



## Now That You Received Paycheck Protection Program (PPP) Funds

April 27, 2020

Dear Valued Client,

Now that you submitted the Paycheck Protection Program (PPP) application, it is time to consider the potential loan forgiveness and what to do over the next 8 weeks. The Mueller COVID-19 Response Team put together the following guide to help with the next steps in the process. These are general rules, for any detailed questions on loan forgiveness please discuss with your Mueller representative.

### 1. Know The Rules

While certain parts of the forgiveness calculation are expected to be updated through future guidance, it is time to learn the general rules. You will qualify for loan forgiveness if you use the proceeds on specifically 'covered expenses' over the 8 weeks starting the day the loan is funded. These covered expenses include payroll costs, covered rent, covered mortgage interest payments, and covered utilities. It is expected that at least 75% of the proceeds need to be used on payroll costs in order to qualify for full forgiveness.

Payroll costs should use the same calculation as used in the PPP loan application and include gross wages, employer retirement contribution, employer health benefit expenses, and state unemployment taxes. Rents, mortgage interest, and utility payments all had to be in place on February 15, 2020. While funds can be used on other types of loan interest, these amounts will not be forgiven. Utilities mean payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access.

For more details on 'Covered Expenses', see the Small Business Administration guidance over the definitions of the covered expenses ([link](#)):

- Mortgage interest payments (but not mortgage prepayments or principal payments) on any business mortgage obligation on real or personal property
  - e.g., the interest on your mortgage for the warehouse you purchased to store business equipment or the interest on an auto loan for a vehicle you use to perform your business
- Business rent payments
  - e.g., the warehouse where you store business equipment or the

vehicle you use to perform your business

- Business utility payments
  - e.g., the cost of electricity in the warehouse you rent or gas you use driving your business vehicle

You must have claimed or be entitled to claim a deduction for such expenses on your 2019 Form 1040 Schedule C for them to be a permissible use during the 8 week period following the first disbursement of the loan (the “covered period”).

## **2. Understand The Two Calculations That Reduce Forgiveness**

There are two primary methods to determine reduction to forgiveness: reduction in headcount (Full Time Equivalents or FTEs) and reduction by more than 25% in wages of employees earning less than \$100,000.

To determine reduction in headcount, calculate the average number of FTEs during the covered period. The exact definition of FTE is not yet clear and guidance is expected. However, a general rule is to count 40 hours per week as one FTE. If a part time employee works 20 hours in a week, for example, that would be 0.5 FTE.

Compare the covered period average to the average number of FTEs in one of two stated periods:

1. February 15, 2019, and June 30, 2019  
OR
2. January 1, 2020, and February 29, 2020

The forgiveness is reduced by the ratio of any reduction in FTEs. For example, if there were 100 average FTEs from the listed 2019 period and 90 in the covered period, the amount of loan forgiveness will reduce by 10%.

The second calculation that reduces forgiveness involves comparing wages of employees earning under \$100,000 pro-rated in the 8 week covered period to a prior period of either 8 weeks or the previous quarter. While the legislation says to compare each employee’s pay during the 8 week covered period to the most recent full quarter, we expect more detailed guidance over the specifics of this calculation. This distinction affects this calculation as a quarter is 9.75 weeks while the covered period is 8 weeks. The legislation also says to exclude employees from this calculation, if the employee earned over an annualized amount over \$100,000 during any single pay period during 2019. We expect further guidance to make this point more clear.

There is an exception for the two calculations. If employees were terminated or wages reduced from February 15, 2020, to April 27, 2020, and this reduction is eliminated by June 30, 2020, these employees are not factored into the reduction calculations.

## **3. Estimate Expected Forgiveness**

Now that you know the general rules and calculations, estimate your expected forgiveness. Calculate expected payroll, rent, utilities, and interest expenses over the 8 week covered period. Use this calculation to determine if you will meet the 75% payroll requirement.

Calculate the number of FTEs in one of the two listed periods and estimate the number of covered period FTEs. Calculate the expected reduction in wages of

employees and compare them to the wages of these employees during the most recent quarter.

Please note that if you received an emergency grant through the CARES Act, the advance amount shall be reduced from the loan forgiveness amount.

Please see a Mueller representative for a forgiveness calculator tool.

#### **4. Save All Documentation Of Expenses**

There will be a second application submitted to the lender after the 8 weeks where loan forgiveness will be determined. It is critical to start tracking your covered expenses in an accounting record and saving all invoices and related contracts. While there is no requirement for a separate bank account to hold the funds, it is worth considering as a strong internal control.

#### **5. Accounting For Proceeds**

A common question is how to account for the funds for record keeping purposes. We expect more guidance from the AICPA on the accounting, although it is important to start a record now. We also recommend talking to your auditor, if needed. As the nature of the program is to cover payroll and certain other expenses, we recommend accounting for the proceeds as a new expense line called "PPP forgivable expenses" for internal record keeping purposes. Record the forgivable loan amount as one total as a contra expense. This would effectively eliminate the expenses paid for the 8 weeks to zero. If a company ends up with a loan amount, any unforgiven amounts can be reclassified to the PPP loan.

#### **6. Prepare Weekly Cash Flow Forecast For The Covered Period Plus Five Weeks, Then Each Quarter After**

Now that you have the PPP funds and estimated forgiveness, it is time for stage 2, which means planning for the 'New Beginning.' Uncertainty will continue for the indefinite future, so we recommend using a forecasting model to project weekly cash flow and track other key metrics during the covered period, then for each subsequent quarter through at least the end of 2020.

You are already tracking expenditures to determine loan forgiveness. Tracking your remaining expenses can help identify areas for cost improvement and breakeven points. If you need help putting together a model, reach out to a Mueller representative.

Sincerely,

**Scott Anderson, CPA**  
*COVID-19 Response Team Lead*  
Mueller  
[sanderson@muellercpa.com](mailto:sanderson@muellercpa.com)  
(630) 524-5259