

Questions and Answers – FHWA Guidance on Treatment of PPP Loan Forgiveness

Introduction

This document presents a set of recommended best practices for use by state DOT auditors, A/E firms, and CPA auditors regarding the treatment of loan forgiveness granted through the operation of the Paycheck Protection Program (PPP), as authorized by the CARES Act and administered through the Small Business Administration (SBA). Although these recommendations do not have the effect of law or regulation, they are encouraged for use to promote fairness and consistency, with the understanding that some flexibility in application is necessary to accommodate the unique contracting policies and procedures of each state DOT, as well as the professional judgment of auditors.

I. Timing of Recognition of PPP Loan Forgiveness and Related Credit

Q1: In what year should any credit for PPP loan forgiveness be recorded in the indirect cost rate? Is there a requirement for an A/E firm to record the forgiveness in the year the loan funds are spent, or should the credit be recorded in the year the firm receives formal notification of loan forgiveness?

A1: A/E firms should follow Generally Accepted Accounting Principles (GAAP) in determining the period in which to record PPP loan forgiveness, including any credit required under FAR Part 31. The AICPA published Technical Question & Answer (TQA) Section 3200.18 which addresses relevant GAAP considerations on this topic.

As described in the TQA, a firm would not be required to account for the loan forgiveness in the year the funds were received, if loan forgiveness was received, or was expected to be received, in a later year. However, the firm would not be precluded from recording the loan forgiveness in the period the funds were received, if the firm chose to do so. States that utilize contracts which require a “true-up” of prior invoiced costs to actual costs using the actual indirect cost rate could apply the indirect cost rate reflecting the PPP credit for purposes of true-up of 2020 contract costs, if the A/E firm has received forgiveness, or has applied for forgiveness and such forgiveness is reasonably assured.

II. Calculation of PPP Credit/Allocation of Forgiveness

Q2: How should the forgiveness credit allocable to government contracts be calculated by an A/E firm that receives loan forgiveness for the entire amount, or a portion, of a PPP loan?

A2: Generally, calculation of the amount of PPP loan forgiveness allocable to government contracts to be recorded as a credit to overhead/indirect costs should be based on the A/E

firm's allocation of PPP funds to the costs incurred during the 8-week to 24-week covered period used as the basis for loan forgiveness. The A/E firm is responsible for calculating and providing support for the allocation of the forgiveness and the related credit to overhead.

In preparing the calculation, the firm may allocate the forgiven PPP amount to any costs available as allowable uses of the PPP loan proceeds in accordance with the PPP program requirements. This includes items such as direct labor, indirect labor, health insurance, rent, and mortgage interest, among others. See the PPP guidance on the SBA website for a list of expenses eligible for forgiveness. All of these cost categories other than direct labor are indirect costs, and allocating a portion of the PPP forgiveness to those categories would require a credit to the indirect cost rate.

Q3: How would this treatment differ, if at all, for A/E firms that elect an 8-week covered period versus a 24-week covered period under the PPP loan provisions?

A3: For purposes of calculating any PPP credit, the A/E firm must use the same covered period (8 to 24 weeks) that it used in its PPP loan forgiveness application. The treatment would be the same under either duration of the covered period, but the pool of costs available for use in allocating the PPP forgiveness credit will be larger for the 24-week covered period.

Q4: What contract types should be considered "non-adjustable" contracts, such that the use of PPP funds to pay the direct labor costs on those contracts would *not* result in a PPP forgiveness credit to overhead? FHWA Memorandum HCFB-30, Treatment of Paycheck Protection Program Funds for Architectural and Engineering Consultants Guidance, issued by FHWA on March 24, 2021, states: "If adjustments to an A&E consultant's indirect cost rate ha[ve] no bearing on the award or contract type (e.g., firm fixed price or lump sum contract), adjustment to that contract would not be required." For example, would direct labor costs for work performed on commercial/private-sector contracts, lump-sum/fixed-price government contracts (see Note 1), and state or local agency contracts not involving federal funds, be excluded from the overhead forgiveness credit?

A4: For purposes of this Q&A, we will refer to the contract types for which the use of PPP funds to pay the direct labor costs on those contracts would not result in a PPP forgiveness credit as "non-FAR-reimbursement-based contracts" (NFRC). In determining what contracts are NFRCs, an important consideration is whether changes in the A/E firm's FAR-compliant indirect cost rate, after contract execution, would have resulted in the A/E firm owing or being owed amounts to/from the government client based on the change in the indirect cost rate. Examples of contract types which are considered NFRCs and therefore "non-adjustable" contracts under this definition include:

- commercial/private sector contracts of any type (where the end client is a private entity; but this does not include work for a prime consultant where the end client is a government agency);
- lump-sum/fixed-price government contracts, except for those which are flexibly priced; and
- government contracts for which the pricing is not established based on the FAR-compliant overhead rate or that have no requirement to follow FAR Part 31 (48 CFR Part 31) in establishing allowable costs.

Note 1: Certain state DOTs include contract provisions that may result in adjustments to lump-sum/fixed-price contracts in certain circumstances.

Note 2: In the above discussion, subject to the foregoing definitions, generally, the direct labor costs for work performed on commercial/private sector contracts, lump-sum/fixed-price government contracts, and state or local agency contracts not involving federal funds would be excluded from the forgiveness credit to overhead.

Q5: What documentation may a state DOT request and should an A/E firm make available for review in support of the allocation of the forgiveness credit? For example, should the A/E firm provide the SBA loan forgiveness application, payroll distribution reports, job cost reports, and other related documentation?

A5: The A/E firm should maintain supporting documentation including the SBA loan forgiveness application, a payroll distribution report, job cost reports, and other documentation necessary and relevant to support its calculation of the forgiveness credit and related allocation to overhead. State DOTs, when performing their reviews of A/E firm indirect cost rates, and CPA firms, when performing indirect cost rate audits, may request any information they consider necessary to gain appropriate assurance that any PPP forgiveness credit was calculated and allocated properly.

Q6: If an A/E firm did not prepare documentation at the time of the loan forgiveness application to demonstrate the allocation of labor costs to direct labor on non-FAR-based contracts, FAR-based contracts, indirect labor, or other costs, but the firm later can provide the documentation in support of the calculation of the FAR credit for PPP loan forgiveness, is that acceptable to support the calculation and allocation?

A6: Yes, if the firm can provide the documentation to support the calculation and allocation of the forgiveness credit at the time of preparation of the indirect cost rate calculation, that is acceptable, even if such documentation was not prepared or provided at the time of the loan forgiveness.

Q7: Who has the burden of proof regarding the calculation and allocation of any PPP forgiveness credit?

A7: The A/E firm is responsible for determining its own accounting policies, and the firm must document how the credit was calculated and allocated. This methodology, and resulting computation is subject to review by the state DOT and, if applicable, audit testing by the CPA firm performing the indirect cost rate audit.

Q8: What is the recommended practice for reporting PPP forgiveness credits in CPA indirect cost rate audit reports or in A/E firm self-prepared indirect cost rate schedules? Are alternative approaches acceptable?

A8: To avoid CPA indirect cost rate audit reports and A/E firm self-prepared indirect cost rate schedules from being misleading to users and to promote transparency on this issue, audit reports and self-prepared indirect cost rate schedules should reflect the applicable credit for PPP loan forgiveness on the face of the indirect cost rate schedule either as: (1) a single line item or; (2) separate amounts, distributed among a number of line items, based on the categories of costs credited.

The main schedule that details the indirect cost rate calculation must include the PPP credit. For example, this should precede any footnotes or supplemental information provided in a CPA indirect cost rate audit report, or any other supplementary disclosures or schedules. If the A/E firm is recognizing a PPP forgiveness credit, regardless of whether the indirect cost rates are audited or self-certified, supplemental information should be provided in the form of footnotes or a supplemental schedule, clearly labeled/described, to reflect what the indirect cost rate would have been if there had been no PPP loan forgiveness.

This information must be presented in a way that is not misleading to the reader, such that an average user of the report would not be confused as to which rate reflects the credit and which rate does not. All indirect cost rate schedules for 2020 and 2021, audited or unaudited, should include a footnote stating whether the A/E firm received a PPP loan and the current status of any loan forgiveness as of the date of issuance of the schedule or audit report.

III. Implementation and Effect on Contracts

Q9: What guidance or approach is a state DOT expected to follow in evaluating the treatment of PPP loan forgiveness by an A/E firm in conjunction with a cognizant review of that firm's indirect cost rate audit report?

A9: In performing cognizant reviews of A/E firm indirect cost rates and determining acceptable and allowable accounting treatment for PPP loan forgiveness and related credits, state DOTs

should follow the guidance included in FHWA Memorandum HCFB-30 (as referenced above), and the guidance included in these Questions and Answers.

Q10: Is a state DOT be permitted to reject or modify an A/E firm's cognizant-approved indirect cost rate because of a different treatment of PPP loan forgiveness by the non-cognizant state?

A10: No, the existing rules regarding acceptance of cognizant-approved indirect cost rates would continue to apply, and the receiving, non-cognizant, state DOT would be required to accept the rate even if their approach on the treatment of PPP loan forgiveness differs from that of the cognizant state DOT. However, the use and application of the cognizant rates may vary based on the unique contracting policies and procedures for each state DOT.

Q11: FHWA Memorandum HCFB-30 states: "The indirect cost rate credit should only be applied until the credit is recovered fully." Who is responsible for tracking the recovery of the credited amount? How will that be determined? What is the process for stopping the application of the lower PPP forgiveness credit-adjusted rate once the credit has been fully recovered?

A11: The A/E firm is responsible for tracking the recovery/payback of the PPP credit. The firm should communicate with the state DOT(s) for whom it performs work, regarding the firm's tracking method and any documentation it may provide in support of the recovery of the credit. State DOTs should establish a process to end the application of the PPP forgiveness credit-adjusted overhead rate (hereinafter the "post-PPP rate") promptly once the credit has been fully recovered and should communicate the process in writing to A/E firms with whom it contracts.

Q12: What are acceptable methods a state DOT might use to limit the impact of the PPP forgiveness credit so the amount credited (i.e., "paid back") does not exceed the allocable portion, to conform with FHWA guidance that "All applicable credits (or loan recoveries) are to be applied based on an equitable allocation to all benefiting costs objectives in accordance with 48 CFR § 31.201-4. The indirect cost rate credit should only be applied until the credit is recovered fully."

A12: State DOTs are expected to establish appropriate methods to comply with the requirement to apply the post-PPP rate only until the total required PPP credit is recovered fully, and A/E firms are expected to maintain and provide any required documentation to track the recovery of the credit. Acceptable methods to limit the application of the credit to the appropriate amount to be recovered should include establishing guidelines to avoid the application of the post-PPP rate to more than a single year of a multi-year contract. For example:

- In negotiating a 5-year contract, the post-PPP rate should only be applied to year 1 of the contract, and the contract pricing for the remaining years should be established based on a rate more representative of the firm's expected actual costs in those later years, excluding any effect from the PPP forgiveness credit.
- Once the A/E firm has notified the state DOT that the PPP forgiveness credit has been fully recovered, and the firm has provided adequate support, the state DOT should apply the indirect cost rate that excludes the PPP forgiveness credit for purposes of any future negotiations.

Q13: What contract types require the application of a post-PPP rate? For example, would the post-PPP rate be applied to lump-sum or fixed-price contracts negotiated for future periods? Would the post-PPP rate be applied differently for purposes of "true-up" of 2020 contracts than for pricing of contracts negotiated for future periods? (See Note 3.)

A13: For purposes of negotiating new contracts, the post-PPP rate should be applied to contracts that require costs to be established using the FAR-compliant indirect cost rate, in a manner that would not result in over-recovery of the PPP credit. For example, the post-PPP rate should be applied to pricing of the first year in a multi-year cost-reimbursable or lump-sum/fixed-price contract, but the post-PPP rate should not be applied to the remaining years.

For purposes of true-up of contracts that were underway when the PPP funds were received and used, the post-PPP rate should be applied to contracts that include a requirement for retroactive adjustments to the invoiced indirect cost rate to the actual indirect cost rate for the current year. The post-PPP rate only should be applied until the credit is fully recovered; any further contract true-ups should be calculated using the indirect cost rate which excludes the credit.

Note 3: Certain state DOTs treat interim billed costs as provisional costs. The true-up process involves the reconciliation of actual overhead rates for a given fiscal year to actual labor costs incurred and billed in the same year.

IV. Impacts of COVID-19 on A/E Firm Indirect Cost Rates

Q14: What methods may state DOTs use to limit the effects of the 2020 and 2021 "pandemic overhead rates" on multi-year contracts, to ensure that indirect cost rates used for establishing billing rates and contract limits (not-to-exceed amounts) on those contracts realistically reflect the amounts of indirect costs expected to be incurred during the years of contract performance? How do such methods correspond to the requirements of 23 CFR 172 that require indirect cost rates to be applied for a one-year period, unless both contracting parties agree to apply such rates for a longer period?

A14: As discussed in relation to the application of the post-PPP rate, state DOTs should limit the use of 2020 and 2021 indirect cost rates to a one-year period in accordance with the requirements of 23 CFR 172.11(b)(1)(vi), which states that the accepted indirect cost rate shall only be applied for the applicable accounting period and shall not be extended beyond that one-year period unless both contracting parties agree, and agreement to such extension shall not be a condition of contract award.

Acceptable methods to limit the use of 2020 and 2021 indirect cost rates to the applicable one-year period include establishing contract pricing for multi-year contracts based on the use of the most recent approved indirect cost rate for year 1, while allowing indirect cost rates for the remaining years of the contract to be established based on rates that are more consistent with the A/E firm's "pre-pandemic" levels of costs.