

LEGAL UPDATES

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PPP Loan Audits Could Affect Millions of Borrowers

WHAT YOU NEED TO KNOW ABOUT AUDITS, REPAYMENT, AND COLLECTIONS

Key points

In March of this year, the SBA began referring around \$20 billion in delinquent PPP Loans with balances of less than \$100,000 to the Treasury Department for collection, and another 10,000 delinquent PPP Loans involving higher balances have already been submitted.

There is growing concern among PPP Loan recipients of potential audits related to the SBA's Office of Inspector General's estimate that up to one-third of PPP Loans showed signs of potential fraud. The SBA is authorized to audit all PPP Loan borrowers' compliance with the eligibility and other requirements established at the time of a borrower's application or related to the terms of a borrower's application.

In March 2020 during the height of the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law establishing, among other things, the Payment Protection Program (PPP) administered by the Small Business Administration (SBA). Funds administered under the PPP (PPP Loans) were to be used by small businesses and nonprofits facing financial hardships during the pandemic. More than 11.5 million PPP Loans were issued to millions of borrowers, with some borrowers receiving the maximum PPP Loan amount of \$10 million. If borrowers used at least 60% of their PPP Loan to cover payroll expenses within eight weeks—or

an optional 24 weeks for some loans—after receiving the PPP Loan, they are eligible for loan forgiveness. In December 2020, the Economic Aid to Hard-Hit Small Business, Nonprofits, and Venues Act revised certain PPP loan requirements. Specifically, the act gave borrowers the option to elect a 24-week window to cover 60% of payroll expenses.

For businesses ineligible for forgiveness, these loans are now coming due. The SBA has referred more than 10,000 delinquent PPP Loans with balances over \$100,000 to the Treasury Department for collection, and in March began referring around \$20 billion in delinquent PPP Loans with balances of less than \$100,000 to the Treasury Department for collection.

As PPP Loans received by small businesses are submitted for collections, there is growing concern among PPP Loan recipients of potential audits related to the SBA's Office of Inspector General's estimate that up to one-third of PPP Loans showed signs of potential fraud. In addition, the recent investigations related to fraudulent Employee Retention Tax Credit (ERC) claims following the Tax Bandits scheme run by an inmate out of a prison in California has drawn further attention to the potential audit of businesses who received economic relief during the height of the COVID-19 pandemic. The ERC is a tax credit program implemented to assist eligible businesses in retaining employees by providing a refundable payroll tax credit. Pursuant to the Consolidated Appropriations Act of 2021, businesses can qualify for both a PPP Loan and ERC. Borrowers who obtained both a PPP Loan and ERC should be prepared for the possibility of audits as the SBA is placing an emphasis on businesses involved in both programs.

The SBA has broad authority to audit loan recipients to ensure compliance and eligibility.^[1] According to the Interim Final Rule, the SBA is authorized to audit all PPP Loan borrowers' compliance with the eligibility and other requirements established at the time of a borrower's application or related to the terms of a borrower's application. These audits entail an investigation into whether the borrower accurately calculated its PPP Loan amount eligibility, whether the PPP Loan funds were used in accordance with the CARES Act (i.e., the portion of the funds used for payroll costs vs. non-payroll costs), and the borrower's eligibility for forgiveness based on the information provided in the borrower's application for forgiveness.

If the SBA decides to conduct such an audit, it will send written notice to the lender, who shall provide notice to the borrower of the audit within five business days. In an effort to eliminate potential delays in the audit process, we suggest PPP Loan borrowers work with their attorneys to begin compiling the documentation likely to be requested during the audit process, which includes:

All borrower's records from the date of receipt of the PPP Loan, and for a period of six years after the PPP Loan was repaid or forgiven.

Copies of all PPP Loan documentation, including (i) the initial PPP Loan application with calculations of the borrower's employee headcount and compensation, (ii) the PPP Loan forgiveness application and all documentation submitted therewith, together with relevant calculations and documentation related to potential forgiveness.

All internal documents and correspondence related to the PPP Loan, including any resolutions or consents to the borrower's receipt of the PPP Loan, meeting minutes, any plans or discussions regarding the use of the funds, and correspondence, agreements, and any other documentation approving, consenting to, or otherwise relating to the borrower's PPP Loan.

All financial records of the borrower relating to and evidencing the borrower's lack of access to other forms of funding and demonstrating the borrower's need for access to funding via the PPP Loan.

Copies of all receipts and documentation relating to non-cash payroll/compensation expenses, including the borrower's contributions to its employees' health insurance, retirement plans, and other benefits, and amounts paid for taxes.

Copies of all borrower's correspondence with its PPP Loan lender.

If a borrower fails to respond to an SBA audit inquiry, the SBA may determine that the borrower was ineligible to receive the PPP Loan, ineligible to receive the amount of the PPP Loan, or ineligible for the loan forgiveness amount claimed by the borrower and may seek repayment of the outstanding PPP Loan balance or pursue any other available remedy. Additionally, following an audit of the borrower's PPP Loan, if the SBA reaches a final loan review decision that is unfavorable to the borrower, the borrower has 30 calendar days to file an appeal with the Office of Hearings and Appeals (OHA). Our firm stands equipped to represent borrowers and lenders in an OHA appeal following an adverse SBA decision related to a PPP Loan audit.

In a recent push to address the financial fraud linked to the pandemic, the White House and key Senate Democrats—including Majority Whip Dick Durbin, Sen. Gary Peters, and Sen. Ron Wyden—have proposed legislative efforts to reclaim funds obtained illicitly through pandemic aid initiatives such as the Paycheck Protection Program. The proposed bill allocates significant funds to combat identity fraud, expand the Department of Justice's COVID-19 fraud task forces, and empower the inspectors general of both the SBA and the Department of Labor to identify and recover funds lost to pandemic-era fraud. Despite bipartisan concerns regarding exploitation of the programs, the bill's journey toward enactment remains uncertain as similar proposals have previously failed to secure the necessary support in Congress.

Contact us

Our firm continues to monitor developments in Congress and the White House related to the PPP program to provide ongoing assistance in this critical area. If you have any questions related to PPP Loans or other pandemic aid initiatives, please contact Kyle Gilster, Mallory Lewis, Jordan Beck, or your Husch Blackwell attorney.

[1] “For a PPP loan of any size, SBA may undertake a review at any time in SBA’s discretion. For example, SBA may review a loan if the loan documentation submitted to SBA by the lender or any other information indicates that the borrower may be ineligible for a PPP loan, or may be ineligible to receive the loan amount or loan forgiveness amount claimed by the borrower,” per the Interim Final Rule published in Vol. 86, No. 23 of the Federal Register on February 5, 2021 (IFR), amending the prior interim federal rules (85 FR 33010, 85 FR 38304, and 85 FR 66214).