

# The Evolving Paycheck Protection Program: How to interpret the forgiveness application and what to expect for next steps

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# Today's Discussion

- Overview of the Paycheck Protection Program (PPP)
- Scrutiny of Economic Necessity for Taking a PPP Loan
- Permissible Use of Funds & Expenses Eligible for Forgiveness
- Forgiveness
  - SBA Loan Forgiveness Application
  - Interim Final Rule on Forgiveness
- Borrower and Lender Responsibilities
  - Validation
  - SBA Review

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## Overview of the CARES Act and PPP

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# What Relief Does the PPP Provide to Small Businesses?

- The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) appropriated \$349 billion for small businesses through federally backed loans under a modified Small Business Administration (SBA) 7(a) loan guaranty program called the Paycheck Protection Program (PPP).
  - Qualifying businesses apply to SBA-approved lenders for loans of up to 2.5 times their average monthly payroll costs (up to \$10 million)
  - Loan proceeds may be used for qualified payroll costs, rent, utilities, and interest on mortgage and other debt obligations
  - Loan forgiveness is available for funds used to pay for payroll costs, rent, utilities, and interest on mortgage for the first 8 weeks after the loan originates
  - All payments (including interest) will be deferred for at least 6 months
  - No collateral or personal guarantee is required
- Congress subsequently approved an additional \$310 billion for the PPP.

## What Are the Qualification Criteria?

- The applicant employs fewer than 500 employees;
- The applicant employs more than 500 employees but fewer than the employee size standard for the applicant's respective NAICS code;
- If the applicant's respective NAICS code does not have an employee size standard, that applicant does not exceed the receipts-based size standard under that NAICS code; **OR**
- The applicant satisfies the SBA's "alternative size standard" test as of March 27, 2020.
  - The maximum tangible net worth of the applicant is not more than \$15 million; AND
  - The average net income after federal income taxes (excluding any carry-over losses) of the applicant for the 2 full fiscal years before the date of application is not more than \$5 million.



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## Scrutiny of Economic Necessity for Taking a PPP Loan

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## What Does the CARES Act Say?

- The CARES Act requires eligible borrowers to make certain certifications in connection with obtaining a loan, including “that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient.”
- The CARES Act ***does not include*** a “means” test or any liquidity test for obtaining a loan.
- In fact, the CARES Act ***expressly waives*** the SBA’s standard “credit elsewhere test” in order to qualify for an SBA loan. Under normal circumstances, a borrower for an SBA loan must demonstrate that the borrower cannot obtain some or all of the requested loan funds from alternative sources without causing undue hardship (13 CFR 120.101).
  - The credit elsewhere test looks at the resources of the applicant business or those of its principals.

# Administration Response to Concerns of Large Borrowers

- April 21, 2020, Secretary Mnuchin raises concern that large businesses that did not need the money were obtaining PPP loans.
- April 23, 2020 Treasury/SBA issue FAQ 31 concerning large companies with adequate sources of liquidity that take out PPP loans.
  - Borrowers must assess their economic need for a PPP loan under the CARES Act and the PPP regulations at the time of the loan application.
  - Although the CARES Act suspends the credit elsewhere test, borrowers must certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” This requires taking into account current business activity and ability to access other sources of liquidity sufficient to support ongoing operations in a way that is not significantly detrimental to the business.
  - The government is skeptical 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 request, the basis for its certification.
  - May 14 Safe Harbor: Any borrower that repays a PPP loan in full by May 14, 2020 will be deemed by SBA to have made the required certification in good faith.
- On April 28, same guidance was issued in FAQ 37, specifically calling out private companies.



## Administration Response to Concerns of Large Borrowers

- April 28, Secretary Mnuchin states that any borrower of a PPP loan of \$2 million or more will be audited.
- April 29, Treasury/SBA issue FAQ 39 explaining that SBA will review individual PPP loan files.
  - References FAQ 31 (certification) and reminds all borrowers of the important certification required to obtain a PPP loan.
  - To further ensure PPP loans are limited to eligible borrowers in need, SBA/Treasury will review all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender's submission of the borrower's loan forgiveness application.

# SBA Refines Certification Requirements

- On May 13, 2020, the U.S. Department of Treasury and the Small Business Administration (SBA) issued FAQ No. 46.
- FAQ No. 46 effectively limited the scope of FAQ No. 31, providing that borrowers with PPP loans of less than \$2 million (combined with the loans of affiliates) will be deemed to have made the borrower certification in good faith.
- Borrowers with loans of more than \$2 million will apparently still be subject to the SBA's additional certification requirements, and the "full audits" Treasury Secretary Mnuchin promised on April 28.
- FAQ No. 46 clarified that if those borrowers are found to have “lacked an adequate basis for the required certification concerning the necessity of the loan request,” they will be required to repay the loan (and will not be eligible for loan forgiveness) but will not be referred for a government enforcement action. The SBA further clarified that its determination regarding the borrower certification will not affect its guarantee of the loan.

# How to Assess Economic Necessity for a PPP Loan

- Document in writing your financial and operational justifications for taking the PPP loan.
- Assess the totality of the circumstances.
- Factors to consider:
  - Liquidity
  - Access to capital
  - Operational revenue
  - Increase/decrease in recent business or expectation of business
  - Aging of accounts receivable
  - Prior or expected layoffs
  - Operational challenges (shutdown orders, sick employees, etc.)
  - Impacts on customers (e.g., is your target customer base significantly impacted by COVID-19?)
- Consider impact at time of application for PPP loan, but also any current new or different challenges or developments.



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## **Permissible Use of Funds and Expenses Eligible for Forgiveness**

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## How Must Relief Be Used?

- Businesses can use funds from the Program loans to cover expenses including:
  - Payroll costs, including compensation to employees; payments for vacation, parental, family, medical or sick leave; severance payments; payments required for group healthcare benefits (including insurance premiums), retirement benefits, and state and local employment taxes
  - Interest payments on any mortgage obligations or other debt obligations incurred before February 15, 2020 (but not any payments or prepayments of principal)
  - Rent
  - Utilities
- The money cannot be used for:
  - compensation of individual employees, independent contractors, or sole proprietors in excess of an annualized salary of \$100,000;
  - compensation of employees with a principal place of residence outside the United States; or
  - leave wages already covered by the Families First Coronavirus Response Act.



# What about Loan Forgiveness?

- Borrowers may apply for loan forgiveness for certain eligible expenses:
  - Payroll costs
  - Rent payments
  - Utility payments
  - Interest on mortgage payments
- Per current Treasury/SBA guidance, 75% of the amount forgiven must be used to cover payroll costs.
- The amount of loan forgiveness may be reduced if the employer reduces the number of employees as compared to the prior year, or if the employer reduces the pay of any employee by more than 25% as of the last calendar quarter. Employers who re-hire workers previously laid off as a result of the COVID-19 crisis will not be penalized for having a reduced payroll for the beginning of the relevant period. Forgiveness may also include additional wages paid to tipped workers.
- Borrowers must apply for loan forgiveness to their lenders by submitting required documentation and are expected to receive a decision within 60 days.



# Reductions to Loan Forgiveness

- **Reductions in FTE**: Reduction in number of full-time equivalent employees (FTEs) in 8-week period after origination of loan.
  - Period for calculating FTEs is average number from either (A) February 15, 2019 to June 30, 2019 or (B) January 1, 2020 to February 29, 2020.
  - Number of FTEs determined by calculating average number of FTEs for each pay period falling within a month.
- **Reductions in Payroll**: Reduction in pay of any employee making less than \$100,000 by more than 25% - compared to last complete calendar quarter.
  - No limit to amount of reduction in pay of employees who make over \$100,000.

# Benefits of Rehiring

- No penalty for lay-offs from February 15, 2020 to April 26, 2020 if employees are re-hired by June 30, 2020.
  - Employee count is based on number of FTEs as of June 30, 2020 being equal to number of FTEs as of February 15, 2020.
  - Example: Company A has 100 employees as of February 15, 2020, but it laid off 50 employees on April 1, 2020. If Company A has at least 100 employees as of June 30, 2020, there will be no penalty regarding the amount of loan forgiveness.

# Repairing Reductions in Payroll

- No penalty for salary reductions from February 15, 2020 to April 26, 2020 if salaries are restored to original amount by June 30, 2020.
  - Example: On February 15, 2020, Company A decreased the salaries of employees making \$75,000 to \$50,000. If Company A increases the salaries of those employees back to \$75,000 by June 30, 2020, there will be no penalty regarding the amount of loan forgiveness.
- Keep in mind that this possible reduction in loan forgiveness applies only to employees who make less than \$100,000 per year.

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**May 15, 2020: SBA Releases Loan Forgiveness Application**

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**PPP Loan Forgiveness Calculation Form**

Business Legal Name ("Borrower")		DBA or Tradename, if applicable	
Business Address		Business TIN (EIN, SSN)	Business Phone
		Primary Contact	E-mail Address

SBA PPP Loan Number: \_\_\_\_\_ Lender PPP Loan Number: \_\_\_\_\_

PPP Loan Amount: \_\_\_\_\_ PPP Loan Disbursement Date: \_\_\_\_\_

Employees at Time of Loan Application: \_\_\_\_\_

Employees at Time of Forgiveness Application: \_\_\_\_\_

EIDL Advance Amount: \_\_\_\_\_ EIDL Application Number: \_\_\_\_\_

Payroll Schedule: The frequency with which payroll is paid to employees is:  
 Weekly  Biweekly (every other week)  Twice a month  Monthly  Other \_\_\_\_\_

Covered Period: \_\_\_\_\_ to \_\_\_\_\_

Alternative Payroll Covered Period, if applicable: \_\_\_\_\_ to \_\_\_\_\_

If Borrower (together with affiliates, if applicable) received PPP loans in excess of \$2 million, check here:

**Forgiveness Amount Calculation:**

Payroll and Nonpayroll Costs

Line 1. Payroll Costs (enter the amount from PPP Schedule A, line 10): \_\_\_\_\_

Line 2. Business Mortgage Interest Payments: \_\_\_\_\_

Line 3. Business Rent or Lease Payments: \_\_\_\_\_

Line 4. Business Utility Payments: \_\_\_\_\_

Adjustments for Full-Time Equivalency (FTE) and Salary/Hourly Wage Reductions

Line 5. Total Salary/Hourly Wage Reduction (enter the amount from PPP Schedule A, line 3): \_\_\_\_\_

Line 6. Add the amounts on lines 1, 2, 3, and 4, then subtract the amount entered in line 5: \_\_\_\_\_

Line 7. FTE Reduction Quotient (enter the number from PPP Schedule A, line 13): \_\_\_\_\_

Potential Forgiveness Amounts

Line 8. Modified Total (multiply line 6 by line 7): \_\_\_\_\_

Line 9. PPP Loan Amount: \_\_\_\_\_

Line 10. Payroll Cost 75% Requirement (divide line 1 by 0.75): \_\_\_\_\_

Forgiveness Amount

Line 11. Forgiveness Amount (enter the smallest of lines 8, 9, and 10): \_\_\_\_\_



By Signing Below, You Make the Following Representations and Certifications on Behalf of the Borrower:

The authorized representative of the Borrower certifies to all of the below by **initialing** next to each one.

- The dollar amount for which forgiveness is requested:
- was used to pay costs that are eligible for forgiveness (payroll costs to retain employees; business mortgage interest payments; business rent or lease payments; or business utility payments);
  - includes all applicable reductions due to decreases in the number of full-time equivalent employees and salary/hourly wage reductions;
  - does not include nonpayroll costs in excess of 25% of the amount requested; and
  - does not exceed eight weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner, capped at \$15,385 per individual.

I understand that if the funds were knowingly used for unauthorized purposes, the federal government may pursue recovery of loan amounts and/or civil or criminal fraud charges.

The Borrower has accurately verified the payments for the eligible payroll and nonpayroll costs for which the Borrower is requesting forgiveness.

I have submitted to the Lender the required documentation verifying payroll costs, the existence of obligations and service (as applicable) prior to February 15, 2020, and eligible business mortgage interest payments, business rent or lease payments, and business utility payments.

The information provided in this application and the information provided in all supporting documents and forms is true and correct in all material respects. I understand that knowingly making a false statement to obtain forgiveness of an SBA-guaranteed loan is punishable under the law, including 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a Federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.

The tax documents I have submitted to the Lender are consistent with those the Borrower has submitted/will submit to the IRS and/or state tax or workforce agency. I also understand, acknowledge, and agree that the Lender can share the tax information with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of ensuring compliance with PPP requirements and all SBA reviews.

I understand, acknowledge, and agree that SBA may request additional information for the purposes of evaluating the Borrower's eligibility for the PPP loan and for loan forgiveness, and that the Borrower's failure to provide information requested by SBA may result in a determination that the Borrower was ineligible for the PPP loan or a denial of the Borrower's loan forgiveness application.

The Borrower's eligibility for loan forgiveness will be evaluated in accordance with the PPP regulations and guidance issued by SBA through the date of this application. SBA may direct a lender to disapprove the Borrower's loan forgiveness application if SBA determines that the Borrower was ineligible for the PPP loan.

\_\_\_\_\_  
Signature of Authorized Representative of Borrower

\_\_\_\_\_  
Print Name

\_\_\_\_\_  
Date

\_\_\_\_\_  
Title

# Loan Forgiveness Application

- Instructions for calculating expenses to confirm loan forgiveness eligibility and, where eligible, ascertain the amount that is forgivable.
- New option for borrowers to calculate payroll costs eligible for loan forgiveness using an "Alternative Payroll Covered Period" that correlates with borrowers' regular payroll cycles.
- Ability to include eligible payroll costs that are incurred but not paid during the forgiveness period, if paid on or before the next regular payroll date, and non-payroll expenses that are paid or incurred but not paid during the forgiveness period, if paid on or before the next regular billing date.
- Clarification that borrowers are not required to report payments for nonpayroll costs that they do not want to be included in the forgiveness amount.
- Clarification that mortgage interest and rent payments can include both real and personal property;
- Formal adoption of the full-time equivalency (FTE) employee Reduction Safe Harbor, which exempts "borrowers who have made a good-faith, written offer to rehire workers," whose offer was rejected, from incurring forgiveness reduction penalties that would otherwise be incurred because of a decrease in the borrower's employment level.
- Statutory exemption from the FTE reduction penalty calculation for any employees who "(a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours," but "only if the position was not filled by a new employee."



# Loan Forgiveness Application

- Borrowers must submit certain documentation, including documents verifying eligible payroll expenses, including bank statements, tax forms, and third-party payroll reports and receipts of benefits payments; documents evidencing FTE numbers for the applicable periods (i.e., payroll tax filings and wage reports).
- Borrowers must submit documentation of nonpayroll expenses, such as amortization schedules and receipts of eligible mortgage interest expenses; leasing agreements and receipts for eligible lease expenses; and utility invoices and receipts for eligible utility expenses.
- Documentation retention requirements – for a period of six years from the date of forgiveness (or loan repayment in full), loan forgiveness applicants must preserve and be prepared to furnish upon request documentation that would support the facts and figures underlying the applicant's calculations and statements submitted as part of the loan forgiveness application, and underlying worksheets, including documents supporting applicants' salary/wage reduction calculation; documents evidencing job offers and rejections, firings for cause, voluntary resignations, and written requests for a reduced work schedule; and other documents supporting the maintenance or reduction of employment and salary levels, as reflected in the borrower's application.
- Must indicate if the borrower (with affiliates, if applicable) received PPP loan proceeds in excess of \$2 million.

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## **May 22, 2020: Interim Final Rule on Loan Forgiveness**

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# Interim Final Rule Supplements Prior Guidance

## General Forgiveness Terms

- Confirms that forgiveness eligibility will be determined based upon the guidance available at the time of the loan application.
- Reaffirms that if only a portion of the loan is forgiven, or if the forgiveness request is denied, the remaining balance must be repaid on or before the 2-year maturity of the loan.

## Payroll Costs

- Restates that payroll costs must make up 75% of the amount for which a borrower seeks loan forgiveness.
- Reaffirms that, in general, payroll costs paid or incurred during the 8 weeks following disbursement of the loan (i.e., the “covered period”) are eligible for forgiveness, but that borrowers may also use an “alternative payroll covered period” as set forth in the instructions to the Loan Forgiveness Application, in which the borrower may opt to use a covered period beginning on the first day of the borrower's first payroll cycle.
- Confirms that payroll costs are generally incurred on the day the employee's pay is earned (i.e., the day the employee worked) and clarifies that where employees are not performing work and are still on the borrower's payroll, payroll costs are incurred based on the schedule established by the borrower (typically, each day the employee would have performed work).
- Confirms that employee bonuses and hazard pay are eligible for payroll costs, as long as the employee's total compensation does not exceed the \$100,000 annualized cap.
- Wages paid to furloughed employees during the covered period are eligible for forgiveness.
- Clarifies that owner-employees and self-employed individuals are limited to "payroll compensation" no greater than the lesser of 8/52 of 2019 compensation or \$15,385 per individual, and owner-employees are further capped by the amount of their 2019 employee cash compensation and employer retirement and health care contributions made on their behalf. Schedule C filers are capped by the amount of their owner compensation requirement, calculated based on 2019 net profit. And general partners are capped by the amount of their 2019 net earnings from self-employment, subject to certain reductions.

# Interim Final Rule Supplements Prior Guidance

## Nonpayroll Costs

- Reaffirms that “eligible nonpayroll costs cannot exceed 25% of the loan forgiveness amount.”
- Reaffirms that nonpayroll costs must be paid during the covered period or incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period, but clarifies that if a borrower’s nonpayroll expenses straddle the covered and noncovered period and are paid after the covered period (e.g., a borrower’s “covered period” ends on July 26 and its electricity expenses for July are not paid until August 10), the borrower may seek partial forgiveness of the expenses incurred during the covered period but paid on the next regular billing date (e.g., electricity expenses for July 1-26 are forgivable).
- Advance payments of interest on mortgage obligations are not eligible for loan forgiveness.

## Forgiveness Reductions

- Confirms that EIDL advances will be deducted from loan forgiveness amounts.
- Head Count Reductions:
  - Confirms that borrowers will not be penalized for voluntary resignations and schedule reductions or for-cause terminations.
  - Reaffirms that borrowers will not be penalized if they offer to re-hire an employee "for the same salary and same number of hours" and the employee declines the offer, although the borrower must appropriately document the request and denial in writing and the borrower must inform the applicable state unemployment insurance office within 30 days of the employee's rejection of the offer.
  - Clarifies that a full-time employee is an employee who works 40 hours or more, on average, each week, and that such an employee would be considered a full-time equivalent (FTE) employee with a weight of 1.0.
  - Clarifies that, to calculate full-time equivalent (FTE) employees, borrowers may either add the hours of all part-time employees and divide by 40, or elect, "for administrative convenience . . . to use a full-time equivalency of 0.5 for each part-time employee," as long as the borrower applies the chosen method consistently.



# Interim Final Rule Supplements Prior Guidance

- Salary/Wage Reductions:
  - Confirms that the 25% salary/wage reduction calculation (for employees who were not paid more than the annualized equivalent of \$100,000 during any 2019 pay period) is performed on a per-employee basis and not in the aggregate;
  - Clarifies that borrowers will not be doubly penalized for reductions, such that the salary/wage reduction applies only to the decline in employee salary and wages not attributable to the FTE reduction.
- Remedies for Reductions in Head Count and Salary/Wage:
  - Appears to confirm that the restoration benefit applies only to eliminating, before June 30, 2020, FTE and salary reductions that occurred between February 15, 2020 and April 26, 2020 (and not reductions that occurred after April 26, 2020).

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**May 22, 2020: Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities**

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# Additional Insight into the Review Process

## Rules for Borrowers

- Clarifies that the SBA may review “any PPP loans,” at any time in its discretion, and that the SBA may consider in that review whether a borrower correctly calculated the loan amount, properly used the loan proceeds, and/or is entitled to the loan forgiveness amount sought.
- Borrowers must retain PPP documentation for at least 6 years after the date the loan is forgiven or paid in full, and the SBA and SBA Inspector General must be granted these files upon request.
- If the SBA believes a borrower may be ineligible for the loan or for some forgiveness amount, it will require that the lender make a written request for additional information from the borrower, and it may also request information directly from the borrower.
- All information provided by the borrower in response (either directly to the SBA or through the lender) will be considered in the SBA's review. Failure to respond to the SBA's request for information may result in a determination that the borrower is ineligible for forgiveness or for the loan itself.
- The shareholders, members, or partners of a borrower that is deemed ineligible to have received a PPP loan will not be protected by "the CARES Act's nonrecourse provision ... which limits SBA's recourse against individual shareholders, members, or partners of a PPP borrower for nonpayment of a PPP loan **only** if the borrower is an eligible recipient of the loan" (emphasis added).
- Borrowers will be given the opportunity to seek reconsideration and appeal of review decisions. The SBA intends to issue a separate interim final rule on this process.

# Additional Insight into the Review Process

## Rules for Lenders

- Lenders must follow the record retention requirements of their regulators, and they must confirm receipt of required documentation to verify payroll and nonpayroll costs.
- Lenders must confirm the loan forgiveness calculations performed by borrowers, although the calculation's accuracy remains the borrower's responsibility, and lenders are only expected to provide a “good faith review” of the borrower's calculations and supporting documents.
- Lenders must issue a loan forgiveness decision to the SBA within 60 days after receiving a complete Loan Forgiveness Application. Such a decision may take the form of an approval (in whole or in part), a denial, or a denial without prejudice (if directed by the SBA) due to a pending SBA review of a loan for which forgiveness is sought.
- If a lender issues a decision approving the application (in whole or in part), it must submit to the SBA the borrower's PPP Loan Forgiveness Calculation form, PPP Schedule A, and the PPP Borrower Demographic Information Form (if submitted by the borrower).
- If the lender determines the borrower is not entitled to forgiveness in any amount, the lender must provide a reason for the denial. The lender must notify the borrower in writing that the denial has been issued to the SBA.
- Within 90 days after notice from the lender, the borrower may request that the SBA review the lender’s decision. For an SBA-directed denial without prejudice, the borrower may subsequently request that the lender reconsider the borrower's Loan Forgiveness Application, unless the SBA has determined the borrower is ineligible for a loan in general.
- If the SBA chooses to review a PPP loan, it will notify the lender in writing, and the lender must notify the borrower within 5 business days of receipt.
- If the SBA determines a borrower was not eligible for the PPP loan, the lender is not eligible to receive a processing fee for that loan. If the SBA reaches this determination within one year after the loan was disbursed, the SBA will seek repayment of the processing fee from the lender, although such a determination will not affect the SBA's guaranty of the loan.

# Preparing for the Audit

- Have a clean file with all calculations and supporting material submitted as part of initial application
- Have a file, including Board resolution and material prepared to support Board decision to keep the money/maintain application. Presume this will be provided as part of the audit
- Segregate loan proceeds
- Prepare a forgiveness model to track forgivable expenditures. Have model reviewed and signed off on by counsel and accounting support
- Track expenditures from segregated funds
- Follow (and document) direction from lender
- Assemble documents relating to expenditures (i.e., leases for lease payments; utility bills; payroll records)
- Prepare backup package in real time

# QUESTIONS?

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