

Responding to SBA PPP loan audits: What we've learned

By J. Richard Kiefer

The Coronavirus Aid, Relief, and Economic Security Act created the Paycheck Protection Program, for which legislators ultimately appropriated \$806 billion. In its latest report, the Small Business Administration reports that it has approved PPP loans of just under \$800 billion. The SBA has also announced that it will audit all PPP loans of \$2 million or more, and it may audit other loans as it deems appropriate. Audits began earlier this year and are expected to continue into next year.

If the SBA determines in an audit that a borrower was eligible for the full amount of its PPP loan and that it spent the loan as authorized by the CARES Act, the SBA will forgive the loan and pay the lending bank the full amount of the loan plus interest. If, however, the SBA determines that the borrower was not eligible for the PPP loan, was not eligible for the entire amount of the loan or did not spend any or all of the loan proceeds as authorized by law, it can require the borrower to repay all or a portion of the loan, with interest. Worse, if the SBA suspects fraud, it will refer the borrower to the Department of Justice for potential criminal prosecution. To date, the DOJ has brought over 300 indictments and has obtained over 60 convictions for PPP loan fraud. These prosecutions may be the tip of the iceberg. The deputy chief of the DOJ Fraud Section in Washington, D.C., told us recently that they have a "huge backlog" of PPP loan fraud cases to investigate and prosecute, and United States attorneys' offices throughout the country report similar backlogs. Now that the FBI and other agents are back to work from COVID-19 furloughs, the number

of criminal investigations and prosecutions will likely skyrocket.

SBA audits of PPP loans thus create both significant risks and offer tremendous potential rewards to borrowers. But the SBA has given little guidance about how it is conducting these audits, what it is looking at, what factors may lead it to make a criminal referral or what borrowers can do to influence the SBA's decisions. Because SBA audits are confidential, knowledge about them is limited to those involved in the audits themselves. Our CARES Act SBA Audit Defense Team at Dentons has represented borrowers across the country in audits ranging from \$150,000 to \$10 million and has gained insight into the SBA audit process, key issues and decision-making. This article is based on what we have learned from SBA PPP loan audits of clients in New York, Massachusetts, California, Pennsylvania, Texas, Arizona, Kansas, Indiana, Illinois and other states.

Key audit issues

SBA audit practice varies from loan to loan. In some audits, the SBA simply notifies the borrower's bank that it is "reviewing" (aka "auditing") the loan, requiring the bank to notify the borrower and upload to the SBA electronic portal all documents relating to the PPP loan within 15 days. No extensions of time are granted. In these types of audits, the SBA does not notify the bank or borrower of any specific issues under consideration. In other audits, the SBA notifies



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the bank that the SBA requires the borrower to provide responses to specific issues. Borrowers in such audits need to understand that even if the SBA has identified one or more issues, the SBA audit may cover issues not identified and, thus, borrowers should provide all information and documents relevant to any potential issue. In the event of an adverse SBA audit decision, an appeal would be based on what is in the SBA file at the time of the decision. Thus, failure to produce essential information or documents could jeopardize a subsequent appeal. There is no right to supplement the record on appeal, and the CARES Act places the burden of proof on borrowers.

Loan necessity is one of the most frequent issues in PPP loan audits. The CARES Act required borrowers to certify that, due to the coronavirus, "the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient." Congress did not define what conditions make PPP loans "necessary," but it delegated to the SBA the promulgation of regulations and issuance of guidance on PPP loan issues. In Frequently Asked Question #31, the SBA advised:

"Borrowers must make this certification in good faith, *taking into account* their current business activity and *their ability to access other sources of liquidity* sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon

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request, the basis for its certification.” (Emphasis added.)

Shortly after the SBA issued this guidance in April 2020, a number of companies repaid PPP loans, concluding their access to private equity or other sources of revenue made them ineligible. For those businesses that kept their PPP loan proceeds or that applied after the SBA issued FAQ #31, proving loan necessity during an audit is critical to obtaining loan forgiveness.

Other eligibility issues must be addressed by many borrowers, including a consideration of the affiliation rules

for borrowers with affiliate, subsidiary and parent companies; the number of employees; and, for some borrowers, the SBA’s alternate eligibility standard of having tangible net worth of under \$15 million and average net income of under \$5 million for the two years before applying for the loan.

Myriad other potential issues could arise in a PPP loan audit. Borrowers must anticipate what issues the SBA may review and provide the SBA with whatever information and documentation is needed to obtain a favorable decision during an audit. Because borrowers have the burden of proof, they are well advised to consider an audit as an opportunity to present their

case, from start to finish, as if they were presenting a case in a trial. This includes submitting affidavits to document decision-making, in addition to producing all necessary documents to support the borrower’s eligibility and expenditures. Doing so gives borrowers their best chance for obtaining loan forgiveness and avoiding a referral to the DOJ. •

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