



2013 OPPORTUNITY FINANCE NETWORK
ANNUAL CONFERENCE
PHILADELPHIA, PA • OCT. 15-18, 2013

**Financial Statement Standards
and Best Practices**

CDFI Financial Statement Working Group
October 18, 2013

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Why Working Group Got Started

- ★ Discussion at industry forums about the considerable variation in accounting and financial statement presentation
- ★ Difficult for investors to understand CDFI financials and CDFI financial performance
 - Lack of uniformity
- ★ Slows advancement of new capital sources for the industry
 - SBA, other government programs, new corporate investors

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Goals of Working Group

- ★ Achieve greater consensus around financial metrics, financial statements, and financial reporting
 - focused on loan funds as depositories have consistency
- ★ Lead to streamlined reporting and clearer messaging by CDFIs
- ★ Ultimately enable increased access to capital sources
 - Easier for current and prospective investors to understand financial statements and financial wherewithal

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Working Group Participation

- ★ Industry led
- ★ Initial Participation by 12 CDFIs (primarily CFOs)
 - Diverse (type, size, geography)
- ★ Managed by OFN
- ★ Accounting and Legal Advisors
- ★ Input from the CDFI industry
- ★ Input from Investors, Funders, and other key stakeholders

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Special thanks to our Experts

★ Accounting

- Alexander, Aronson, Finning & Co, Tom Washburn
- Novagradac & Company LLP, Owen Gray
- Reznick Group, Scott Szeliga
- Reznick Group, Anne Schrantz

★ Legal

- Arent Fox, David Dubrow



Outcomes (Short-Term)

- ★ White Papers on various topics including recommendations for new standards related to accounting and financial presentation issues
 - GAAP requirements; industry practice; working group recommendations
 - Initial two topics:
 - Net Assets and Grants
 - Portfolio Reporting
- ★ Create an infrastructure among CDFI CFOs to facilitate exchange of documents, information, and best practices



Outcomes (Long-Term)

- ★ CDFIs and accountants incorporate recommendations into accounting treatment and financial statement presentation
- ★ Funders and investors incorporate standards into agreements and reporting
- ★ Increase flow of capital to CDFIs

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Complement CARS Efforts

- ★ Both have a goal to increase the flow of capital to CDFIs
- ★ Working group focus on financials and portfolio reports
- ★ CARS Data Platform focus on taking data from different reports and putting them in a standardized format
 - cloud-based system; quarterly
- ★ Working Group efforts should greatly simplify and reduce time to report to CARS Data Platform

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Current Industry Practice Grants and Net Assets

- ★ Accounting treatment
 - Operating grants relatively consistent
 - Unrestricted (general operating support) vs. temporarily restricted
 - Book at fair value
 - Unconditional grants vs. conditional grants
 - Earned income (exchange transaction) vs. grants
 - Grants for financing vary widely
 - Unrestricted (UR), Temporarily restricted (TR), Permanently restricted (PR)
 - Often classified based on how classified in the past
 - Similar differences for CDFI Fund grants

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- ★ Financial Statement Presentation
 - Varies with both net assets and grants

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Working Group Recommendations Grants

- ★ Best to classify grants in the **least restrictive manner** possible (within the terms of the grant)
 - Gives CDFI more flexibility
 - Gives creditors more protection

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Working Group Recommendations Grants for Financing

- ★ Classify as UR if for financing in general
 - No other restrictions
 - Support general business & mission of the CDFI
- ★ Classify as TR if a time or purpose restriction
 - Make loans, LLR, specific geography, or program
 - Revolving funds, maintain as TR until a loan is written-off
 - If meet the restriction in the same year as receive the grant, can book as UR
- ★ Not typically classify as PR
 - Category intended for grants that remain into perpetuity
 - Nature of lending business could be used to cover loan losses
 - Would need to go back to donor and ask for permission to use

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Working Group Recommendations Grants

- ★ CDFI Fund grants
 - Book as UR, for typical CDFI Fund Financial Assistance Agreement
 - Broad in potential use to support CDFIs business plan
 - Lending operations, loan capital, loan loss reserve
 - If further restrictions (i.e. geography, program), book as TR and release when meet restriction
 - Not book as deferred revenue

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Working Group Recommendations

Presentation of Grants on Statement of Activity

Current Practice

Presentation Varies Across CDFIs


| | UR | TR | PR |
|---------------------------------|----|----|----|
| Grants, Operations | | | |
| Grants, Re-granting | | | |
| Grants, Financing | | | |
| Grants, by source | | | |
| Net Assets Released, Operations | | | |
| Net Assets Released, LLR | | | |

Recommendation

Clean, simplified, consistent presentation

| | UR | TR | PR |
|--------------------------|----|----|----|
| Grants and Contributions | | | |
| Net Assets Released | | | X |

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Working Group Recommendations

Presentation of Net Assets on Statement of Activity

Current Practice

Presentation Varies Across CDFIs


- Unrestricted
 - Unrestricted
 - Board designated for operating reserve
 - Board designated for LLR
 - Board designated for financing
 - Unrestricted, Property and Equipment
 - Unrestricted, Contractually limited in use
 - Non-controlling interest in subsidiaries
- Temporarily Restricted
 - Operations
 - Capital (general or program/sector specific)
 - Loan loss reserves/credit enhancement
 - Re-Granting
- Permanently Restricted
 - Capital
 - Other

Recommendation

Clean, simplified, consistent presentation

- Unrestricted
- Unrestricted, non-controlling interest in subsidiaries
- Temporarily restricted – Operating
- Temporarily restricted – Financing
- Temporarily restricted – Re-Granting
- Permanently restricted

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Working Group Recommendations Net Assets

- ★ Most important distinction is whether net assets can be used to protect lenders
 - Unrestricted; TR – financing
- ★ Do not include board designation on the SFP
 - Include significant designations in notes
 - Reflect management's intent and strategy
- ★ Presentation of net assets on unaudited should mirror audited statements

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Portfolio Reporting

The CDFI Dilemma - What's in a Definition?

- ★ As generally unregulated mission-centric financial intermediaries focused on lending in the "gaps", CDFIs are confronted with the challenge of accurately reporting their financial position within the context of their unique business model.
- ★ Essential CDFI Loan Portfolio terms to define:
 - Non-Accrual Loans
 - Impaired Loans
 - Troubled Debt Restructures (TDR)

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Portfolio Reporting

What's in a Definition?

- ★ **Non-Accrual Loan** - a loan is reported as non-accrual status if:
 - (1) payment in full of principal or interest is not expected due to a deterioration in the financial condition of the borrower,
 - (2) interest is no-longer accrued in the Statement of Activity and all payments are first applied towards principal reduction,
 - (3) principal or interest is in default **typically** for a period of 90 days or earlier if CDFI perceives enhanced repayment risk. *
- ★ Impaired Loans
- ★ Troubled Debt Restructures (TDR)

* Note: US-GAAP: For banks reporting under US bank regulatory standards, all loans past due 90 days or more are required to be placed on non-accrual status. For CDFIs, we are recommending 90+ days past due as the cut-off, except for special circumstances.

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What's in a Definition?

- ★ Non-Accrual Loan
- ★ **Impaired Loan** – As per FASB Accounting Standards Codification (ASC) 310-10-35-16:
 - “a loan identified as impaired is one for which it is probable the institution will be unable to collect all principal and interest amounts due according to the contractual terms of the original loan agreement.”
 - An impaired loan does not need to be restructured or modified to be considered impaired.
 - An impaired loan may migrate off impaired status based on CDFI management analysis
 - If restructured, will remain as Impaired loan

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What's in a Definition?

- ★ Non-Accrual Loan
- ★ Impaired Loan
- ★ **Troubled Debt Restructures (TDR)**
 - A loan is considered a TDR that is restructured or modified for economic or legal reasons, where,
 1. The creditor grants a *concession** that it otherwise would not consider, but for the
 2. borrower's *financial difficulties**

*NOTE: Both *Concession* and *Financial Difficulties* - have specific meaning under FASB Accounting Standards Codification (ASC) 310-40.

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TDR & Non-Accrual Status

- ★ **Troubled Debt Restructures (TDR) = Restructured loans**
- ★ **All TDR loans are impaired.**
- ★ ***TDR = Impaired + Restructured***
- ★ Can a TDR loan be returned to accrual status?
 - Yes. Under certain conditions:
 - The restructuring must be *prudently underwritten* so that it has economic substance and improves the collectability of the loan, and
 - Any uncollectible amounts are charged off, and
 - The CDFI, based on the prudently restructured terms and *supported by a well documented analysis of the borrower's capacity*, is *reasonably assured* that the borrower will be able to repay the principal and interest on the modified debt according to the restructured terms, and
 - The borrower demonstrates repayment performance consistent with the modified terms for at least six months.

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What's in a Definition?

- ★ **Modified/Extended Loans (non-impaired/TDR loans)**
 - **Not all** loan modifications are TDR loans, as they must meet the ASC 310-40 definition of a TDR.
 - CDFIs modify, extend, and restructure loans as a normal course of business for reasons other than borrower financial deterioration and/or hardship.
 - While CDFIs track and monitor impaired, TDR loans, not all CDFIs track modified/extended loans as a separate category as a normal course of business.
 - Should not be required to report balances of modified/extended loans

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Portfolio Reporting

Proposed Loan Portfolio Summary Table

- ★ Proposed creation and use for all CDFIs of a universal loan portfolio performance summary table for inclusion in MDA narratives and/or Quarterly Loan Portfolio reports.

| Principal Amount (\$) | Delinquency Status | Non-Accrual | Impaired | TDR |
|-----------------------|--------------------|-------------|----------|-----|
| Current | | | | |
| 31-60 days past due | | | | |
| 61-90 days past due | | | | |
| 90+ days past due | | | | |
| TOTALS | * | ** | ** | ** |

*Totals = Total outstanding portfolio; **Totals = A subset of total outstanding portfolio

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Next Steps

- ★ Continue to seek industry input
- ★ Publish Papers
- ★ Cover new topics
 - Consolidation
 - Statement of Activities presentation
 - Standard financial covenants
 - Financial Dashboard and metrics
- ★ Develop platform to share information

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