CPA Now

Fraud and PPP Loans: What We Know May Only Be the Beginning

By Allison Greenfield, CPA, CFE

It's been a year since COVID-related Paycheck Protection Program (PPP) loans were introduced, and I am sure you've heard at least a few stories about abuses like these:

- In October 2020, a Florida man and Pennsylvania towing company owner were charged with alleged participation in a schedule to file fraudulent loan applications seeking over $24 million in forgivable PPP loans.
- In March 2021, a tax preparer in South Florida allegedly submitted more than 100 fraudulent PPP loan applications by falsifying income, expenses, and IRS tax forms. Over $2.3 million was sought and, allegedly, about $975,000 in loans were received. If convicted, he faces a maximum penalty of 20 years in prison.
- In March 2021, in Washington, a tech executive allegedly submitted at least eight fraudulent PPP loan applications, by making numerous false and misleading statements about the operations and payroll expenses and submitted fake tax filings.[1]

The Coronavirus Aid, Relief, and Economic Security Act, enacted in March 2020, provided financial assistance to small businesses through $300 billion in forgivable loans for job retention and other expenses.

The PPP loans can be used to help fund payroll costs, including benefits, as well as mortgage interest, rent, utilities, worker protection related to COVID-19, uninsured property damage costs caused by looting or vandalism during 2020, and certain supplier expenses for operations.[2] With the possibility for borrowers to apply for loan forgiveness, PPP loans become more similar to grants. For the loan to be eligible for forgiveness, the following must be met during the eight- to 24-week period following loan disbursement: employee and compensation levels are maintained; the loan proceeds are spent on payroll costs and other eligible expenses; and at least 60% of proceeds are spent on payroll costs.[3] The application for loan forgiveness extends for 10 months after the last day of the covered period.

Accounting for PPP

Since PPP loans can be used to cover multiple expenses among many businesses, there are many opportunities for fraud to occur. Business owners, for example, could use a loan for unrelated expenses or they could apply using fraudulent documents (tax returns, business records), among other ways. CPAs can be invaluable to their clients in keeping them out of trouble by properly supporting the expenses identified by the government in the proportions required. While the fraud examples referenced in the opening were detected early for a variety of reasons, it will probably be some time before we understand the true depth of fraud that occurred from a lack of accounting support for expenses.

Should a PPP loan become a grant, and it was used in 2020 for payroll expenses, it would be shown as income in 2020 (which is part of the matching principle). If the loan did not qualify for forgiveness, the treatment would be the same as any other loan, including the interest paid at 1% and the expectation for the loan to be paid back in two years. According to the Small Business Administration (SBA), as of March 11, 2021, $178.7 billion in loans have been forgiven out of $521.2 billion.[4]

According to the *Journal of Accountancy*, the SBA may review and audit PPP loans to check for fraud. Therefore, borrowers must retain relevant records for four years (employment records) and other records for three years.[5] According to the IRS RR-2021-2 ruling, "No amount shall be included in the gross income of the eligible recipient by reason of forgiveness of indebtedness … no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied by reason of the exclusion from gross income."[6] This ruling overrides Notice 2020-32 and Rev. Rul. 2020-27. The exclusion from gross income would be recorded as tax-exempt income or an increase in tax basis by the share of tax-exempt income. The main issue appears to be the period in which potentially tax-exempt income is recorded as a loan which can be forgiven 10 months later. This could impact financial statements and tax returns. The IRS had not yet issued guidance on this issue as of April 7, 2021. However, on April 2, 2021, the IRS did issue guidance in Notice 2021-2 related to the Employee Retention Credit for the first two quarters of 2021.

What CPAs Can Do

Many alleged schemes to commit PPP fraud were done by submitting false documents. However, with loan forgiveness, a new issue arises with proving the loan was specifically used for payroll and other applicable expenses. Proper payroll documentation, along with support for the 60% payroll threshold, will be important. Many CPAs surely have fielded a multitude of emails and phone calls from clients asking for help in submitting loan forgiveness packages to the bank. How far have you gone to satisfy yourself that the documents your client provided are authentic and complete?

In cases of fraud related to loan applications, due diligence and professional skepticism will help you identify potential fraud. If employees are paid hourly, the payroll expense is more variable, whereas salaried employees cause the payroll expense to be more fixed. Analysis of nonfinancial data, such as number of employees from human resource records, can be important to compare to the amount of payroll expense to see if it meets the 60% threshold.

Here are some basic questions that should be asked first:

- Did gross income increase substantially? What could have caused it?
- Does an increase in expenses make sense for the change in income? Did fixed and variable expenses adjust properly?
- Does the company website or social media show that they were closed for a period of time?

It is currently unknown how hard the government will challenge or audit these forgiveness packages in the future. If they do, it will put CPAs' work to the test.

Be vigilant. Even if every other aspect of our lives changed during the pandemic, we know fraud will remain a constant. CPAs should remain on high alert as we are called in to help our clients with PPP claims.

[1] **www.justice.gov/opa/pr/florida-recording-artist-and-pennsylvania-man-charged-role-24-million-covid-relief-fraud**; **www.justice.gov/opa/pr/tax-preparer-charged-covid-19-loan-fraud**; **www.justice.gov/opa/pr/tech-executive-pleads-guilty-wire-fraud-and-money-laundering-connection-ppp-loans**
[2] **www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/first-draw-ppp-loans**
[3] **www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-loan-forgiveness**
[4] **www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-data**
[5] **www.journalofaccountancy.com/news/2021/jan/sba-treasury-issue-ppp2-guidance.html**
[6] **www.irs.gov/pub/irs-drop/rr-21-02.pdf**

Allison Greenfield, CPA, CFE, is an associate with Forensic Resolutions Inc., which has offices in Westmont, N.J., and Philadelphia. She can be reached at ***agreenfield@forensicresolutions.com****.*