Certification of the Need for PPP Loan Funds

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Since the release of several FAQs and a safe harbor provision by the Treasury Department, a number of Paycheck Protection Program borrowers have expressed a fair amount of angst regarding their need for these funds and, indeed, tens of millions of PPP loan funds have already been returned. The reason for this angst is understandable. Neither the Act nor the SBA have defined "necessary" or "ongoing operations," nor have they provided any meaningful guidance that would shed additional insight into the meaning of these terms. In this article, we share our thoughts on what this guidance means and how to apply it. We encourage all PPP borrowers to take action now to avoid the possibility of significant penalties in the future.

Background

On April 23, the Treasury Dept. issued FAQ No. 31, "Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?" In the response, Treasury pointed out that borrowers are required to certify that "Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." They go on to say that "Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not detrimental to the business. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith …"

A few days later, on April 28, FAQ No. 37 was issued, raising a similar question with regard to privately-owned businesses with adequate sources of liquidity. The SBA's response to this question was "See response to FAQ No. 31." That same day, Interim Final Rule No. 4 was released reiterating the required certification and providing a safe harbor to avoid prosecution and potential criminal liability under the False Claims Act. The safe harbor provides that "Any borrower that applied for a PPP loan prior to the issuance of this regulation and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith." The very next day, FAQ No. 39 stated that SBA "will review all loans in excess of $2 million, in addition to other loans as appropriate …"

The Time to Take Action is Now

In light of the heightened scrutiny of PPP borrowers, we recommend that ***all borrowers***, and especially those with PPP loans of $1 million or more, formally assess and document their need for the funds and the rationale they used in making that determination in order to document their ***good faith***. We believe this is best done with a formal financial projection and a narrative explaining the rationale for need. The extent of the assessment and the level of documentation will depend, in part, on the size of the loan. Furthermore, if there is an active board of directors, the board, or perhaps the Executive or Finance Committee, should review and accept the needs assessment.

Below, we share our thoughts on how to interpret the standard imposed by the Act and what should be considered in making this assessment. Please keep in mind that this is subjective. Not everyone will agree with all the points below, and this is clearly not a one size fits all scenario. What is most important is that these decisions be thoughtful, well documented and prudent.

What We Know or Can Reasonably Infer About the Treasury's Expectations

- The standard against which a business should measure their projected performance is the ability to *retain workers and maintain payroll and make mortgage payments, lease payments and utility* *payments*. (This standard is also a required borrower certification included in the PPP Loan Application that pertains to the use of funds.) Absent guidance to the contrary, it is likely reasonable to assume that when the Act says *retain and maintain*, it is referring to retaining and maintaining the business at pre-pandemic levels. This interpretation is consistent with the apparent overall intent of the Act of “keeping American workers paid and employed” and with the granting of loan forgiveness for actually retaining and maintaining the workforce at average 2019 levels.

- The business should be evaluated as it is/was at or about the time the PPP loan application was submitted. Revenue/support should be projected based on the existing projects and backlog, taking into account anticipated delays due to mandatory and voluntary work from home orders, the anticipated duration of the shut-down and the time it would take to ramp back up to, or near to, 2019 levels. To appropriately demonstrate the economic uncertainty, it would be appropriate to look at a range of possibilities: What if business drops 20 percent, 30 percent or 40 percent? What if the shutdown lasts 6 weeks, 8 weeks, 12 weeks? How long will social distancing last, and what impact will that have on my organization’s operations? What if it takes 3 months, 6 months or 12 months to return to *normal*?

- If the projected revenue/collections plus the available other sources of liquidity are not sufficient to carry the business through this challenging time while retaining and maintaining workers at or near pre-pandemic levels, we believe it would be reasonable to conclude you meet the standard of need. Alternatively, if you determine that you can get through the next 6 to 12 months in a way that is not detrimental to the business, then you should consider returning the funds.

What Are Other Sources of Liquidity?

The Act specifically states that you don’t need to demonstrate an inability to obtain credit elsewhere in order to qualify for a PPP loan. However, the Treasury Department’s statement that “it is unlikely a public company with substantial market value and access to capital markets will be able to make the required certification in good faith … ” certain, insinuates that you must consider the availability of credit elsewhere in making your good faith assessment. With this in mind, sources of liquidity likely include cash on hand, unrestricted reserves or investments, available lines of credit (however, consider the possibility that a bank may freeze or not renew a line of credit due to, among other things, material adverse change clauses in the applicable agreements), elimination of bonuses, pay reductions for highly compensated employees or owners, reduced profitability and elimination of dividends or distributions.

Furthermore, if there is a wealthy owner with substantial liquidity who could finance the business, this could, in the eyes of the SBA, be enough to preclude a good faith certification of need; although, of course, this decision by the SBA is completely subjective. Not-for-profit organizations should consider the prudence of borrowing from endowment and quasi-endowment funds, as well as utilizing unrestricted reserves.

Consideration of Recent Changes to Forward-Looking Projections

There is information about your business available today that may not have been available at the time the PPP application was submitted. For example, you may have been awarded a new contract that was not expected at the time you applied for the PPP loan. Health care providers are now aware of the amount of funding they received from the Provider Relief Fund. Not-for-profit organizations may now know that state grant funding will continue to June 30 (or beyond) or that their virtual gala was nearly as successful as the live event they had planned. Or perhaps the decline in revenue to date has not been as severe as originally anticipated. Keep in mind that the projections should reflect what was known at the time of the application and the level of uncertainty that existed at that time.

Perhaps you were aware that some of these things might happen, but there was still considerable uncertainty at the time the application was submitted. The Act requires an Applicant to make these judgments at the time the application is submitted. As far as we are aware, there is no requirement to reassess need after application submission or to return funds if things turn out better than originally feared. And despite what has transpired over the weeks since the PPP application was submitted, there is likely still considerable uncertainty regarding the level of business looking forward and how quickly it will recover, if at all.

Outcomes That Might Be Considered Detrimental to the Business

Keep in mind that we believe the outcomes to be evaluated are those that would/could occur based on the range of possible revenue levels while maintaining staffing levels commensurate with average 2019 levels. (Again, we believe this is consistent with the primary intent of the Act.) Detrimental outcomes would likely include violations of existing debt covenants, inability to service existing or new debt, defaulting on lease agreements, or reductions in working capital that would make it difficult to operate the business in a prudent manner, including needed capex, repairs and maintenance. On the other hand, reductions in profits, and even operating losses, might not be detrimental if they don't result in covenant violations (defaults) or working capital insufficiency; nor would the inability to pay dividends.

In Conclusion

The regulations give businesses until this Thursday, May 7, to return unneeded funds and avoid potential prosecution under the False Claims Act. If your PPP loan was over $2 million, hopefully you are already well underway with your analysis and preparation of supporting documentation. We don't know what the penalties might be if you decide you don't need some or all of the funds and you return them after May 7, but this is certainly a much better alternative than keeping funds you cannot justify retaining in good faith.

Inaction is not a good choice for any borrower. There are differing opinions regarding how the SBA will evaluate a business's need for the funds. While the lack of guidance is quite disconcerting, a few things are eminently clear:

- Any borrower of more than $2 million will be audited and many borrowers of lesser amounts will be audited as well. The larger the loan, the higher the level of scrutiny is likely to be.
- All borrowers, large and small, should be prepared to defend their good faith certification of need.
- The best defense is to be proactive in assessing/re-assessing need by preparing projections supported by a narrative outlining key considerations and the rationale for your conclusions.

Contact Us

As always, we are here to help. While the decision to keep or return any PPP loans received must be yours, we can guide you through the assessment process, helping you to identify and document key considerations and acting as a sounding board along the way. Please reach out to your PKFOD engagement team with questions or for assistance or contact Bruce L. Blasnik, CPA, CGMA, Partner at CLT-SBATechnical@pkfod.com.