

Small Business Administration’s Paycheck Protection Program Documentation Tips for Borrowers

This document has been prepared by our legal counsel, but should not be considered legal advice. All borrowers are encouraged to seek advice from their own independent legal counsel.

The following list of tips is a tool for our customers that we are providing as a courtesy due to certain changes to the Frequently Asked Questions (“FAQs”) issued by the U.S. Small Business Administration (“SBA”) with respect to the required borrower certifications for the Paycheck Protection Program (“PPP”). Specifically, applicants for the PPP are required to certify that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant” (this is referred to as the “Economic Uncertainty Certification”).

Subsequently, the U.S. Treasury (Treasury) and the SBA expressed concerns about public companies or “large companies with adequate sources of liquidity” (this is referred to as the “Liquidity Test”) obtaining PPP loans. The SBA has created significant uncertainty for all PPP borrowers by issuing a FAQ purporting to relate this new standard to all “private companies with adequate sources of liquidity to support the business’s ongoing operations.” Note that at this time there is no indication that the SBA or Treasury is suggesting businesses should consider personal sources of liquidity of owners with respect to the Liquidity Test.

The SBA’s latest interim final rule (“Rule”) supplementing the PPP creates a limited safe harbor for borrowers who feel they can no longer make the Economic Uncertainty Certification as a result of updated guidance and new rules issued by the SBA. In light of the new Rule and recent SBA guidance, if you believe that you are no longer eligible for a PPP loan, the SBA has established a relatively short “no questions asked” deadline to return the funds without subjecting borrowers to any liability. This change creates a limited safe harbor for any applicants that repay the loan in full by **May 14, 2020** – borrowers who return PPP funds prior to this date will be deemed to have made the economic uncertainty certification in good faith. The tips outlined below may assist you in deciding whether to return PPP funds prior to May 14, 2020.

While we are eager to assist our small business customers during this time of crisis, we feel compelled to advise you that acceptance of your PPP loan application and/or funding of your PPP loan does not constitute, and cannot be relied on as implying, a conclusion or affirmation from us that such PPP loan proceeds are necessary for ongoing operations of your business or that you have otherwise met the applicable eligibility requirements for participation in the PPP.

1. General

- Please keep in mind that the decision of whether or not to return (or apply for) PPP funds is a business decision that must be made by the borrower based on each businesses specific facts and circumstances experienced as a result of the current crisis.
- The initial rules and guidance for the PPP, as well as public comments from the SBA and Treasury officials, indicated that the significant uncertainty created by the current crisis implied that essentially

any small business could make the Economic Uncertainty Certification in good faith. Unfortunately, this appears to no longer be the case.

- With the Liquidity Test, the SBA is seeking to add, on a retrospective basis, new measurements for PPP eligibility.

2. Recommended Steps Borrowers Should Take to Support Certifications

If a borrower believes it can continue to make the required certification in good faith, borrowers are strongly advised to work with their CPAs, lawyers or advisors in creating a record supporting the Economic Need Certification. Specifically, the following non-exhaustive list of practices may assist borrowers and their advisors in supporting that the borrowers made the required certifications in good faith:

- Identify and segregate records relevant to the two elements of necessity under the new guidance: “*current business activity*” and “*ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.*” (Emphasis added).
 - Again, for the current business activity analysis, businesses should work with their accountants to develop documentation addressing how the borrower’s operations changed after the current economic conditions in the wake of the civil orders responding to the COVID-19 pandemic, including:
 - impact on revenues,
 - reductions in prices,
 - order reductions,
 - deferral of expansion plans,
 - layoffs,
 - furloughs,
 - potential hiring freezes, and
 - any other relevant records.
 - For the liquidity analysis, borrowers and their advisors may want to prepare to address questions about:
 - what cash reserves they had;
 - their ability to draw down on lines of credit;
 - their history of prior credit line draws;

- their uses of cash preceding submission of the loan application (e.g., compensation);
- the need for such other liquidity to cover expenses or investments not paid from PPP proceeds;
- their access to capital from related parties; and
- available forbearance or deferral options from landlords, suppliers, lenders and others that may have provided options for relieving pressure on operating cash requirements.

If other sources of liquidity were available, borrowers should document how and to what extent accessing such liquidity would be “significantly detrimental to the business.” Businesses should make the case that furloughing or cutting employees would have been the result if it was not for the PPP loan, identifying how accessing any alternate sources of liquidity was not a sound business option. The crisis has created significant uncertainty that businesses should be able to justify saving certain sources of liquidity for beyond an eight-week period.

As noted above, at this time borrowers should be assured that the SBA will respect the corporate entity and not expect businesses to include personal liquidity sources of the owners of businesses.

- Collect and maintain documentation concerning support that the certifications were correct. For example, borrowers could review industry data, speak to their legal counsel, communicate with their accountants or other advisors, develop and maintain records of order cancellations, analyses of lost revenues and projected losses, employee count records, internal estimates or reductions in payroll, capital, inventory and other operating expenses (including revised forecasts and budgets)—among other records—that the borrowers examined at the time of filing the loan application to determine financial capacity, outlook and the impact the current economic crisis may have on them.
- In light of the safe harbor and new guidance, borrowers may want to reperform the analysis of the initial need for a PPP loan and maintain all documents related to decisions whether to repay or retain.
- Borrowers may want to examine any internal communications, including with board members, and external communications with landlords, investors and other third parties around the time the loan was applied for, and after that time, to identify any statements that may be considered inconsistent with the determination of necessity or other certifications.
- Borrowers should continue to follow all typical corporate governance procedures and documentation of compliance with such procedures. For example, approvals and other decisions by the board of directors should be documented by minutes and the supporting information supplied to the board to make any decisions should be maintained.
- Borrowers should establish processes to identify and document their assessment of actual and potential economic challenges that they face and establish how loan proceeds were spent.
- Borrowers who have not yet received loan disbursements, and even those who have, should consider establishing a separate bank account for loan proceeds and document how funds in the account were applied to qualified expenses, *e.g.*, payroll, rent, and interest.

3. Auditing

- The Treasury and the SBA announced that all PPP loans in excess of \$2 million, and a random sample of loans under \$2 million, will be audited by the federal government. There has been no additional guidance on the full extent of auditing or other details providing any insight on the auditing process.
- The Treasury announced that PPP loans under \$2 million will be audited on a random basis and that the auditing will be focused on borrower certifications, but there is no guidance on the extent of such random auditing or additional guidance on other details providing any insight on the auditing process.
- The SBA has not provided any guidance on what audits may consist of, when audits will commence, or what types of alternate funding sources it will deem to have been adequate so that a business could not have made the Economic Need Certification in good faith.

4. Returning Funds

- Borrowers who no longer believe that they can make the Economic Uncertainty Certification in good faith, as well as borrowers who are no longer comfortable with the lack of adequate guidance, may repay the loan in full by May 14, 2020, and will be deemed to have made the initial certification in good faith even if they can no longer do so based on updated guidance and new rules.
- The SBA has stated that it will not ask borrowers any questions who decide to return the funds prior to the May 14, 2020 deadline.
- We understand businesses may have used PPP funds for eligible payroll and business expenses, but borrowers will be required to repay the loan in full if they want to receive protection under the SBA's limited safe harbor by returning funds before the May 14, 2020 deadline.
- Unfortunately, borrowers that wish to return PPP funds will be required to repay accrued interest on returned funds. Interest at the rate of 1% annually began to accrue on the date the loan was disbursed. If you are interested in an estimate of accrued interest, please contact us and we will provide an estimate of accrued interest as of a specific date.

5. Forgiveness

- The Treasury and the SBA have yet to release the specific details of what will be required from borrowers to obtain forgiveness of the PPP loans. Following the steps listed above may allow businesses to start preparing some of the documentation that will potentially be required for the loan forgiveness process. Please note that this is merely a recommendation as we will not know what is required until the SBA releases official guidance.
- While the SBA has not provided final guidance on the forgiveness process. The SBA has previously described certain items that will be required for forgiveness, such as (i) documentation verifying the number of full-time equivalent employees on payroll and pay rates for the covered periods, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings, and (ii) documentation, including cancelled checks, payment receipts, transcripts of accounts, or other

documents, verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments.

- Considering the evolving standards of the SBA and Treasury, borrowers should be prepared to take additional steps as described above even though these steps are beyond what has been officially announced as what is required to obtain full forgiveness of any PPP loans. Again, we are providing this non-exhaustive list of tips as certain best practices that may assist certain borrowers.

6. Closing/Follow-up Guidance

- The SBA continues to release new guidance and rules on an almost daily basis and there is no way to predict what changes or clarifications may come next. Please continue monitoring for new information as it is made available by the SBA and Treasury.
- The SBA generally provides updated information on the agency's website at: www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program
- We feel obligated to reiterate that the determination of whether you can make the required certifications is a business decision and is not one we can make on your behalf.

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