

Should You Return or Turn Down the PPP Loan?

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SBA Issued FAQ 31 April 23

- FAQ 31 likely was a response to the negative publicity about public companies and private banking clients receiving both PPP loans and preferential “front-of-the-line” treatment.
- Unfortunately, the guidance in the FAQ will have unintended consequences for many borrowers.

<https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

FAQ 31 stated the following:

- PPP loan recipients who have not faced COVID-19 crisis **liquidity problems** and **economic harm** were not PPP-eligible borrowers.
- Anyone who received PPP funds has until **May 7** to return unneeded funds without violating the “good faith” certification (statutory certification) made about suffering economic harm.

The *statutory certification* to which the FAQ 31 refers to is a needs-based test, which all PPP loan applicants must sign states the following:

- **Current economic uncertainty** makes this loan request necessary to support the ongoing operation of the Applicant.”
 - Until now, this has generally been interpreted as COVID-19 causing significant current or prospective economic harm due to materially reduced revenue and operations that would likely lead to layoffs or a similar interpretation.

The *statutory certification* to which the FAQ refers to is a needs-based test (continued):

- FAQ 31 has changed this with **two highly subjective tests**, nowhere to be found in the statute, involving a borrower's undefined level of “**current business activity**” and “**ability to access other sources of liquidity.**”
- The lack of definition will be problematic for many current and prospective PPP borrowers.

Questions

- If a local wine store was weathering the COVID-19 pandemic with no trouble, it is fairly clear that it could not make the economic harm certification
- The dry cleaner next door whose revenue had seriously declined could.
 - But has it declined enough to now meet this vague new “current business activity” standard?
 - In addition, do the dry cleaner’s owners have to put their personal savings into the business as an available “source of liquidity” before taking a PPP loan?

Questions

- Does a 501(c)(3) whose revenue programs and fundraising gala were cancelled due to COVID-19 have to return PPP funds because it didn't spend down "other sources of liquidity" reserves it may or may not need for the recovery?
- Does an independent contractor whose revenue has evaporated due to COVID-19 become PPP-ineligible because he prudently has liquid resources saved for retirement?
- What is the bright-line test to determine if spending a liquidity source is or is not "significantly detrimental to the business?"

Questions

- What level of “current business activity” is required for a PPP loan?
- Who will evaluate or adjudicate the facts and circumstances around these tests, which will be unique for each entity?
- For both small businesses and 501(c)(3)s, existing sources of liquidity will likely be vital after the PPP ends and the economy slowly opens again.
- The wording of the “current economic uncertainty” certification could have been clearer, but those who have become familiar with PPP’s rules generally understand it to mean that a borrower is suffering or will likely suffer meaningful economic harm as a result of the crisis.

Initial SBA Q&A

- **Do I need to first look for other funds before applying to this program?** No. We are waiving the usual SBA requirement that you try to obtain some or all of the loan funds from other sources (i.e., we are waiving the Credit Elsewhere requirement).
- This Q&A **does not state that an entity must assess its** (per FAQ 31) **“ability to access other “sources of liquidity”** that are not “credit elsewhere sources” before being PPP-eligible. In fact, **the FAQ 31 requirement seems like a close cousin to the “credit elsewhere” requirement that the PPP statutory provisions expressly set aside for PPP loans.**

Questions

- Another unanswered question is the extent to which business owners' assets outside the business are an “other source of liquidity” under FAQ 31.
- Entities accepting PPP funds would be wise to prepare at least a **brief written analysis, possibly including projections, covering their reasons for meeting the FAQ 31 tests**, as subjective as such an analysis might need to be.
- One approach is to prepare three scenarios—one best-case, one worst-case, and one in-between—for the economic recovery and project how using an entity's other sources of liquidity would or would not be “detrimental to the business.”

Example of Evaluation of FAQ 31

	A	B	C	D	E	F	G	H	I	J	K	L	M
19	Statement of Operations - Forecast					COVID 19 Forecast based on Current Business Activity							
20				March		April	May	June	July	August	September	Total	
21													
22	Sales			1,000,000		700,000	650,000	650,000	700,000	800,000	850,000	4,350,000	
23				Historical		Forecasted	Forecasted	Forecasted	Forecasted	Forecasted	Forecasted	Forecasted	
24	Cost of Sales												
25	Purchases			280,000		196,000	182,000	182,000	196,000	224,000	238,000	1,218,000	
26	Labor (1)			240,000		240,000	240,000	240,000	240,000	240,000	240,000	1,440,000	
27	Depreciation			25,000		25,000	25,000	25,000	25,000	25,000	25,000	150,000	
28	Rent			30,000		30,000	30,000	30,000	30,000	30,000	30,000	180,000	
29	Other			65,000		65,000	65,000	65,000	65,000	65,000	65,000	390,000	
30			Total Cost of Sales	640,000		556,000	542,000	542,000	556,000	584,000	598,000	3,378,000	
31			Gross Profit	360,000		144,000	108,000	108,000	144,000	216,000	252,000	972,000	
32	Sales, General & Admin												
33	Salaries (1)			175,000		150,000	150,000	150,000	150,000	150,000	150,000	900,000	
34	Marketing			50,000		50,000	50,000	50,000	50,000	50,000	50,000	300,000	
35	Depreciation			5,000		5,000	5,000	5,000	5,000	5,000	5,000	30,000	
36	Other			45,000		45,000	45,000	45,000	45,000	45,000	45,000	270,000	
37			Total Sales, General & Admin	275,000		250,000	250,000	250,000	250,000	250,000	250,000	1,500,000	
38			Operating Income	85,000		(106,000)	(142,000)	(142,000)	(106,000)	(34,000)	2,000	(528,000)	
39													
40	Interest Expense			(25,000)		(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(25,000)	(150,000)	
41	Net Income			60,000		(131,000)	(167,000)	(167,000)	(131,000)	(59,000)	(23,000)	(678,000)	
42													
43	Computation of Net Cash Provided (Required)												
44	Net Income			60,000		(131,000)	(167,000)	(167,000)	(131,000)	(59,000)	(23,000)	(678,000)	
45	Depreciation			30,000		30,000	30,000	30,000	30,000	30,000	30,000	180,000	
46	Accounts receivable (2)			-		(75,000)			(50,000)	(50,000)	(0)	(175,000)	
47	Accounts payable (3)								14,000	28,000	14,000	56,000	
48	Cash Flow Provided (Required) from Operations			90,000		(176,000)	(137,000)	(137,000)	(137,000)	(51,000)	21,000	(617,000)	
49	Principal Debt Payment			(20,000)		(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(120,000)	
50	Net Cash (Required) Provided			70,000		(196,000)	(157,000)	(157,000)	(157,000)	(71,000)	1,000	(737,000)	
51													
52	(1)	Assumes NO reduction in FTE's											
53	(2)	This adjustment would represent either a significant slowdown in collections of receivables due to COVID-19 or Sales Terms Net 30											
54													
55	(3)	Assumes Accounts Payable Terms of Net 30											
56													

Example of Evaluation of FAQ 31

	A	B	C	D	E	F	G	H	I	J	K	L
1	ABC Company											
2												
3	PPP Funding											
4				Gross Payroll		Multiplier	Loan Amount					
5			Computation of PPP Loan Amo	\$ 340,000		2.5	\$ 850,000					
6												
7	Summary of Additional Source of Funds (Required) or Excess											
8	Source of Funds											
9			Cash as of March 31, 2020			50,000						
10			Line of Credit Available as of March 31, 2020			250,000						
11			Estimated Additional Sources of Funds (1)									
12			Total Source of Funds			300,000	+					
13												
14			Net Cash (Required)	<i>From cell L50</i>		(737,000)	+					
15			Additional Funds (Required)			(437,000)	=					
16												
17	(1) This may be additional debt available from current lender or possibly additional funds from other sources. Needs additional guidance											
18												



Disclaimer - This spreadsheet is designed to provide a potential example of performing a FAQ 31 evaluation of "current economic uncertainty" certification. This is based on the Current Business Activity and Sources of Funds. As of 5/5/20 there are still a number of questions in addressing the Certification. Also, this analysis is based on the best information at the time of requesting the PPP Loan.



Unanswered Questions:

- SBA FAQ 31 has created new PPP loan qualification standards that were not envisioned until its issuance
- Leaving many open questions that require answers for entities that seemed clearly entitled to PPP funding.
- If the SBA does not quickly provide clarification, many entities with significant COVID-19 revenue losses that received PPP loans but also have internal or external “sources of liquidity” may believe they now have to return the funds.

If you have further questions please
contact your BGM professional

or

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