

AUDIT RISKS FOR PAYCHECK PROTECTION PROGRAM BORROWERS

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Paycheck Protection Program (“PPP”) borrowers will face heightened scrutiny concerning their eligibility and use of funds. On April 28, 2020, the U.S. Small Business Administration (“SBA”) updated its [“Frequently Asked Questions \(FAQs\)”](#), outlining key compliance concerns.

Businesses that accept and use their PPP funds should expect some level of audit. The CARES Act [instituted a new oversight and enforcement agency](#) solely for this purpose, and Treasury Secretary Steven Mnuchin has [stated that the government will perform a full audit on any company borrowing more than \\$2 million](#). Traditional oversight and law enforcement agencies will participate as well.

If an audit turns up errors or misconduct, the business may be denied PPP loan forgiveness. Worse, the business and its stakeholders could face civil and even criminal penalties. Now is the time to verify that your PPP compliance is air-tight – and, if it is not, to return the money and avoid repercussions.

For its part, the SBA will likely target four dimensions of PPP borrower compliance:

1.Necessity

Did the business truly need the PPP funds? The major factor will be whether the business had alternative access to capital.

To be clear, for the sake of the PPP, the SBA officially removed the typical requirement that a business exhaust all other lending options before turning to the SBA.

Nevertheless, the FAQs indicate that public companies with liquidity will face the highest scrutiny. Similarly-situated private companies should expect to be audited as well. The SBA will likely penalize any business that already had sufficient cash reserves and/or projected only a limited impact from the COVID-19 crisis.

2.“Small business” qualification

As discussed in our prior posts, would-be borrowers from the PPP had to fit highly-specific size, affiliation, and/or industry restrictions in order to qualify.

The SBA’s affiliation rules create particular vulnerability. An affiliate’s employees must be included in the borrower’s headcount for purposes of qualifying for the PPP by size. Affiliation can be found by ownership (e.g., stock options and convertible securities), control (e.g., voting interests, management, veto-power, or agreements to merge), and family relationships.

The SBA will hunt for any miscalculations or misrepresentations in borrowers’ loan applications.

3.Loan amount

Similarly, PPP loan amounts were tightly correlated to borrowers’ historical payroll costs. Any potential miscalculation or misrepresentation in a business’s employee headcount or compensation will be heavily critiqued.

4.Use of funds

Borrowers who qualified for PPP funds must comply with usage restrictions in order to obtain loan forgiveness. Businesses should expect a thorough government inquiry as a prerequisite to forgiveness, including a review of expense documentation.



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Businesses must comply to avoid additional civil and criminal liability.

Oversight and law enforcement agencies have multiple tools in their arsenal to prosecute abuses of the PPP. Agencies are likely to make use of the civil False Claims Act (“FCA”), 31 U.S.C. § 3729 et seq., which prohibits retaining overpayments or avoiding an obligation to repay money to the federal government. The FCA does not require specific, fraudulent intent, but only a reckless disregard for the rules. Offenders and their conspirators (e.g., affiliates, banks, or brokers) may be liable for treble damages and per-claim penalties in excess of \$21,000. The FCA provides and compensates private-actor whistleblowing as well.

The government has criminal prosecution tools at hand as well. These include 18 U.S.C. § 1001 (false statements to federal officials), 15 U.S.C. § 645 (misrepresentation of size status), 18 U.S.C. § 1014 (false statements to a lending institution), 18 U.S.C. § 287 (criminal false claims), 18 U.S.C. § 1344 (bank fraud), 18 U.S.C. § 1341 (mail fraud), 18 U.S.C. § 1343 (wire fraud) and 18 U.S.C. § 371 (criminal conspiracy). Such counts see frequent use in other, SBA fraud cases and may be used in prosecuting abuses of the PPP.

Contact either of the authors to review your particular situation and determine next steps.

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