industry, we are recommending the following scenarios should be considered and modeled:
  - Deferral of loan payments for 6 months (principal and interest);
  - Repayment of 100% of interest accrued during the first six months;
  - Forgiveness date is 3, 6, 9 and 12 months after receipt of proceeds;
  - Loan is not forgiven and needs to be repaid in 24 months after receipt of proceeds;
  - Amortize partial loan forgiveness payments of principal and interest over 18 months leading to maturity; and
  - Headcount fluctuation percentages based on the “bounce back” of your operations.
9. **Try Something New.** Organizations may have employees on payroll under the PPP loan that are unable to work in their previous capacity. If there are other organizational tasks or processes that can be evaluated and changed during this “down-time”, consider what can be done now that will help your organization cope and survive. Determine if those unable to work in their previous roles can evolve to assist with what the organization will require prospectively.

**Expect Change.** Remain calm, be prepared, and be patient with the process. Remember, this is a new program of incredible scope and magnitude and new processes will continue to be introduced to help the employers take care of their employees. We are aware that many PPP applicants have failed to receive funding from the first round of funds and we continue to be hopeful that additional resources will be made available. Keep your eyes open for additional changes and information that will become available for you and your organization to comprehend and adapt to what the future will bring us.

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Sincerely,

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