

# PPP Forgiveness, Indirect Rates, and The Incurred Cost Proposal: Considerations for Government Contractors

There is no reason why contractors can't or shouldn't take advantage of the COVID-19 relief programs that Congress has approved for businesses.

BY ROBERT E. JONES



**C**ongress approved several COVID-19 relief programs for businesses in 2020, many of which were extended into 2021. These programs are available to businesses in all industries, including government contractors. The proper treatment of these programs is of particular interest to government contractors, who must follow another set of rules: the *Federal Acquisition Regulation (FAR)*.

Government contractors can benefit from these programs and should participate to the maximum extent possible. This article addresses the various reporting requirements necessary to remain compliant with each program and with the *FAR*.

## Tax Issues

Congress approved the Coronavirus Aid, Relief, and Economic Security Act (CARES) in March 2020, including funding for Paycheck Protection Program (PPP) loans with forgiveness: a mechanism intended to get tax-free money into the hands of small businesses. On April 9, 2020, the IRS issued Notice 20-32, stating that businesses could not deduct expenses that generated PPP loan forgiveness – a stance in line with IRC Section 265(a)(1). In November 2020, the IRS issued Rev Rule 2020-27, which further clarified that expenses would not be deductible in the year incurred if, at the end of the tax year, the taxpayer expected to receive forgiveness of the loan. Both IRS documents effectively made loan forgiveness taxable.

Fortunately, Congress stepped

Tax example of a business receiving a \$100,000 PPP loan and forgiveness:

	BEFORE	EXP NOT DEDUCT	AFTER
REVENUE	\$1,000,000	\$1,000,000	\$1,000,000
EXPENSES	\$950,000	\$850,000	\$950,000
TAXABLE INCOME	50,000	150,000	50,000

in on December 27, 2020 to approve the Consolidated Appropriations Act, which included, among many other things in 5,000+ pages, the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA) and a clarification that expenses related to PPP loan forgiveness would be tax deductible.

## Concerns for Government Contractors

In addition to tax concerns facing all businesses, government contractors were concerned about the effect of PPP forgiveness on their contract billings, indirect rates, and incurred cost proposal. In addition to PPP loans, contractors have asked about the proper treatment of employer paid leave, the employee retention credit, and other parts of the CARES and Families First Coronavirus Relief Acts (FFCRA). This article addresses those concerns and answers some questions.

## Eligible Expenses That Qualify for PPP Forgiveness as a Government Contractor

The list of eligible expenses for government contractors is the same

as for all other businesses. However, the selection of specific expenses can have a significant effect on indirect rates and reimbursable amounts on cost-type contracts. Whereas most commercial entities simply track and report salaries and wages as a single line item, government contractors must segregate salaries and wages into Direct Labor, Overhead Labor, General and Administrative (G&A) Labor, and Paid Absences. The segregation of these expenses is critical to the accurate calculation of indirect rates and the respective amounts must be accurately reported on the incurred cost proposal.

Eligible expenses include:

- ▶ Payroll Costs, including
  - Labor/Salaries,
  - Group Health Benefits Paid by Employer,
  - Employer State and Local Taxes, and
  - Retirement Plan Contributions;
- ▶ Business Mortgage Interest;
- ▶ Rent;
- ▶ Utilities;
- ▶ Covered worker protection and facility modification expenditures, including personal protective

## Rates Before Forgiveness Calculation

		DIRECT	FRINGE	OVERHEAD	G&A	TOTAL
LABOR		\$100,000	\$	\$150,000	\$45,000	\$295,000
EXPENSES		\$300,000	\$95,000	\$155,000	\$105,000	\$655,000
APPLIED FRINGE		\$32,203	\$	\$48,305	\$14,492	\$95,000
<b>TOTAL POOL</b>	NUMERATOR	\$432,203	\$95,000	\$353,305	\$164,492	
<b>BASE</b>	DENOMINATOR		\$295,000	\$132,203	\$785,508	
<b>RATE</b>	POOL/BASE		32.20%	267.24%	20.94%	

equipment, to comply with COVID-19 federal health and safety guidelines;

- Expenditures to suppliers that are essential at the time of purchase to the recipient's current operations; and
- Covered operating costs, such as software and cloud computing services and accounting needs.

Since contractors cannot receive payment from the government and PPP loan forgiveness for the same expenses, contractors must carefully select and document the expenses used to claim forgiveness. FAR 31.201-5 clearly states that the contractor must pass on any rebates, refunds, or other credits in the form of reduced costs or cash refunds. By carefully selecting and documenting their forgiveness calculations, government contractors can meet the requirements of FAR 31.201-5 and avoid double-dipping on any government-funded payments.

### PPP Forgiveness Strategy for Government Contractors

Government contractors should focus on seeking forgiveness of indirect

## Forgiveness 100 Percent Applied to Labor

	FRINGE	OVERHEAD	G&A
LABOR	\$	\$150,000	\$45,000
EXPENSES	\$300,000	\$95,000	\$105,000
<b>FORGIVENESS</b>		(\$80,000)	(\$20,000)
LABOR	\$	\$70,000	\$25,000
EXPENSES	95,000	\$155,000	\$105,000

expenses (fringe, overhead, and G&A) without including any direct expenses on government contracts (we will discuss direct expenses on commercial contracts below). By claiming forgiveness on indirect expenses, government contractors can still bill the government all direct costs incurred plus the newly adjusted indirect costs.

### Contractors Must Use the Same Expenses Claimed for PPP Forgiveness When Calculating Indirect Rates and Preparing the Incurred Cost Proposal.

While contractors cannot use PPP loan forgiveness for direct expenses on government contracts, they could (in theory) use them for direct

expenses on commercial contracts. Keep in mind that all direct expenses affect fringe, overhead, and G&A rates, and the reduction of direct expenses through the application of PPP loan forgiveness is not advisable. Furthermore, I can't foresee a situation wherein a government contractor would not have enough indirect expenses to absorb PPP loan forgiveness.

### Why Government Contractors Should Apply for PPP Forgiveness

Throughout the PPP loan process, some government contractors expressed concerns about applying for forgiveness, citing issues with

## Rates After-100% Applied to Labor

		DIRECT	FRINGE	OVERHEAD	G&A	TOTAL
LABOR		\$100,000	\$	\$70,000	\$25,000	\$195,000
EXPENSES		\$300,000	\$95,000	\$155,000	\$105,000	\$655,000
APPLIED FRINGE		\$48,718	\$	\$34,103	\$12,179	
<b>TOTAL POOL</b>	NUMERATOR	\$432,203	\$95,000	\$259,103	\$142,179	
<b>BASE</b>	DENOMINATOR		\$195,000	\$148,7183	\$707,821	
<b>RATE</b>	POOL/BASE		48.72%	174.22%	20.09%	

## Forgiveness 60% Applied to Labor

	FRINGE	OVERHEAD	G&A
LABOR	\$	\$150,000	\$45,000
EXPENSES	\$95,000	\$155,000	\$105,000
<b>FORGIVENESS</b>		(\$80,000)	(\$20,000)
LABOR EXPENSES	\$	\$102,000	33,000
	\$95,000	\$123,000	\$97,000

tax deductibility, double-dipping on government payments, and the effect on their indirect rates.

There is nothing to keep government contractors from participating in the forgiveness aspect of PPP loans. While there are some issues unique to government contractors, they are easily resolved through the proper allocation of refunds, rebates, or credits received in accordance with FAR 31.201-5. In fact, PPP loan forgiveness may have a positive effect on indirect rates as discussed below.

### The Effect of Section 3610 Assistance

Section 3610 of the CARES Act allows contractors to ask contracting offi-

cers, on a contract-by-contract basis, for additional funding to keep staff in a ready state while idle due to facility closures or other restrictions preventing the completion of work. These funds were to be added to the existing contract as a separate contract line item (CLIN) and could be issued as cost-type or fixed price modifications.

### These Idle Costs are Now Direct Costs for Those Specific Contracts Since the Readiness is a Paid Deliverable of that Contract.

Contractors may be confused and potentially mischarge labor when idle employees on a contract with 3610

funding are treated as direct while idle employees on a contract without 3610 funding are treated as indirect. In this situation, terms of the contract supersede the normal treatment of a cost in accordance with the contractor's standard practices and should be noted in the contract, the project/job, timekeeping, and incurred cost proposal.

### How to Report PPP Forgiveness and Section 3610 on the ICP

Adjustments to GL balances are reported in the "Adjustment" column on the incurred cost proposal with a note explaining the adjustment. Since PPP forgiveness will cause adjustments to the fringe, overhead, and/or G&A pools, contractors will want to include a worksheet (preferably as a separate tab) showing the calculation of PPP forgiveness funds applied to each pool.

Section 3610 funds are billable CLINs just like any other CLIN and will appear on Schedule H as separate line items (in the appropriate section) for the affected contracts.

## Rates After - 60% Applied to Labor

		DIRECT	FRINGE	OVERHEAD	G&A	TOTAL
LABOR		\$100,000	\$	\$102,000	\$335,000	\$235,000
EXPENSES		\$300,000	\$95,000	\$123,000	\$97,000	
APPLIED FRINGE		\$40,426	\$	\$41,234	\$13,340	\$95,000
<b>TOTAL POOL</b>	NUMERATOR		\$95,000	\$263,234	\$143,340	
<b>BASE</b>	DENOMINATOR		\$235,000	\$140,426	\$703,360	
<b>RATE</b>	POOL/BASE		40.43%	187.45%	20.37%	

### Why Government Contractors Should Seek Section 3610 Funding

The CARES Act originally provided Section 3610 funding of paid leave for contractors who could not access the worksite or telework due to COVID-19 restrictions. The intent of this funding was to keep employees in a ready state for when work could resume.

The Consolidated Appropriations Act extended the eligibility date from December 21, 2020 (previously September 30, 2020) to March 31, 2021. With more funding opportunities available, contractors should work with their contracting officers to determine if continued COVID-19 restrictions make them eligible to receive these funds.

DoD used Section 3610 more than any other agencies and provided guidance to contractors (including a class deviation) regarding eligibility to receive funds and the proper treatment of costs and credits. The proper treatment of costs and credits is critical to the accurate calculation of indirect rates and preparation of the incurred cost proposal.

### PPP Forgiveness

PPP loan forgiveness, when applied to indirect costs, will reduce indirect rates. For some contractors, this may be their saving grace. At a time when many contractors shifted direct employees to overhead, an opportunity to reduce overhead expenses may be a breath of fresh air.

### Should I Be Concerned About Reducing My Indirect Rates?

No, not really.

First and foremost, the incurred cost proposal must be presented, and indirect rates calculated, in accordance with the FAR, Cost Accounting Standards (CAS), and other contract requirements. In other words, the rates are the rates. At the end of the day, we must calculate and report the rates for what they are regardless of our subjective opinion of those rates.

Secondly, reduced rates for 2020 (or any fiscal years incorporating the covered period for any COVID-19 relief programs) do not mean reduced rates for future years. While many contractors use actual historical rates for future provisional

rates, they can (and should) develop forward-looking budgets for those future periods. Yes, DCAA or another cognizant agency will evaluate indirect rate trends, but the 2020 blip can be easily explained and reconciled. Provisional billing rates are intended to reflect what the contractor expects to experience. If historical rates do not accurately reflect a contractor's forecast, they should not be used.

### Section 3610

Section 3610 should work to reduce indirect rates by increasing the amount of direct costs. Remember that direct costs are in the bases of fringe, overhead, and G&A, and that increases in direct costs work to reduce indirect rates by providing a larger base/denominator over which to apply the pool/numerator.

### Other FFCRA & CARES Act Relief

The principles addressed here also apply to other forms of relief, including employer paid leave, employee retention credits, and deferred payroll taxes.

## Rate Summary

COST ELEMENT	JAN	FEB	MAR	APR	MAY	JUNE
DIRECT LABOR	\$22,000	\$20,000	\$18,000	\$12,000	\$11,000	\$12,000
MATERIALS	\$5,000	\$6,000	\$4,000	\$3,000	\$2,000	\$2,500
TRAVEL	\$2,800	\$2,700	\$2,000	—	—	—
ODC	\$200	\$100	\$200	\$100	—	—
SUBCONTRACTOR	\$13,000	\$12,000	\$11,000	—	—	—
OH LABOR	\$10,000	\$12,000	\$14,000	\$20,000	\$21,000	\$20,000
OH EXPENSES	\$7,500	\$7,400	\$7,800	\$8,000	\$8,000	\$7,800
GA LABOR	\$8,500	\$8,700	\$8,500	\$8,500	\$8,500	\$8,700
GA EXPENSES	\$10,000	\$11,000	\$10,000	\$11,000	\$10,000	\$11,000

◀ 8 Week Period ▶

	FRINGE	OVERHEAD	G&A	MULTIPLIER
BEFORE	32.2%	267.24%	20.94%	5.871532
100% LABOR	48.72%	174.22	20.09%	4.89751
60% LABOR	40.43%	187.45%	20.37%	4.858928

In the case of employer paid leave and employee retention credits, tax credits reimburse employers for qualified wages and healthcare expenses. Remember *FAR* 31.201-5 from above? Any credit, rebate, or refund of taxes, the original payment of which would otherwise be included in an indirect pool, must be credited back to the indirect pool and passed on to the government in the form of reduced costs.

The Consolidated Appropriations Act's changes to the CARES Act allow companies to apply for both PPP forgiveness and the employee retention credit. However, companies

may not count the same wages toward multiple forms of relief. A company with \$500,000 in eligible payroll expenses may separately apply portions of those wages to the applicable forms of relief:

- ▶ \$200,000 PPP forgiveness,
- ▶ \$50,000 employer paid leave,
- ▶ \$30,000 employee retention credit, and
- ▶ \$220,000 not applied to any form of relief.

Please contact your payroll and/or tax advisor(s) for the proper reporting of wages and accurate calculation of tax credits.

### Best Practices

Document, document, document. As with all things legal and accounting, documentation is key. Contract and incurred cost audits often occur months or years after the fact making the explanation of events more difficult as time passes. Factors necessitating accurate recordkeeping that make accounting documentation in 2020 even more important:

- ▶ Multiple forms of relief,
- ▶ Varying and extended eligibility dates,
- ▶ Various reporting requirements, and
- ▶ Differing tax treatments.

JULY	AUG	SEPT	OCT	NOV	DEC	TOTAL
\$11,000	\$14,000	\$15,000	\$14,000	\$15,000	\$14,000	\$178,000
\$3,000	\$2,500	\$3,000	\$2,000	\$3,000	\$2,000	\$38,000
—	—	—	—	—	—	\$7,500
—	—	—	—	—	—	\$600
—	—	—	\$3,000	\$4,000	\$3,000	\$46,000
\$21,000	\$18,000	\$17,000	\$18,000	\$17,000	\$18,000	\$206,000
\$7,900	\$7,700	\$7,600	\$7,700	\$7,600	\$7,700	\$92,700
\$8,600	\$8,500	\$8,600	\$8,500	\$8,600	\$8,500	\$102,800
\$10,000	\$11,000	\$10,000	\$11,000	\$10,000	\$11,000	\$126,000

◀ Extended 24 Week Period ▶

The issues discussed in this article will result in different reported amounts for book, tax, and incurred cost purposes. Contractors will want to develop and maintain a worksheet identifying the expenses they claim for each, and a reconciliation between and among the differing reported amounts. I recommend filing a copy of the worksheet and reconciliation with the PPP forgiveness application, financial statements, income and payroll tax returns, Section 3610-affected contracts, and the incurred cost proposal.

Contractors should capture all these costs in separate general ledger accounts to allow for easy identification, reporting, and reconciliation of amounts. For example:

- ▶ Direct Labor,
- ▶ Direct Labor 3610,
- ▶ PTO,
- ▶ PTO FFCRA,
- ▶ Overhead Labor, and
- ▶ Overhead COVID Idle Labor.

Contractors should create separate jobs or tasks to capture these amounts to allow for easy identification, reporting, and reconciliation. Section 3610 funds need to be reported as separate line items on the invoice and ICP Schedule H. Even separate indirect jobs can further support a contractor's proper claim of forgiven amounts when calculating indirect rates.

With a second round of PPP loans now available and Section 3610 extended through March 31, 2021, it's not too late to start off on the right foot.

Access tools and resources, such as an indirect rate calculator and incurred cost proposal template at [www.LeftBrainPro.com](http://www.LeftBrainPro.com). **CM**

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