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Navigating PPP Loan Forgiveness

Your Guide to Best Practices

BEST of Accounting
CLIENT SATISFACTION 2020

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Housekeeping

The webinar will remain live for ten additional minutes after the conclusion of the presentation to provide the opportunity to submit follow up questions via the Q&A function. A summary of top questions will be provided to all attendees.

Additionally, all attendees will be emailed a link to a recording of the webinar, a pdf of the presentation, and a listing of speaker biographies and contact information.

Today's presentation is not:

- Legal advice
- The final word on today's topics – updates will be continuously provided via herbein.com
- Qualified for learning CPE, HR, or CE credits

Before taking any action, employers should review this material with internal and/or external counsel.

Quick Survey Number One of Two

Tell us where you stand in the PPP process:

- Applied and received funding (or confirmed date when it will arrive)
- Applied and did not hear if you will receive funding
- Have not applied, but plan to do so during next round
- Have not applied, do not plan to do so during next round
- Unsure of how to proceed

THE PPP & LOAN FORGIVENESS: THE PILLAR OF THE CARES ACT

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- For small businesses, the pillar of the **Coronavirus Aid, Relief and Economic Security (CARES) Act** is the **Paycheck Protection Program (PPP)**.
- The PPP initially authorized up to $349 billion of federally-guaranteed loans to qualifying small businesses. Businesses were eligible to apply for a PPP loan starting April 3, 2020, and millions have applied since.
- **On April 21, the Senate passed a bill approving over $480 billion in additional coronavirus relief – the new package includes another $310 billion for the PPP, specifically setting aside $60 billion to be funded by credit unions and community banks.**
- PPP loans are designed to be forgiven if employers keep employees on their payroll and spend the loan proceeds on qualified expenses.
- As businesses' loans are funded, they now need to shift their focus to administering the use of the funds to ensure compliance and maximize loan forgiveness.

Managing PPP Loan Proceeds

PIVOTING YOUR CONCERNS

- For businesses that have successfully navigated the PPP loan application race and received news from their lender that their loan was approved, the reward is the loan proceeds.
- ***However, with this reward comes tremendous uncertainty on what happens next.***
- Loan recipients will have to pivot their concerns from maximizing their PPP loan amount to maximizing PPP loan forgiveness.

Managing PPP Loan Proceeds

- **Note:** Loan proceeds used for unauthorized purposes are not eligible for loan forgiveness.

- We recommend that borrowers set up a separate bank account for the loan proceeds so that the funds are not co-mingled with other accounts.

- Maintaining a separate bank account will also aid in the recordkeeping process when applying for loan forgiveness.

Eligible expenses

Authorized uses for PPP loan proceeds include:

- Payroll costs;
- Continuation costs of group health care benefits (during periods of PTO for sick, medical and FMLA) and insurance premiums;
- Interest on mortgage obligations incurred before February 15, 2020;
- Rent, under lease agreements in force before February 15, 2020; and/or
- Utilities, for which service began before February 15, 2020.
- Interest payments on any other debt obligations incurred before February 15, 2020.

SBA guidance currently indicates that up to 100% of the PPP loan principal and interest may be forgiven.

LIMITATIONS ON PPP LOAN FORGIVENESS

On April 15, 2020, the SBA issued an Interim Final Rule regarding administration, including certain limitations on PPP loan forgiveness.

Some limitations to note are:

- The borrower must use at least 75% of the PPP loan proceeds for payroll costs in order to be eligible for full forgiveness of the PPP loan principal and interest amounts.
- No more than 25% of the forgiveness amount may be attributable to non-payroll costs, and any excess amounts will not be eligible for forgiveness.

IS THIS ALL STRAIGHTFORWARD?

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- While the list of eligible expenses may seem relatively straightforward, there are a few questions re: which expenses are eligible - and how the loan proceeds can be spent.

- **Example:** If a borrower has its loan funded on April 14, 2020 and has payroll due on April 15, 2020 for the pay period from April 1 to April 15, 2020, does the entire payroll qualify as eligible payroll costs?

- ***Or*** is only the portion of payroll incurred from the date of loan funding considered as eligible payroll costs?

The "Covered Period"

The CARES Act refers to **"costs incurred and payments made during the covered period":**

- The covered period in this section of the CARES Act is defined as the eight-week period after the lender makes the first loan disbursement of proceeds.
- The "payments made" implies a cash basis of accounting. However, the "costs incurred" leaves open the possibility that Congress intended an accrual basis of accounting.

The "Covered Period"

- Questions have also arisen as to whether a borrower can pay bonuses that accrued from an earlier period or whether a business can pre-fund retirement contributions for the eight-week covered period.

- The answers to these questions will need to be clarified in guidance from the Small Business Administration (SBA).

Managing Documentation for Loan Forgiveness

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How important is documenting your expenses?

- To ensure proper documentation for loan forgiveness, it is extremely important that borrowers maintain adequate substantiation for all eligible expenses as the funds are being spent.

- The CARES Act stipulates that borrowers must provide documentation to verify the use of funds on eligible expenses and forgiveness is prohibited without the submission of the required documentation to the lender.

What documentation is required?

Required documentation:

- **Payroll costs**
  - Borrowers must provide documentation to verify the number of full-time equivalent (FTE) employees on payroll and pay rates for the period.
  - This documentation should include payroll tax filings reported to the IRS and state income, payroll and unemployment insurance filings.
  - We recommend tracking your FTE employee calculation each pay period.
- **Mortgage interest, rent, and utilities**
  - Borrowers should also provide documentation such as cancelled checks, payment receipts, transcripts of accounts or other documents verifying payments on covered mortgage and other debt obligations, covered lease obligations and covered utility obligations.

You MUST certify your documentation

- Additionally, borrowers must provide certification that the documentation presented for loan forgiveness is true and correct and the amount for which forgiveness is requested was used for eligible expenses.
- The SBA has said it will issue additional guidance on loan forgiveness, but at a minimum, borrowers should be prepared to document their expenses with the documentation noted above.

Understanding the PPP Loan Forgiveness Process

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Use a four-part test to help determine the amount of loan forgiveness:

- **First:** Borrowers must use PPP loan proceeds for payroll costs, mortgage and other debt obligation interest, rent and utilities payments over the eight-week covered period after receiving the loan.

- *Important note:* The PPP Interim Final Rule published by the Treasury on April 2, 2020 provides that not more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs.

MAINTAIN YOUR EMPLOYEE HEADCOUNT

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- **Second:** Borrowers must maintain headcount, as loan forgiveness will be reduced if a business decreases its FTE employee headcount.
- This is determined by dividing the average FTE employee headcount during the eight-week covered period by the average FTE employee headcount during one of the following periods, at the election of the borrower:
    - Period from February 15, 2019 to June 30, 2019;
    - Period from January 1, 2020 to February 29, 2020.
- For seasonal businesses, the eight-week covered period is compared to the period from February 15, 2019 to June 30, 2019.
- The result is multiplied by the loan proceeds spent on qualified expenses to determine the amount that is eligible for forgiveness.

CAN YOU HAVE A REDUCTION IN COMPENSATION?

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- **Third:** If a borrower decreases salaries and wages by more than 25% for any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than $100,000, then a portion of the loan may not be forgiven.
- Under the test to determine if there has been a 25% reduction in salary, borrowers are required to compare total salary and wages of an employee during the eight-week period to the most recent full quarter that the employee was employed.
- If an employee's wages or salary decreased by more than 25%, then the difference in excess of 25% is not forgivable.

PROBLEMS WE FACE WITH REDUCTION ISSUES

- Guidance is needed from the SBA to address several issues borrowers will face when calculating the 25% reduction.
- **Example:** How should bonuses, commissions or other forms of compensation be considered in this calculation for comparing compensation?
- Additionally, the periods being compared are <u>not</u> comparable based upon the number of weeks being computed, as the calculation requires the comparison of an eight-week period to a thirteen-week period.

SAFE HARBOR FOR REHIRES

- The CARES Act also contains what appears to be a safe harbor for rehires, such that a borrower will not have its loan forgiveness proportionately reduced if the decrease in FTE employee headcount and wages is eliminated by June 30, 2020.

Restore FTE count by June 30, 2020

- **Fourth:** To prevent any reductions in the forgiveness provisions already described above, **the final part of the loan forgiveness calculation provides that borrowers have until June 30, 2020 to restore FTE employee headcounts and salary and wage levels for any decreases made between February 15, 2020 and April 26, 2020.**
- For purposes of this test, the number of FTE employees on or before June 30, 2020 is compared to the number of FTE employees on February 15, 2020.
- Although not confirmed by the SBA, we believe this provision is an "all-or-nothing" test. In other words, either the borrower restores ALL of its FTE employee headcount and wages by June 30, 2020, or it will not eliminate any proportionate reduction calculated in steps two and three.

What to do after the Eight-week period

- After the eight-week covered period following the loan origination date, borrowers have 90 days to submit loan forgiveness documentation to the lender.
- Then, the lender has 60 days to make a decision on loan forgiveness.
- Borrowers deferring the employer's portion of Social Security taxes under the CARES Act should be aware that they are no longer eligible to defer these taxes once they receive a decision on loan forgiveness from the lender.

Full-Time Equivalent Employees

What / Who is a Full-time Equivalent employee (FTE)?

- The SBA has not yet definitively stated how to calculate FTE employees.
- The general consensus is that this test will be similar to the **Affordable Care Act** (ACA) in that all employees who work 30 hours or more per week will be considered full-time employees.
- All employees working less than 30 hours will be considered part-time employees.
- The ACA treats any person who holds a full-time position as one FTE employee, and then calculates for part-time employees and adds the results.
- The hours of part-time employees are aggregated on a monthly basis and divided by 120 to determine the number of FTE employees.

Putting it all together…

- **Step One:** Loan proceeds spent on qualified expenses (up to 25% can be non-payroll costs) = Amount eligible for loan forgiveness

PAYROLL COSTS AND NON-PAYROLL COSTS

PAYROLL COSTS

Payroll costs include: salary, wages, commissions or similar compensation; cash tips or the equivalent; vacation, parental, family, medical or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums and retirement; payment of state and local taxes assessed on compensation of employees; and for an independent contractor or sole proprietor, wage, commissions, income or net earnings from self-employment or similar compensation.

The Act expressly excludes the following from payroll costs:

1. Any compensation of an employee whose principal place of residence is outside of the United States;
2. The compensation of an individual employee in excess of an annual salary of $100,000, prorated as necessary;
3. Employer's share of federal unemployment taxes, FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes; and
4. Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act (Public Law 116–127).

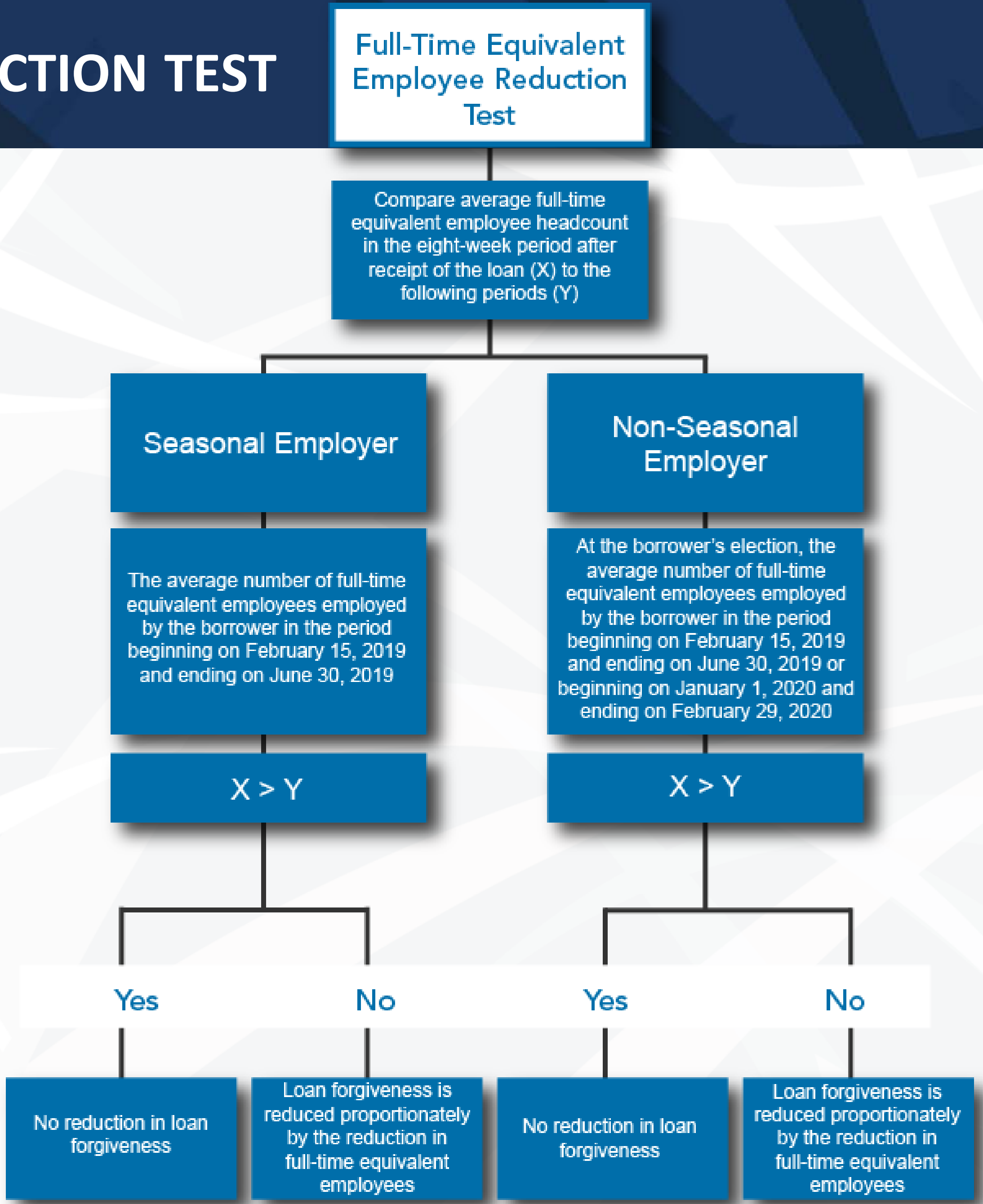
NON-PAYROLL COSTS

- Rent
- Utilities
- Mortage interest on real or personal property debt obligations

75% OR MORE OF LOAN FORGIVENESS MUST BE PAYROLL COSTS

25% OR LESS OF LOAN FORGIVENESS CAN BE NON-PAYROLL COSTS

Step Two - FTE reduction test



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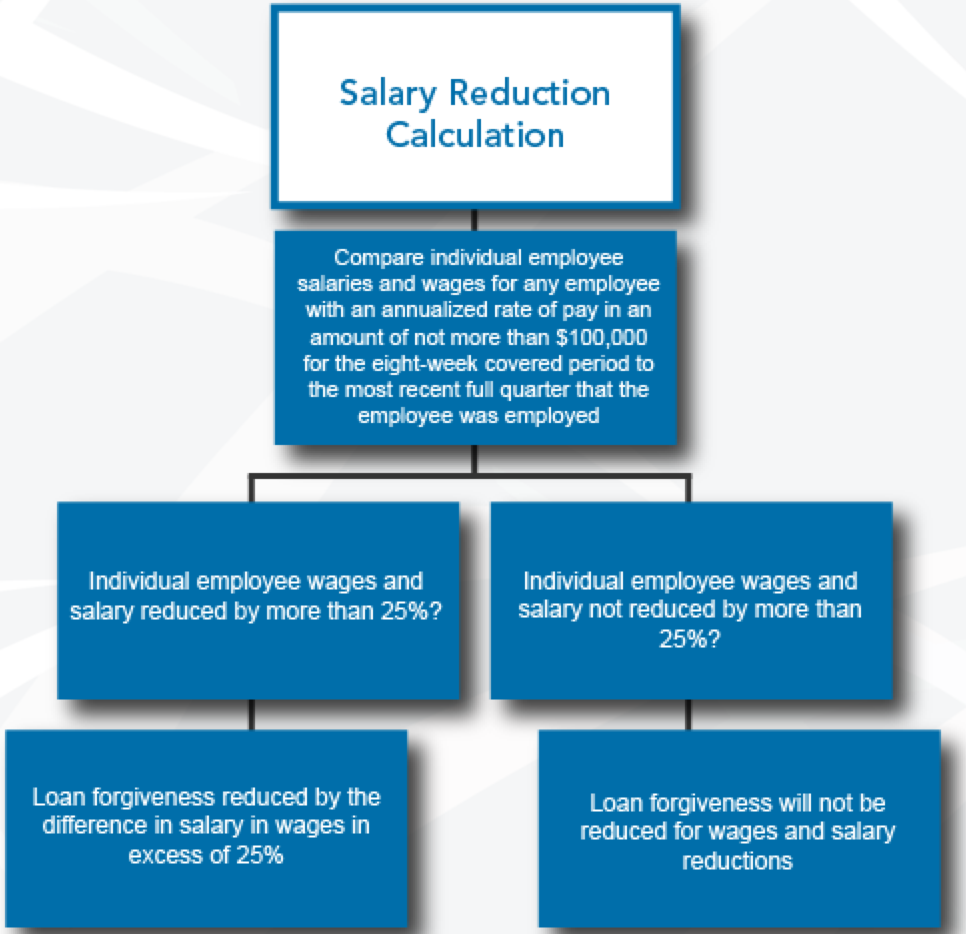
Step Three – Salary Reduction Test



Step 4 – June 30, 2020 Restoration Test

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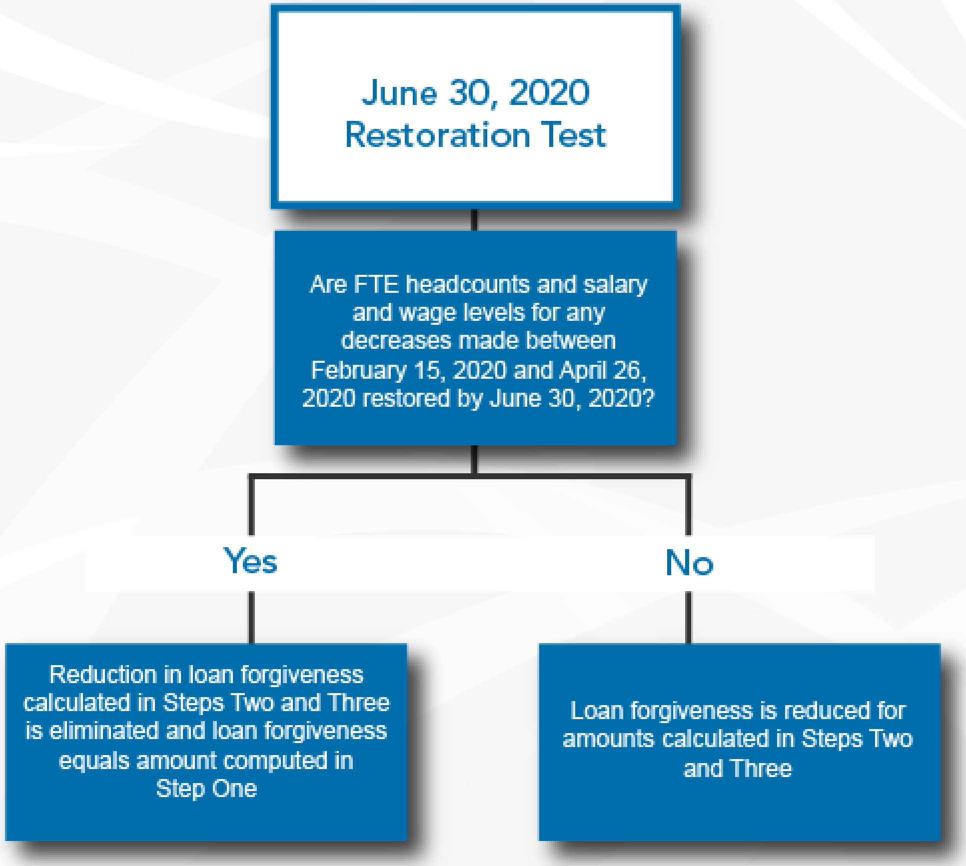

As we have discussed, clarifying guidance is needed from the SBA on several issues:

- While borrowers await guidance from the SBA concerning loan forgiveness, they should take steps now to ensure they properly administer the use of the funds to stay in compliance and maximize loan forgiveness.
- Reach out to your Herbein + Company advisor with questions about documentation requirements and navigating the PPP loan forgiveness process – and subscribe to our Coronavirus Resource Center.

Quick Survey Number Two

Tell us about your confidence level for your business over the next 6 months:

- Very confident that your organization will prosper
- Somewhat confident that your organization will prosper
- Neutral
- Less confident that your organization will prosper
- Not confident that your organization will prosper

Closing Thoughts…

We hope you found today's webinar to be helpful to your organization.

Parting thoughts:

- *Jim Michalak*
- *David Peritz*
- *Josh Pollet*

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Thank you for attending our webinar!

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PRESENTER BIOGRAPHIES

James A. Michalak, CPA, CITP- jamichalak@herbein.com
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James A. Michalak, CPA, CITP joined Herbein in 2002 as a Manager in the Accounting & Auditing Department. He is a Partner and serves as the firm's first Chief Information & Digital Officer.
Jim has over 25 years of experience servicing manufacturing and distribution companies, financial institutions (in areas such as audit, internal audit, asset based lending field exams) and employee benefit plan audits.
As chair of Herbein's Internal Technology committee, Jim is responsible for ensuring the firm remains on the cutting edge in providing effective solutions to current clients. Jim also serves as the partner in charge of marketing. In this role he works closely with the marketing team to optimize opportunities and ensure firm growth.

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Senior Manager, Herbein + Company, Inc.

David E. Peritz has twenty five years of diversified public accounting experience. His background includes many years with two national accounting firms prior to joining Gable, Peritz, Mishkin & Co. in 2002, then merging into Herbein + Company, Inc. in 2018. He has extensive experience in accounting for health care professionals, wholesale and retail businesses, real estate entities, and construction companies.
He has provided consulting and has been involved in the organization and start up of many business ventures and operating businesses, in every stage from forecast through the operational phases of the entity. His accounting and tax background not only provides him with solid credentials, but also provides him with knowledge that help many business owners succeed. Dave specializes in business consultation services for closely held companies, start-up ventures, and medical and dental practices.
Dave has also conducted seminars and spoken to various groups, covering a broad range of topics including real estate, management advisory services, business start-ups, pension and profit sharing plans, and various tax issues for construction companies.

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Josh A. Pollet, CPA has the distinction of becoming the third Herbein partner who began their career as an intern with the firm. Upon graduation from Pennsylvania State University, he joined the audit department in 2005. Josh manages the audits of several of the firm's largest clients. He works primarily within the dairy, food, cooperatives, and manufacturing industries.
Josh has addressed key financial measurements and cost accounting topics at various food and agricultural industry conferences. His knowledge of cooperative operations has led him to speak at the National Society of Accountants for Cooperatives (NSAC) national conference. Josh is the current chairman of the Accounting and Auditing Committee for the NSAC and serves as the vice president of the organization's Atlantic Chapter.