Government Grant Recipients Face an Uncertain Road to PPP Loan Forgiveness

By Bruce L. Blasnik, CPA, CGMA, Partner

Nonprofit organizations ("nonprofits") that receive significant amounts of federal and state grant funding ("government grants" or simply "grants") are likely to face challenges in maximizing the benefits of their Paycheck Protection Program (PPP) loans. Most government *grants* are structured as cost reimbursement contracts, and they prohibit "double-dipping" – you can't be reimbursed for the same cost twice.

The guidance on how this will impact the forgiveness of PPP loans is scant, to say the least. And while the federal government may theoretically be neutral with respect to which federal dollars an organization keeps and which they lose, that is clearly not the case with state grantor agencies. State agencies, all of which are under significant financial stress, stand to benefit if they disallow grant costs covered by forgivable PPP loans.

Forgive or Repay

Here are four possible scenarios which could occur with respect to forgiveness of PPP funds for nonprofits:

1. Federal and state governments will recognize the extreme duress faced by nonprofits and neither the federal agencies nor state agencies will claw back or disallow any funding. While this is certainly a possibility, it is probably not the likely outcome.

2. Nonprofits will be allowed to keep all their PPP funds and the full amount of the loan will be forgiven providing they meet the applicable requirements for forgiveness, but federal and state agencies will claw back or disallow grant funding for the forgiven costs. Given the financial dire straits many states are in, this is, no doubt, what the states are counting on. This, in essence, allows the states to be the pass-through beneficiaries of the PPP funds, which they were not eligible for directly.

3. Nonprofits will be allowed to keep all their PPP funds, but a portion of those funds will not qualify for forgiveness because the costs were not really borne by the nonprofit agency. The unforgiven PPP funds will have to be repaid over time, but the PPP funds would not supplant federal and state funding. Short of no claw back at all, this is the best outcome for nonprofits. Being able to retain all the PPP loan funds, even as a long-term loan, could be the difference between survival and demise for many nonprofits, particularly in the face of future funding delays, freezes, or cuts.

4. It turns into a free-for-all where every federal and state agency makes their own rules, leaving nonprofits in a quandary, not knowing what to do or how to proceed. This is a very real and unfortunate possibility, and we are already seeing signs that this is beginning to happen. The PPP has generated a multitude of questions and issues for borrowers (and lenders). So far, the Small Business Administration (SBA) has been slow to respond, and often the responses themselves have generated more questions than answers. When you consider the fact that the SBA does not typically deal with the nonprofit sector, it seems likely that guidance on this very important issue will be late in coming, ambiguous and insufficient. Let's hope this is not the case.

Action Plan

Managing through the COVID-19 crisis has stretched many nonprofits to their limits. Unfortunately, there is more to do, and the time to start is now.

Do Not Rush Forgiveness

We know that many nonprofits are anxious to file their forgiveness applications, get the PPP loan off their books and move on. But don't rush it! Congress has given you 24 weeks to spend the money and another 10 months to submit the application for forgiveness. Use this time to your advantage. The more forgivable costs a nonprofit incurs, the better off they are likely to be when the funding conundrum is resolved, particularly under possible scenario 3 (above). In that scenario, total costs would have to be reduced by grant-funded costs to arrive at forgivable costs. So only non-grant expenses would qualify for forgiveness. The more non-grant expenses, the better.

We don't know where this is going. However, it's difficult to imagine a scenario where more time – and more expenses qualifying for forgiveness – is not beneficial except, perhaps, in a situation where there might be a significant reduction in full-time equivalent employees (FTEs) before the end of the Covered Period. But even if a nonprofit is concerned about a reduction in FTEs, they have nearly a year from the date of their PPP loan to elect an 8-week Covered Period. Using this time will give the nonprofits the benefit of significant hindsight in running the numbers.

Furthermore, delaying the formal request for forgiveness provides both more time for the issuance of definitive guidance and potentially defers the recognition of revenue. Further, delaying revenue recognition may lead to other benefits. (See *Consider the Accounting Treatment*, below.)

Reallocate Your Grant Budgets

Some federal and state agencies allow, or have revised their rules to allow, government grant recipients to reallocate their program budgets among different line items, with or without grantor agency permission. Take advantage of this opportunity by reviewing your program budgets and consider allocating costs away from line items that qualify for PPP loan forgiveness to other cost line items that may be underfunded.

Consider the Accounting Treatment

The accounting guidance that is emerging for PPP loan funds allows, generally, two alternative accounting treatments (for both nonprofits and for-profit businesses):

1. If an entity expects to meet the forgiveness criteria and concludes that the PPP loan represents, in substance, a grant that is expected to be forgiven, the entity may record the loan as a refundable advance. The advance would be recognized as income once there is reasonable assurance that it is probable the conditions for recognition have been met. (This is the accounting model promulgated by International Accounting Standards No. 20 and Accounting Standards Codification section [ASC] 958-605.)
2. Alternatively, regardless of whether an entity expects to repay the PPP loan, in whole or in part, it may account for the loan as a financial liability (debt). The debt remains a liability until the earlier of (a) when the borrower has been legally released, in whole or in part, or (b) the loan is repaid. (This is the accounting guidance under ASC 405.)

The second alternative, above, is generally thought to create a more formidable barrier to the recognition of income. This is likely the more appropriate accounting model for entities that receive a significant amount of government grant funding, as given what we know today, the amount of forgiveness, or any at all, is not assured. This accounting treatment has the advantages of both delaying revenue recognition and not linking revenue recognition directly to expenditures.

Government grantor agencies may have a difficult time clawing back PPP loan funds that have not yet been taken into income, which, at the very least, should delay the return of funds to the grantor. Furthermore, if a grantor agency intends to claw back PPP loan funds, it is unclear how they would do so if the revenue is not recognized in the same period as the grant expenses are incurred.

Be Proactive

We understand the nonprofit sector and the important roles it plays in our communities. Without the nonprofits to shelter the homeless, feed the hungry, educate our children, care for those who cannot care for themselves, and provide a whole range of other needed services, our communities would suffer greatly. Reach out to and support your industry associations, and reach out to your legislators at every level of government. Make sure your voice is heard and your plight is fully understood. Encourage swift and decisive action to address the snowballing issues and demand guidance and clarity.

Talk to Your Lenders – Now

The Paycheck Protection Program Flexibility Act of 2020 (the Flexibility Act) extends the minimum time for repaying the unforgiven portion of a PPP loan from two years to five years. But this extension is not automatic unless the PPP loan is dated June 5 or later. Borrowers need to ask for this extension of time. Also keep in mind that the five years is a minimum; the maximum maturity is 10 years. If there is a chance your PPP loan will not be completely forgiven, why wait? Start that discussion with your lender now.

A Word About For-Profit Government Contractors

While the focus of this article is the nonprofit sector, the same principles and concerns apply to any business that does work for the government under any type of cost-plus arrangement. Many of the above action steps apply to these businesses as well.

In Conclusion

Uncertainty, and the stress that goes along with it, continues to plague both nonprofit and for-profit businesses that rely on the federal, state or local governments for a portion of their funding / revenue. While the path forward remains clouded with ambiguity, we urge you to be thoughtful about how you move forward and to be proactive in helping to shape your future.

Contact Us

As always, for further guidance and assistance, please reach out to your PKFOD engagement team members, or Bruce L. Blasnik, CPA, CGMA, Partner at LoanForgiveness@pkfod.com. We are here to help.

About PKF O'Connor Davies