

August 23, 2020

Dear Friends and Colleagues,

We are approaching the end of August, and most of the major lenders are still not accepting forgiveness applications for the Paycheck Protection Program Loans. The reason for this is twofold: one, the SBA is still doing some final tinkering to the forgiveness rules and requirements; and two, lenders are hopeful that legislation will soon pass automatically forgiving the smaller loans without the application process. (Automatically forgiving all loans under \$150,000 would eliminate the application process for close to 3.9 million loans, about 86% of total.)

Regardless of which path you end up taking, it is best to be prepared.

What to expect

In preparation of the application process, there are basically three “tests” that your business needs to pass to get loan forgiveness.

The first involves proving that the funds you received were spent correctly. At least 60% needs to have been used on payroll related items, and under 40% needs to have been spent on non-payroll related costs.

The second test involves proving that your employee head count stayed the same or increased over this period. Small businesses will not be penalized if employees refuse to come to work, were terminated for good cause, left voluntarily, or cut their hours voluntarily. Even if you are short, you have time to correct this in the coming months.

The third test is to prove that you didn’t cut salaries or hourly rates for any of your employees during this period.

Qualifying for the SBA Form 3508EZ

Borrowers can apply for PPP loan forgiveness using the simplified application if **one** of these three statements applies:

- The borrower is a self-employed individual, independent contractor, or sole proprietor who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the original PPP loan application;

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- The borrower did not reduce the annual salary or hourly wages of any employee by more than 25 percent during the Covered Period; and the borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. (Again, reductions can be ignored if employees refused to come to work, were terminated for good cause, left voluntarily, or cut their hours voluntarily;
- The borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period; and the borrower was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with safety or governmental requirements (such as the closing of a non-essential business, or reduction in services because social distancing requirements).

Documentation to have prepared

Request specifics from your lender, but here is a summary of the documents you should have at your fingertips during the application process:

- Payroll reports for the period in question;
- Payroll registers listing employee compensation for period in question;
- Federal Form 941s for the period in question;
- State filings which shows state and local taxes assessed on an employee's compensation (i.e. SUTA) for the period in question;
- For organizations that were in business, payroll registers for the period beginning Feb. 15, 2019 through June 30, 2019, and Jan. 1, 2020 to Feb. 29, 2020;
- Group health care benefits documentation and proof of payment showing total costs paid for all health care benefits, excluding owners;
- Retirement plan benefits documentation showing the sum of all retirement plan funding costs paid by the organization, including owners;
- Proof of payment and invoices for all non-payroll related costs claimed.

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The Process

Once the application is submitted, the lender will have 60 days to approve the loan forgiveness in its entirety or in part. Once done, the lender will submit the application and documentation to the SBA for its own review. The SBA will then have 90 days to complete this process. It can either agree with the lender's recommendation, ask for additional documentation, or approve only partial forgiveness. If it is the latter, then the borrower will have five years to repay the balance at an annual interest rate of 1%.

Accounting for all of this

Step 1 - Let's assume the PPP Loan is \$200,000. This should be entered as a deposit into your checking account, and the other side should be entered as a Long-Term Liability: "PPP Loan." Remember, until this loan is officially forgiven, the business owes this money back to the government, which makes it a liability. The repayment process is over one year, which makes it a long-term liability.

Step 2 – The expenses that this \$200,000 are spent on should be recorded in the typical manner done by the business in the past. For instance, payroll should be recorded as it always has, using the same categories/chart of accounts. Rent should be recorded as rent, health insurance should be recorded as health insurance, etc. This will keep your financial statements consistent with prior years and will allow you to monitor costs and benchmarks during this unique period.

Step 3 – If the loan is entirely forgiven, you will reduce the "PPP Loan" category by \$200,000, and record the other side to "Other Income/Expense", which is a category at the bottom of your profit and loss. This account is meant for unusual or one-time-only items. The forgiven amount should not be recorded as revenue or a similar category that implies it was earned through typical business operations. This is for two reasons: it will distort your true business results and, if you pay any tax based on gross receipts, it will inflate that amount.

If the loan is partially forgiven – let's say \$180,000 - you will reduce the "PPP Loan" category by \$180,000, and record the other side to "Other Income/Expense". This will leave you with a loan balance of \$20,000, which the business would begin to pay down based on the final repayment terms.

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Should you have any questions about the above, please feel free to contact our office at any time.

Sincerely,



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