

## Companies Receiving PPP Funds Should Prepare for Audits, and Implement Compliance Now

Treasury Secretary Steven Mnuchin issued a warning on the heels of the second funding of the federal Payroll Protection Program (PPP) that large or public companies will be audited if they received a loan under the program. Moreover, he said that they will be subject to criminal liability if it turns out that they were not eligible to apply for the relief money because they did not have *financial need* for the funds. Applicants for PPP funds are required to certify that the funds “are necessary to support the ongoing operations” of the business. Further to this requirement, companies that have received federal relief funds under the PPP should anticipate an audit and take steps now to ensure their compliance with program requirements.

Even smaller and private companies that obtained PPP funds are subject to audit by the Small Business Administration (SBA) or the lender through which they applied for the funds if they are seeking forgiveness of loan funds. Loans up to \$10 million will be forgiven if not more than 25 percent of the funds are used for allowed expenses other than employee payroll expenses. Implicit in this qualification is that federal agency or lending officials will audit at least some, if not all, borrowers seeking loan forgiveness to determine if they have met the use of funds requirements.

In addition, federal program officials have greatly emphasized the likelihood of audits in connection with dissemination of the second round of funding. Following the first round of funding, there was a groundswell of public dissatisfaction that large chain businesses and big companies were able to obtain federal financial assistance that was intended to assist small businesses in keeping people employed while weathering COVID-19-induced closures and limitations. In the days leading up to the release of the second tranche of funding, and in an apparent effort to dissuade big companies with access to other sources of capital from applying, the Treasury Department and the SBA stated that only companies without access to alternate forms of debt or equity financing would qualify.

The second round of PPP funding became available on Monday, April 27, 2020. A day later, Secretary Mnuchin pronounced that the Treasury Department would conduct comprehensive audits of businesses that received more than \$2 million in federal relief funds, with spot checks of those that received less. Simultaneously, the Treasury Department Secretary said that big companies who applied for the loans but might later determine that they did not meet the financial need standard would be given a safe harbor — the government will not prosecute them for fraudulently applying for the loans if they return the money by May 7, 2020. In the wake of that announcement, many, but far from all, of the hundreds of large and public companies that disclosed that they had obtained funds under the program, have returned those funds.

As a result of audit efforts, federal investigators and prosecutors are likely to uncover at least some businesses and individuals that intentionally falsely certified that they needed the loan monies or that they would use them to support business operations, as required by the PPP application form. The SBA, federal Treasury, CARES Act inspector general, or the FBI all have authority to investigate any wrongdoing related to the program. Assistant Attorney General Brian Benzowski, who is in charge of the Department of Justice Criminal Division, has said that DOJ already has many leads and is investigating individuals and companies that may have engaged in fraud in connection with obtaining relief funds.

Even companies that have applied for and received funds properly should be prepared to demonstrate their compliance with PPP and SBA rules in any subsequent audit. The SBA will forgive the loans if at least 75 percent is used for employee payroll costs. The remainder of the funds can only be used for certain authorized types of expenses, like rent, mortgage payments, and certain utilities expenses. In order to ensure that these requirements are met, and to determine



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whether a recipient of program funds is entitled to have their loan forgiven (or otherwise be subject to repayment at a one percent interest rate), their lending institution or the SBA must make that determination. A fact-specific determination of that nature is certain to involve a detailed review of company records.

Consequently, companies that have received PPP loans should take certain steps to ensure that their receipt and use of those funds are subject to internal due diligence and should prepare in advance for potential external audit:

- At the outset, companies should take care to confirm that they had the requisite financial need that entitled them to the funds at the time of their application. Particularly those that are large, public, or have clear access to other funding sources should anticipate review and should consider resolving doubt in favor of returning loan funds.
- Companies should also ensure their uses of program funds support business operations and are consistent with program rules.
- Businesses should ensure — through an internal accounting, audit, or compliance function, that expenditures are allowable under the program and are properly authorized pursuant to internal company approval policies and procedures.
- If a company's intent is to seek loan forgiveness, PPP funds should be expended only for items and in proper proportions prescribed by the program for forgivable loans. Care should be taken with respect to every payment that program funds are not inadvertently used for a purpose or in an amount outside the strict formula for loan forgiveness.
- Expenditures must be accurately recorded in company books and records.

Pursuant to the PPP rules, the federal government made it easier than in most commercial settings to obtain business loans, but included restrictions that require considerable diligence after receipt of the funds. Taking these steps now will help avoid problems later if and when a company is audited, including denial of a request to forgive the company's PPP loan, discovery of disallowed uses of funds, or, even worse, activity that federal enforcement officials believe is unlawful.

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