



CDFI Portfolio Reporting

Definitions, Accounting Treatment, and Reporting Guidance



PERFORMANCE COUNTS

Best Practices for CDFI Financial Statements and Management

TABLE OF CONTENTS

I. INTRODUCTION	1
II. LENDING PORTFOLIO TERMS & DEFINITIONS	3
III. ALLOWANCE AND PROVISION FOR LOAN LOSSES	10
IV. LOAN CHARGE-OFFS AND RECOVERIES	15
V. FORECLOSED OR REPOSSESSED ASSETS	16
VI. LOAN PORTFOLIO REPORTING STANDARDS	17
VII. CONCLUSION & SUMMARY TABLE OF RECOMMENDATIONS	21
APPENDIX A: PERFORMANCE COUNTS WORKING GROUP AND ADVISORS	22
APPENDIX B: OTHER ACCOUNTING RESOURCES RELATED TO LOAN PORTFOLIO AND CREDIT QUALITY	23

I. INTRODUCTION

The Community Development Financial Institution (CDFI) industry has experienced unprecedented growth over the past few years, the result of a higher public profile and an increased awareness that CDFIs offer essential solutions to problems for low-income and low-wealth people and communities. With this growth and higher visibility comes greater scrutiny and accountability. While CDFIs have long been responsive to the communities they serve, their expansion and growth—particularly with new large-scale capital providers to the industry—make it even more critical to communicate clearly and transparently to external stakeholders and investors about their financial position and stability.

In support of this purpose, Opportunity Finance Network (OFN) convened a new industry-led initiative, *Performance Counts: Best Practices for CDFI Financial Statements and Management*, to develop financial best practices, guidance, and financial statement standards for CDFIs. An industry-led Working Group (the Working Group) convened to develop standards and best practices for CDFI financial statements and management. Accountants and other professionals advised the Working Group.

The goals of the effort are to:

- Achieve greater consensus within the CDFI industry around financial metrics, financial statements, and reporting;
- Enhance financial management and best practices within the CDFI industry;
- Promote streamlined reporting and clearer messaging by CDFIs; and
- Enable increased access to capital sources by helping current and prospective investors better understand CDFI financial statements, financial performance, and financial wherewithal.

This paper is the second in a series addressing specific financial statement and financial management topics, with the goal of encouraging agreement and ultimate adoption of recommendations on how best to present CDFI financial information in a more clear, standard, and transparent way. OFN welcomes feedback, as continuous communication regarding process and work product is critical to the success of this initiative.

ABOUT THIS PAPER

Currently, the CDFI industry is awash in terms used to describe and report on loan portfolio quality. Certain terms are and can be used interchangeably, whereas other terms are used by CDFIs but have a different specific meaning to certain key industry stakeholders (e.g., regulated banks). This use of terms often causes unintentional confusion among CDFI financial statement readers. In addition, there is also a lack of consistency among CDFIs in the formats and methodologies used for reporting on their portfolio credit quality, including the Allowance for Loan Losses (ALL) on the Statement of Financial Position (SFP), and the Provision for Loan Losses (PLL) on the Statement of Activities (SOA). This lack of standardization can cause confusion, making it more difficult for investors and funders to adequately analyze the creditworthiness of a CDFI and potentially limiting access to new capital.

Further, the Financial Accounting Standard Board's GAAP (Generally Accepted Accounting Principles)¹ accounting standards have evolved over the past several years, requiring greater credit quality disclosure. Even as CDFIs move to adopt these new requirements, the interpretations of these requirements are not consistent across the industry.

¹The Financial Accounting Standards Board (FASB) is the designated organization in the United States for establishing standards of financial accounting governing the preparation of financial reports by private sector, nongovernmental entities. These financial account standards are called generally accepted accounting principles (GAAP). On July 1, 2009, the FASB announced the launch of its Accounting Standards Codification (ASC), as "the single source of authoritative nongovernmental U.S. generally accepted accounting principles." The Codification organizes the many pronouncements that constitute U.S. GAAP into a consistent, searchable format. See appendix B.



This paper offers background and information, and specific recommendations for the adoption of certain portfolio quality terms and definitions.

The paper is organized to:

- Provide context to CDFI industry lending;
- Provide definitions of commonly used terms to describe lending portfolio characteristics and associated credit quality;
- Discuss and provide recommendations for definitions, accounting treatment, presentation, and setting of ALL and PLL;
- Discuss and provide recommendations for definitions, accounting treatment, and timing of charge-offs and assets acquired by CDFIs in foreclosures;
- Discuss GAAP-required disclosures in portfolio quality reporting in audited financials and recommend additional supplemental credit quality disclosures for interim financials and other reporting.

This paper does not and is not intended to discuss all components of a CDFI's lending practice, credit risk rating system, and credit portfolio management and monitoring processes. Instead, this paper specifically addresses the reporting requirements and recommended best practices in accounting for lending activity and portfolio quality in published financial statements, audit statement disclosures, and supplemental portfolio quality reports. It is intended to be a starting point for the CDFI industry to move towards greater standardization and best practices. Performance Counts may publish additional papers on this topic in the future.

A special note: Terms used in this paper relating to balance sheet and income statement descriptions are expressed in a nonprofit accounting terminology. While nonprofit accounting is different from for-profit accounting in many respects, as it relates to loan accounting by creditors, there is no distinction in accounting guidance between nonprofit and for-profit entities.

CONTEXT FOR CDFI INDUSTRY LENDING

While the goal of this paper is to recommend consistent practices among CDFIs related to loan portfolio and credit quality definitions, presentation, and reporting, it is not intended to limit a CDFI's ability to work with borrowers creatively and constructively to accomplish its mission.

The nature of the CDFI industry is such that CDFIs provide loans that conventional financial institutions are not or may not be willing to finance. Loans from CDFIs may include more flexible credit terms and conditions, as well as technical assistance support to borrowers. The CDFI industry succeeds in finding ways to structure loans and provide supporting technical assistance to mitigate risks in their portfolio. One of the biggest benefits CDFIs bring is their market knowledge, patient lending, and ability to work creatively and prudently with borrowers to provide flexible financing to serve their community. As an industry, CDFIs finance underserved borrowers while still maintaining delinquency and loan rates that rival conventional financial institutions.

Because of the type of lending and support CDFIs bring to their communities, they occasionally modify or restructure loans as a normal course of business. When considering definitions for loan terms, the Working Group considered both the GAAP requirements and the context in which the CDFI industry operates. The definitions recommended address both of these factors.



II. LENDING PORTFOLIO TERMS AND DEFINITIONS

CDFIs use a variety of terms for reporting on their loan portfolios and associated credit quality. In some cases, the terms have specific definitions in GAAP (e.g., troubled debt restructurings (TDRs) and impaired loans) and in some cases they describe more subjective risk rating quality categories. Often times, the terms are used interchangeably within a CDFI and across CDFIs. For example, some CDFIs use the terms modified loan and restructured loan interchangeably. Also, the terms “substandard” and “watch list” are not specific accounting terms but instead are regulatory terms used in the banking sector or are subjective loan portfolio credit quality terms employed by many lenders to describe loans that need to be reviewed or “watched” more frequently for further signs of credit deterioration.

Some of the more commonly used terms by CDFIs to report on their loan portfolio or associated credit quality status of their portfolio are included in the chart below. When there are terms that have the same meaning as another term, the “Notes” column includes an indication of which term is recommended for use in the CDFI industry.

LENDING PORTFOLIO TERMS AND DEFINITIONS

Term	Definition	Notes
Allowance for Loan Losses (ALL)	The calculated reserve that institutions establish in relation to the estimated credit risk within the institution’s assets. The ALL serves as a cushion to protect an organization against potential future losses. <i>Source: ASC 310 & ASC 450</i>	Recommend using “ALL” instead of “Loan Loss Reserve.” For lending entities that also provide leasing services, the recommended term is “Allowance for Loan and Lease Losses” (“ALLL”).
Bad Debt Expense	Bad debt expense is the amount of an account receivable that is considered to not be uncollectible. The amount of bad debt is charged as an expense. <i>Source: ASC 310</i>	Recommend using “Charge-off” instead of “Write-off” or “Bad Debt Expense” for loans receivable. Bad debt expense is typically used in relation to non-loan receivables. Bad debt expense is typically not used within the banking industry.
Charge-off	A direct reduction of the carrying amount of a financial asset measured at amortized cost resulting from uncollectibility. A financial asset is considered uncollectible if the entity has no reasonable expectation of recovery. <i>Source: www.ifrs.org/Meetings/Documents/FI0211b09obs.pdf</i>	Recommend using “Charge-off” instead of “Write-Off” or “Bad Debt Expense.” Charge-off is usually a non-cash event impacting the balance sheet.
Criticized Asset List	A list of loans and other assets that needs to be reviewed or “watched” more frequently by the lender for further signs of deterioration, according to its respective credit policy standards. Loans on the criticized asset list may or may not be past due and may or may not be performing in accordance with the loan terms. <i>Source: OCC Comptroller’s Handbook for Rating Credit Risk</i>	Recommend using “Criticized Asset List” rather than “Watch List.” Criticized Asset List is a defined term within the banking industry, as used by regulators. Note that assets other than loans can be included in a criticized asset list, although for most CDFIs, it only includes loans.
Current Loans	A current loan is any loan in the portfolio where principal and interest is current according to the scheduled repayment terms specified in the note or loans that are up to 30 days past due.	Past due loans typically begin with the 31-60 days category, since lenders often give a grace period for a short period of time.



Term	Definition	Notes
Delinquent Loan	Any loan where a principal and/or interest payment is past due according to the scheduled repayment terms specified in the loan documents.	Recommend using “Past Due Loan” rather than “Delinquent Loan.” Typically, it’s divided into categories beginning with 31 days past due.
Impaired Loan	A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. <i>Source: ASC 310-10-35-16 Assessing Whether a Loan is Impaired, also ASC 360</i>	See next section below for further discussion.
Loan	A contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor’s statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable. <i>Source: ASC 310-10-20 Glossary</i>	Financing receivables is also a term used for loans by financing companies. Recommended term is Loan or Loan Receivable.
Loan Loss Reserve (LLR)	The calculated reserve that institutions establish in relation to the estimated credit risk within the institution’s assets. The LLR serves as a cushion to protect an organization against potential future losses. <i>Source: ASC 310 & ASC 450</i>	Recommend using “ALL” instead of “Loan Loss Reserve.” For lending entities that also provide leasing services, the recommended term is “Allowance for Loan and Lease Losses” (“ALLL”).
Modified Loan	A loan in which the original terms (e.g., purpose, interest rate, repayment schedule, and/or maturity) have been changed but not to the extent that the modification constitutes a TDR. Does not include loans listed as TDRs.	Recommend using “Modified” rather than “Restructured”, as restructured is too often confused with a TDR. Not all CDFIs report modified loans, as these loans are often modified or extended in the normal course of business, and do not represent loans with credit quality issues.
Non-Accrual Loan	A past due loan that is no longer accruing interest on the SOA.	By definition, non-accrual loans are deemed impaired. See next section for further discussion.
Non-Performing Loan	A loan that is in or near default. A loan that is not performing according to the loan documents, including loans in violation of repayment obligations. Includes loans that are 90+ days past due, on non-accrual status, or impaired.	Recommend using “Non-Performing Loan” instead of “Problem Loan.” If loans are TDR or modified and are performing according to the new loan terms, they are no longer included as non-performing loans.

Term	Definition	Notes
Other Real Estate Owned (OREO)	OREO is property the lender receives as a result of foreclosure, in lieu of payment, on a defaulting loan when the borrower used the property as collateral for the loan. <i>Source: ASC 310 and ASC 360 provide general guidance for the recording of OREO.</i>	If a CDFI plans to hold the property (e.g., for rental property), it will need to classify the property as fixed assets, not OREO.
Past Due Loan	Any loan where a principal and/or interest payment is past due according to the scheduled repayment terms specified in the loan documents.	Recommend using “Past Due Loan” rather than “Delinquent Loan.” Typically, it’s divided into categories beginning with 31 days past due.
Performing Loan	A loan that is meeting all repayment obligations, and financial and legal terms of a note and/or loan agreement.	
Portfolio At Risk (PAR)	The value of all loans outstanding that have one or more installments of principal past due more than a certain number of days. This item includes the entire unpaid principal balance, including both past-due and future installments, but not accrued interest. It also does not include loans that have been restructured or rescheduled. Portfolio at risk (PAR) is usually divided into categories according to the amount of time passed since the first missing principal installment. PAR90 means all loans where payments are 90 days or more past due. <i>Source: CGAP/The World Bank Group: Microfinance Consensus Guidelines. Definitions of Selected Financial Terms and Ratios</i>	Recommend using “Past Due” rather than “Portfolio At Risk.” Please note the CDFI Fund uses PAR (defined as loans 90+ days past due) in their loan portfolio minimum prudent standards definitions. PAR is often used in the microfinance industry.
Portfolio Segment	The level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses. <i>Source: ASC 310-10-20 Glossary</i>	Lenders use portfolio segments to group loans that have similar risk characteristics. CDFIs may use loan products, lending sectors, or another methodology to determine portfolio segments.
Problem Loan	A generic term used to describe a loan that is having some type of credit quality issue. It could include loans in violation of repayment obligations, loans on non-accrual status, or impaired loans.	Recommend using “Non-Performing Loan” rather than “Problem Loan” as problem loan is more “industry speak” as opposed to having a specific GAAP or accounting definition.
Problem Loan List	A list of loans that needs to be reviewed or “watched” more frequently by the CDFI for further signs of deterioration, according to its respective credit policy standards. Loans on the problem loan list may or may not be past due and may or may not be performing in accordance with the loan terms.	Recommend using “Criticized Asset List” rather than “Watch List” or “Problem Lost List.” Similar term as “Criticized Assets List” except that criticized assets could include other types of assets (although for CDFIs, it is typically only loans).



Term	Definition	Notes
Provision for loan losses (PLL)	A non-cash expense set aside to cover future potential loan losses in the loan portfolio. <i>Source: ASC 310 and ASC 450</i>	Recommend using “PLL” instead of “Bad Debt Expense” or “Loan Loss Reserve Expense.”
Real Estate Held for Sale	Real estate held for sale is property the lender receives as a result of foreclosure on a defaulting loan when the borrower used the property as collateral for the loan, or other assets that the lender is holding for sale. <i>Source: ASC 310 and ASC 360 provide general guidance for the recording of OREO.</i>	Recommend using “Other Real Estate Owned (OREO)” rather than “Real Estate Held for Sale” as real estate held for sale could include other properties held for sale by lender.
Recorded Investment	The amount of the investment in a loan, which is not net of a valuation allowance, but which does reflect any direct write-down of the investment. <i>Source: ASC 310-10-20 Glossary</i>	
Recovery	A recovery is any amount that is reclaimed on loans that were charged-off in previous years.	If a loan was charged-off and then recovered within the same fiscal year, those amounts can be netted against each other.
Restructured Loan	A loan in which the original terms (e.g., purpose, interest rate, repayment schedule, and/or maturity) have been changed but not to the extent that the modification constitutes a TDR. Does not include loans listed as TDRs.	Recommend using “Modified” rather than “Restructured”, as this term is too often confused with a TDR. Not all CDFIs report modified loans, as these loans are often modified or extended in the normal course of business, and do not represent loans with credit quality issues.
Special Mention	A special mention loan asset is a risk rating classification for a loan that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. <i>Source: OCC Comptroller Handbook on Rating Credit Risk</i>	Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification or specific ALL.
Substandard Loan	Typically refers to a credit quality classification for loans and borrowers that are performing below “acceptable” level of credit quality or performance.	Typically used by bank examiners as one of three designated classes of “adversely classified” loans, reflecting risk of nonpayment: Substandard, Doubtful, and Loss.
Technical Default	A loan that is in violation of a reporting requirement, financial covenant, or other legal requirement of the loan agreement, with the exception of repayment obligations.	If the loan is in violation of a repayment obligation, it is non-performing.
Troubled Debt Restructuring (TDR)	A TDR is a loan that was restructured where the lender granted a concession that it otherwise would not consider but for the borrower's financial difficulties . <i>Source: ASC 310-10-20 Glossary</i>	See next section for further discussion.

Term	Definition	Notes
Watch List	<p>A list of loans that needs to be reviewed or “watched” more frequently by the CDFI for further signs of deterioration, according to its respective credit policy standards.</p> <p>Loans on the criticized asset or “watch” list may or may not be past due and may or may not be performing in accordance with the loan terms.</p>	<p>Recommend using “Criticized Asset List” rather than “Watch List”</p> <p>Watch List is a specific term used in the banking industry. Many CDFI funders and investors are banks and may utilize a different definition for Watch List than CDFIs.</p>
Write-off	<p>A direct reduction of the carrying amount of a financial asset measured at amortized cost resulting from uncollectibility. A financial asset is considered uncollectible if the entity has no reasonable expectation of recovery.</p> <p><i>Source: www.ifrs.org/Meetings/Documents/FI0211b09obs.pdf</i></p>	<p>Recommend using “Charge-off” rather than “Write-off.”</p>

RECOMMENDED CDFI LOAN PORTFOLIO REPORTING TERMS

To promote more standardization of terminology, the Working Group recommends CDFIs use the following terms from the list above in their audited financial statements and other loan portfolio reporting communications to describe portfolio performance. More detailed definitions and/or recommended accounting application for each of these terms are described below.

- Current loans
- Past due loans
- Non-accrual loans
- Impaired loans
- Troubled debt restructurings (TDRs)

FASB regulations mention non-accrual loans, TDRs, and impaired loans as requirements in the disclosure guidance for financing receivables in all financial audit reports. However, some CDFIs currently do not report these amounts in the notes to their audited statements.



Current and Past Due Loan

A current loan is any loan in the portfolio where principal and interest is current according to the scheduled repayment terms specified in the note or loans that are up to 30 days past due.

A past due loan is any loan in the portfolio where a principal and/or interest payment is past due according to the scheduled repayment terms specified in the note; past due loans typically are divided into categories beginning with 31 days past due.

Loan funds and banks typically report the following aging categories:

Current

31-60 days past due

61-90 days past due

>90 days past due

For credit unions, the categories are: Current, 2-6 months, 6-12 months, and >12 months past due.

Non-accrual Loan

When a loan is placed on non-accrual status, interest is no longer accrued on the SOA and all payments received from the borrower are first applied towards principal reduction.

Non-accrual treatment is required on any asset, due to financial condition deterioration, for which payment in full of principal or interest is not expected, or upon which principal or interest has been in default for 90 days or more unless the asset is both well secured and in the process of collection. However, there is no requirement that a loan must be past due for 90 days. Once reasonable doubt exists about a loan's collectability, the CDFI should place the loan on non-accrual status.

As a standard practice for the CDFI industry, the Working Group recommends CDFI loan funds and banks place all loans >90 days past due on non-accrual status. On a case-by-case basis, CDFIs can place loans on non-accrual earlier or later than the 90-day threshold (earlier, if the CDFI perceives enhanced repayment risk or later, if the CDFI has verifiable evidence that the loan will repay). For loans 90 days or more past due but still on accrual status, the Working Group recommends the CDFI specifically note the reason for not placing the loan on non-accrual status.

CDFIs will make a determination about the appropriate time to take a loan off of non-accrual status. In most cases, a loan restructured as a TDR will already be on non-accrual status. However, it is possible to return a TDR to accrual status. Below are the recommended guidelines for CDFIs to consider in returning a loan to accrual status:

- The CDFI should prudently underwrite the restructuring so that it has economic substance and improves the collectability of the loan,
- The CDFI charges off any uncollectible amounts, 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.

In some cases, the borrower may also need to demonstrate repayment performance consistent with the modified terms for at least six months.

Impaired Loan

According to FASB ASC 310-10-35-16: “A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement.”

Other important considerations to keep in mind when identifying impaired loans in a portfolio:

- An impaired loan does not need to be extended or modified to be considered impaired,
- A loan can be classified as impaired even if the borrower is making scheduled payments,
- For loans classified as impaired, CDFIs must conduct an impairment analysis (discussed in the section below on ALL), and
- An impaired loan may migrate off impaired status based on the CDFI’s impairment analysis,
- All loans on non-accrual should be classified as impaired,
- Once a loan is identified as a TDR, it must always remain in the impaired loan category until the loan is sold or repays.

Troubled Debt Restructuring (TDR)

A TDR is a loan that was restructured where the lender granted a ***concession*** that it otherwise would not consider but for the borrower’s ***financial difficulties***.

Whenever the terms of a loan are modified, the lender must evaluate whether the modification represents a TDR.² In this context, the terms “concession” and “financial difficulties” have specific definitions in FASB ASC 310-40. In the CDFI industry, CDFIs often make loan modifications in the normal course of business to extend the loan term when take-out financing is delayed or under other similar circumstances. If the CDFI determines that a modification is not concessionary, due to the financial difficulties of the borrower, and the CDFI continues to expect full repayment of the loan, the CDFI should not classify the loan as a TDR.

If the lender determines a modification is a TDR, it may need to perform a different impairment measurement analysis, which will impact ALL, and/or provide additional financial statement disclosures. Once a loan is modified as a TDR, it is considered an impaired loan and TDR until the loan is paid in full or charged-off or sold and needs to be reported as such.

Many CDFIs modify and extend loans as a normal course of business for reasons other than borrower financial deterioration and/or hardship. While CDFIs should report impaired loans and TDRs per GAAP requirements, not all CDFIs currently report modified loans that are not considered impaired and/or TDRs.

Additional Loan Portfolio Quality Rating Terms

There are a number of other terms CDFIs use for loan portfolio reporting purposes. These portfolio quality metrics are not required for audits and financial statements, but rather help the CDFI report to its board, funders, investors, or others about its portfolio quality performance.

²The accounting standards for TDRs are set forth in ASC Subtopic, 310-40, Receivables – Troubled Debt Restructurings by Creditors. In April 2011, FASB issued ASU 2011-02, A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring, to clarify whether a loan modification or restructuring is considered a TDR.

As we have discussed, the Working Group recommends the categories that we identified (current; past due; impaired; non-accrual; and TDR) are the most important credit quality indicators for investors, funders, and other external parties, and should generally be sufficient to evaluate the credit quality of a CDFI's loan portfolio.

However, at the CDFI's discretion, they can use other credit quality indicators that help them describe and demonstrate portfolio quality. CDFIs employ a variety of credit quality or risk rating categories to classify and risk score their loan portfolios internally. There are also a variety of ways that CDFIs choose to segment the portfolio by risk categories. For example, some CDFIs use a numeric scoring system (e.g., 1 through 5), while others use words which best describe risk categories for their CDFI (e.g., strong, adequate, special mention, substandard, and doubtful). As described in Section VI on "Loan Portfolio Reporting Standards," GAAP requires that financial institutions report on loan receivables by credit quality indicators in their notes to the audited financials. While it is not necessary for credit quality categories to conform across CDFIs, it is important for CDFIs to use terms consistently within their organization and to have categories that CDFIs can explain and define to their auditors who will review their portfolio by credit quality indicators.

III. ALLOWANCE AND PROVISION FOR LOAN LOSSES

TERMINOLOGY

Within the finance industry generally, and the CDFI industry specifically, there are a variety of terms used to refer to the contra-asset account on a CDFI's SOFP (balance sheet) and the non-cash expense on the SOA (income statement). Some of the more commonly used terms are:

Statement of Financial Position (SOFP)

- Allowance for loan and lease losses (GAAP term)
- Reserve for loan losses
- Allowance for credit losses
- Loan loss reserves

Statement of Activities (SOA)

- Provision for loan losses
- Bad debt expense
- Loan loss reserve expense

The Working Group recommends using the "Allowance for Loan Losses" and "Provision for Loan Losses" as the preferred terminology, defined as follows:

Allowance for Loan Losses (ALL) is the calculated reserve that institutions establish in relation to the estimated credit risk within the institution's assets. The ALL serves as a cushion to protect an organization against potential future losses.

The ALL reduces the book value of the institution's loans to the amount that the institution reasonably expects to collect. The ALL is reflected as a contra-asset against loan receivables on the CDFI's SOFP. See page 12 for the recommended financial statement presentation of ALL.

Provision for Loan Losses (PLL) is a non-cash expense set aside to cover future potential loan losses in the loan portfolio.

The PLL is reflected as an unrestricted expense on a CDFI's SOA.

Please note that most CDFIs do not have lease receivables, but if they do, they can expand the terminology and definitions to include leases.

Guidance for Determining the Amount of Allowance for Loan Losses

Under current GAAP,³ the amount of an institution's ALL is based on the institution's estimate of "probable losses" and losses that are "known" in the portfolio (such as anticipated future charge-offs). When establishing an ALL, GAAP requires lenders to consider both external factors (e.g., changes in macro-economic factors) and internal factors (e.g., asset quality trends, portfolio concentrations, and strength of the institution's credit administration process).

Similar to the banking industry, there are several acceptable methods used and factors CDFIs consider in determining the amount of the ALL. For non-impaired loans, the CDFI may choose to establish the ALL amount as a percentage of certain classes or segments of loans in the portfolio (e.g., real estate or small business). For impaired loans, individual, specific reserve amounts must be established for each loan.⁴ The ALL for non-impaired loans is typically referred to as the "general" ALL and the ALL for impaired loans is typically referred to as the "specific" ALL.

When establishing a general ALL amount for segments of the portfolio, it is based on both qualitative and quantitative factors, which may include:

- Historical loan losses and trends for a particular segment of loans,
- Nature and value of collateral,
- Past due status of loans,
- Term trends (loans with longer maturities are generally more risky),
- Loan rating trend,
- Concentration risks (geography, industry, loan size) and changes in levels of concentration,
- National/local economic trends and business conditions,
- Changes in the experience, ability, and depth of lending management and other relevant staff,
- Effects of other external factors such as competition and legal and regulatory requirements, and/or
- CDFI Industry conditions.

Each CDFI needs to determine the factors that it will utilize and apply a weighting to those factors which it considers most important.

Most CDFIs have a risk rating system to help set the ALL where loans that have similar risk characteristics are grouped together. While the specific parameters of these systems will vary among organizations, the risk rating system provides a methodology for scoring loans (or groups of loans) based on certain criteria. The specific rating then translates into an ALL percentage or range of percentages used to compute the general ALL amount.

³FASB recently released a proposal that would change the way financial institutions calculate the ALL. The new model, if adopted would require the ALL be established for losses expected over the life of the loan based on current and future economic conditions.

⁴See ASC 450 and ASC 310 for further detail.

When establishing the specific ALL for impaired loans in a portfolio, CDFIs should base their calculation ultimately on the collectability of the loan, which they can estimate through an evaluation of underlying collateral value (for collateral dependent loans) and/or a discounted future cash flow analysis. Other factors to consider include:

- Third party guarantees, if applicable;
- Other credit enhancements (e.g., a stand-by letter of credit); and
- Reliability of repayment source.

In cases where there is a third-party guarantee (whether the loan is impaired or not), the CDFI should assess the creditworthiness of the guarantor and its ability to repay all or a portion of the loan. Depending on the conclusion of that analysis, the CDFI may choose to apply an allowance to all, a portion, or none of the loan. In situations where loans (or portions of loans) do not have an allowance based on the strength of the guarantor, adding a note to the financial statements with this information is recommended. Based on the above analyses, it is possible that an impaired loan has a \$0 specific reserve. Because investors typically calculate a ratio of ALL / Gross Loans Receivable, it is useful to know for which loans the CDFI does need to hold an ALL.

A CDFI's auditor will test the methodology the CDFI uses to determine the general and specific ALL as part of the annual audit process.

OTHER ISSUES RELATED TO ALLOWANCE FOR LOAN LOSSES

ALL vs. Restricted Cash Reserves

While GAAP requires that lenders establish a contra-asset account for an ALL, some CDFIs also have restricted cash accounts on the SOFP labeled as a loan loss reserve. This may occur when a government funded loan program or a particular funder has required the CDFI to maintain cash reserves for potential loan losses.

The purpose of the ALL contra-asset account is to provide a realistic assessment of what the CDFI will realize in collections on the loan portfolio. Restricted cash accounts provide a different function as an additional source of liquidity for the CDFI, which the CDFI can use ultimately to repay its obligations to funders and investors in the event there are losses in a particular loan portfolio. The CDFI should not add restricted cash reserves to the amount of the contra-asset account when calculating the ALL or when determining loan covenants. We recommend that the CDFI label the cash as "Cash, Restricted" on the SOFP, rather than specifying that it is for reserves (since the CDFI ultimately would use it as cash to repay investors). If the CDFI has cash that is restricted for other purposes, it can include a note to the audited financial statements which further describes the nature of the restricted cash account.

Even if a CDFI has restricted cash to cover future losses on a loan, the CDFI still needs to have an ALL for that loan so that the net realizable value of the loan is accurately reflected on the SOFP.

Presentation of ALL on the Statement of Financial Position

When presenting the loan portfolio information on the SOFP, the Working Group recommends including gross loans receivable and then netting the ALL against gross loans receivable. CDFIs should report restricted cash reserves, if any, separately as "Cash, Restricted." The CDFI has the option to report its assets and gross loans receivable by current and non-current (classified), or in aggregate (unclassified). If the CDFI presents current and non-current loans receivable, GAAP indicates that they should also report current and non-current ALL.

The Working Group does not have one preferred methodology, but believes the CDFI should consider materiality in their presentation.

Option 1: Non-classified SOFP Reporting

Loans Receivable	\$1,000,000
Allowance for Loan Losses	(\$50,000)
Loans Receivable, net	\$ 950,000

Option 2: Classified SOFP Reporting

Current Assets

Loans Receivable	\$ 500,000
Allowance for Loan Losses	(\$25,000)
Loans Receivable, net	\$ 475,000

Long-Term Assets

Loans Receivable	\$ 500,000
Allowance for Loan Losses	(\$25,000)
Loans Receivable, net	\$ 475,000

Presentation of PLL on the Statement of Activities

CDFIs currently use two primary methods for presenting the PLL (and interest expense) on the SOA. Both approaches are acceptable under GAAP. In the first method, revenues and expenses related to the organization's financing activities are presented in the revenue section typically under a title called "Net financing income." The CDFI would include loan fees as part of "Net financing income" as these fees result from the CDFI's financing activity. This results in a net financing income subtotal, which is followed by other operating revenues and then other operating expenses. In the second method, interest expense and the PLL are included in the expense section of the SOA.

The Working Group recommends CDFIs adopt the first approach. During the past five years, a number of CDFIs have already migrated to this approach. It is the approach the majority of financial institutions and Aeris (formerly CARS) use. By presenting the revenues and expenses from financing together, it provides a more transparent understanding of net financing income and whether the revenues from financing activities are sufficient to cover the cost of funds for financing and losses in the loan portfolio. One challenge with this approach is that it could potentially cause substantial fluctuations in net financing income if the PLL fluctuates widely from year to year.



Recommended Approach for Presentation of PLL on SOA in Net Financing Income Section

	2013	2012
Financing Revenue		
Interest Income – Loans	\$500,000	\$450,000
Interest Income – Investments	\$100,000	\$75,000
Loan Fees	\$25,000	\$25,000
Realized Gains (Losses) on Portfolio Investments	\$10,000	\$7,000
Total Financing Revenue	\$635,000	\$557,000
Financing Expenses		
Interest Expense	(\$200,000)	(\$175,000)
Provision for Loan Losses	(\$85,000)	(\$75,000)
Total Financing Expenses	(\$285,000)	(\$250,000)
Net Financing Income	\$350,000	\$307,000

Release of Net Assets to Cover PLL or Actual Loan Losses

In general, CDFIs use earned income generated from financing and other operating activities to cover the PLL. In some cases, CDFIs receive grants specifically for charge-offs. Initially, these grants are recognized as temporarily restricted revenues by the CDFI (previously discussed in the Performance Counts paper, *Presentation and Classification of Grants and Net Assets on CDFI Financial Statements*, available on OFN.org). For situations where CDFIs can use the grant for the PLL, the Working Group recommends releasing the grant from restriction when the PLL expense is incurred. If the grant is solely to fund actual charge-offs, then the Working Group recommends releasing the grant from restriction when the loan is charged-off. Once released, the grants should typically not be replenished or rebooked unless specifically required by the funder.

Lender Covenants Related to the ALL and Restricted Cash Reserves

Funders and investors in CDFIs sometimes include a loan agreement covenant that either i) requires the CDFI to maintain a minimum ALL or ii) requires the CDFI to maintain a restricted cash account to cover losses.

The Working Group recommends moving away from this practice in the future preferring instead to follow GAAP practices for setting the ALL, which are verified by the independent auditors. A minimum threshold for an ALL (e.g., 5%) could cause the CDFI to have larger reserves than required by GAAP, which in itself could violate the traditional reporting covenant that all financial statements be prepared in accordance with GAAP. Some recommended language for a loan agreement covenant related to ALL is as follows:

“Borrower shall maintain an ALL at the level indicated by its internal risk assessment of its loan portfolio and consistent with its policies for managing risk, or other minimum required by GAAP.”

Having minimum ALL threshold requirements by investors has also caused other non-recommended accounting practices, such as CDFIs “setting aside” or “designating” a portion of their net assets to cover loan losses. The Working Group recommends moving away from the practice of “designating” net assets for loan losses, as it confuses the GAAP-required contra-asset and other reserves. Instead, the Working Group recommends that the ALL covenant should relate to GAAP, and then the investor can have other covenants related to liquidity and/or net assets if the investor desires further protections for repayment of investments.

IV. LOAN CHARGE-OFFS AND RECOVERIES

TERMINOLOGY

CDFIs often use the terms charge-off, write-off, or loan loss interchangeably. Write-off is a GAAP term defined by FASB; however, charge-off is traditionally used by financial service companies to refer to an amount of a loan asset's value written down. The Working Group recommends using charge-off as the standard term.

A **Charge-off** is a direct reduction of the carrying amount of a financial asset measured at amortized cost resulting from uncollectibility. A financial asset is considered uncollectible if the entity has no reasonable expectation of recovery.

A charge-off is the accounting entry recording a direct reduction in the carrying amount of a financial asset (loan) measured at amortized cost. The charge-off is equal to the amount of the loan asset that the lender deems uncollectible. A lender shall charge-off a financial asset or part of a financial asset in the period in which the entity has no reasonable expectation of recovery of the financial asset (or part of the financial asset). Charge-offs are reported after default, foreclosure, and liquidation costs. Charging-off a loan does not release the borrower from its legal obligation to repay the loan in full and does not mean the lender does not continue to pursue collection efforts.

CDFIs can charge-off a whole loan or a portion of a loan. If a CDFI has an appropriate level of ALL, a charge-off is simply an accounting transaction which reduces the asset (receivable) and ALL by the same amount (and does not cause a reduction in net assets/equity).

A **Recovery** is any amount that is reclaimed on loans that were charged-off in previous years. If a loan was charged-off and then recovered within the same fiscal year, those amounts can be netted against each other.

Net Charge-offs are the amount of charge-offs reported in a given year less recoveries in that year.

Timing and Basis for Loan Charge-Offs

There is a lot of subjectivity in the CDFI industry around when and how much of a loan to charge-off. The Working Group understands that circumstances to charge-off a loan may vary based on loan type, asset class, and loan size. Below are some typical events that could give rise to a charge-off:

- A new appraisal on a property,
- Changes in occupancy,
- Change in market value of property and/or collateral,
- Changes in net operating income of a business,
- Changes in the financial strength of borrower or guarantor, or
- Changes in property condition.

In each of these circumstances, the CDFI will need to analyze the appropriate factors and make a determination about the appropriate level of charge-off. For example, for a real estate loan, CDFIs typically charge-off a loan (or a portion of a loan) when an event occurs which is a basis for a charge-off or an event occurs which gives information about asset valuation. If the CDFI obtains a new appraisal, this will help establish if a charge-off is warranted and could help determine the amount of the charge-off. If the CDFI is taking title to the property, the charge-off amount will be the difference between the loan receivable and the appraisal value less disposition costs. In determining the charge-off amount, the CDFI should factor in the time that it will take to dispose of the asset, and the fact that the asset may go down in value during that timeframe.



For business loans, CDFIs often have a more prescribed methodology for charge-offs. For example, business lenders often define in their procedures a certain minimum number of days past due before charging off business loans (typical between 120 and 180 days past due). Business lenders typically pick the number of days which is appropriate for them that represents the point in time when they have exhausted other options with the client, and there is likelihood that the loan will not be recovered in full.

When a CDFI conducts an impairment analysis on a loan or portfolio of loans, the CDFI may record a charge-off. An impairment analysis involves re-evaluating collateral the CDFI holds, as well as an analysis of discounted cash flows expected from the loan. The impairment analysis may or may not result in a need for a charge-off. If the collateral value and cash flow analysis demonstrates that the loan expects to be repaid in full, the CDFI will not record a charge-off. If the impairment analysis demonstrates a highly probable shortfall, the CDFI will record a partial or full charge-off.

When CDFIs charge-off loans, it does not mean they stop their process to collect on the loans. Sometimes, after loans are charged off, CDFIs will recover all or a portion of loan proceeds, which the CDFI will book as a recovery.

Accounting For Charge-Offs and Recoveries

When a CDFI takes a charge-off, they will reflect it as a reduction in ALL and a reduction in the corresponding loans receivable. This transaction itself will not impact the net assets of the CDFI. If the CDFI needs to replenish its ALL, the replenishment of the ALL may affect the net asset position.

If the CDFI receives a recovery on a loan that was previously charged-off, it will record income on the SOA in that amount as a line item such as “Charge-off Recovery Income.” This would flow through the SOFP as an increase in net assets. Alternatively, the CDFI could replenish its ALL for the amount of the recovery (if the recovery does not flow through the SOA). In that case, the CDFI will need to consider the replenishment of the ALL in the context of the overall ALL for the loan portfolio.

V. FORECLOSED OR REPOSSESSED ASSETS

Consistent with their role as disciplined financial lenders, CDFIs, at times, need to foreclose on real estate or other assets as a result of a default by the borrower. Other Real Estate Owned (or “OREO”) is property the lender receives as a result of foreclosure on a defaulting loan when the borrower used the property as collateral for the loan. Most items that are foreclosed are available for sale, but CDFIs may also maintain the property to rehabilitate and rent or maintain the equipment to use by the CDFI in its operations.

If the assets transferred into OREO are real estate, they are typically included on a CDFI’s financial statement as “OREO” or “Property Held for Sale,” with accompanying notes if the amounts are material. The Working Group recommends calling these assets OREO, as Property Held For Sale could include other property (not foreclosed) held by the CDFI for sale. If a CDFI plans to hold the property (e.g., for rental property), it will need to classify the property as fixed assets, not OREO.

As indicated in *ASC 310-45-3*, “foreclosed and repossessed assets shall be classified as a separate balance sheet amount or included in other assets on the balance sheet with separate disclosures in the notes to financial statements. Certain returned or repossessed assets, such as inventory, shall not be classified separately if the assets subsequently are to be utilized by the entity in operations.”



FASB issued *ASU-2014-0, Reclassifications of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure* to clarify when a lender should reclassify an asset from a loan receivable and recognize real property. FASB guidance indicates that a creditor should reclassify a collateralized mortgage loan when it determines that there has been “in substance repossession or foreclosure by the creditor;” that is, the creditor received physical possession of the borrower’s assets regardless of whether formal foreclosure proceedings took place. The ASU further clarifies this to include either:

- 1) The creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or
- 2) The borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

A lender that receives an asset that it will sell in satisfaction of a receivable shall account for those assets at their fair value less cost to sell. If there is an excess amount over the amount of the receivable, the lender will reduce its ALL on the SOFP or will record a loss on the SOA. *ASC 310-40 on Troubled Debt Restructuring By Creditors* has more detailed information on the accounting for these assets.

VI. LOAN PORTFOLIO REPORTING STANDARDS

CDFIs have a variety of types of reports they provide to describe the credit quality of their loan portfolio, some of which are required by GAAP in audited financial statements and some of which are supplemental to the required GAAP disclosures.

GAAP REQUIREMENTS

In 2010, FASB issued *ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires significantly expanded disclosures about the credit quality of an entity’s loan, lease and other financing receivables and its related ALL. The main objective in developing these standards was to provide financial statement readers with greater transparency of credit quality in receivables.

Some of the key requirements that relate to CDFIs and other lenders include the following:

- A breakdown of receivables by “portfolio segments.” The portfolio segments will be different across different CDFIs based on the types of loans financed, but should be at a level at which an entity develops and documents a systematic method for determining its ALL. For example, the CDFI may create portfolio segments by types of receivables, industry sectors, risk ratings, or other grouping;
- A schedule of activity in the ALL from the beginning to the end of the reporting period;
- For each ending balance in the ALL, the related balance of receivables;
- The non-accrual status of financing receivables by portfolio segment or for the entire portfolio;
- Impaired financing receivables by portfolio segment;
- Credit quality indicators of financing receivables at the end of the reporting period;
- The aging of past due financing receivables at the end of the reporting period by portfolio segment;
- The nature and extent of financing receivables modified as a result of TDRs within the past twelve months that defaulted during the reporting period, and their effect on the ALL; and
- Significant purchases and sales of financing receivables during the reporting period by portfolio segment.

CDFIs should present these new disclosure requirements in the notes to the CDFI’s audited financial statements. Presented below are sample disclosure templates for the notes to the financial statements. These templates provide examples of the types of information need to comply with the expanded disclosure requirements. Each CDFI will have different disclosures (and accompanying narrative) based on the characteristics of their individual loan portfolios. ***The sample charts below do not cover every potential disclosure required related to credit quality or the accompanying narrative, but rather are illustrative to describe the primary disclosures required by GAAP for typical CDFI lending activity.*** For a number of these disclosures, CDFIs need to report on both the current fiscal year as well as the prior fiscal year.



Sample Notes to Audited Financials related to Credit Quality

Total Loans Receivable, By Portfolio Segment

	2013	2012
Facility	\$2,000,000	\$1,500,000
Affordable Housing	\$1,500,000	\$1,000,000
Business	\$1,000,000	\$1,000,000
Pre-Development	\$500,000	\$500,000
Other	\$500,000	\$500,000
Total Loans Receivable, Gross	\$5,500,000	\$4,500,000
Allowance for Loan Losses	(\$295,000)	(\$220,000)
Loans Receivable, Net	\$5,205,000	\$4,280,000

Loans Receivable Aging, By Portfolio Segment, 2013

	Current	31-60 days past due	61-90 days past due	90 days past due	Total	Non-accrual Loans
Facility	\$1,800,000	\$100,000	\$0	\$100,000	\$2,000,000	\$100,000
Affordable Housing	\$1,300,000	\$0	\$200,000	\$0	\$1,500,000	
Business	\$825,000	\$0	\$0	\$175,000	\$1,000,000	\$175,000
Pre-Development	\$500,000	\$0	\$0	\$0	\$500,000	\$0
Other	\$500,000	\$0	\$0	\$0	\$500,000	\$0
Total Loans Receivable, Gross	\$4,925,000	\$100,000	\$200,000	\$275,000	\$5,500,000	\$275,000
Non-accrual Loans	\$0	\$0	\$0	\$275,000	\$275,000	

Loans Receivable By Credit Quality Indicators, By Portfolio Segment, 2013

Credit Quality Indicators	Rated 1	Rated 2	Rated 3	Rated 4	Total
Facility	\$1,650,000	\$200,000	\$50,000	\$100,000	\$2,000,000
Affordable Housing	\$1,300,000	\$200,000	\$ -	\$ -	\$1,500,000
Business	\$625,000	\$ -	\$200,000	\$175,000	\$1,000,000
Pre-Development	\$500,000	\$ -	\$ -	\$ -	\$500,000
Other	\$500,000	\$ -	\$ -	\$ -	\$500,000
Total Loans Receivable, Gross	\$4,575,000	\$400,000	\$250,000	\$275,000	\$5,500,000



Activity in Allowance for Loan Losses, by Portfolio Segment, 2013

	Beginning Balance Allowance for Loan Losses	Provision for Loan Losses	Charge-Offs	Ending Balance Allowance for Loan Losses
Facility	\$75,000	\$25,000	\$ -	\$100,000
Affordable Housing	\$50,000	\$40,000	\$ -	\$90,000
Business	\$50,000	\$50,000	\$(40,000)	\$60,000
Pre-Development	\$25,000	\$ -	\$ -	\$25,000
Other	\$20,000	\$ -	\$ -	\$20,000
Allowance for Loan Losses	\$220,000	\$115,000	\$(40,000)	\$295,000

Impaired Loans*

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
Facilities	\$100,000	\$100,000	\$20,000	\$5,000
Affordable Housing	\$ -	\$ -	\$ -	\$ -
Business	\$175,000	\$200,000	\$35,000	\$9,000
Pre-Development	\$ -	\$ -	\$ -	\$ -
Other	\$ -	\$ -	\$ -	\$ -
Total, Impaired Loans	\$275,000	\$300,000	\$55,000	\$14,000

Troubled Debt Restructuring

	Number of Loans	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Facility	1	\$125,000	\$100,000
Affordable Housing	0	\$ -	\$ -
Business	1	\$175,000	\$175,000
Pre-Development	0	\$ -	\$ -
Other	0	\$ -	\$ -
Total	2	\$300,000	\$275,000

*See ASU 310-10-50-15 for more detail on required disclosures for impaired loans, which indicate that creditors should disclose the following related to impaired loans: unpaid principal balance, the recorded investment, the average recorded investment, and the interest income recognized. Recorded investment is the amount of the investment in a loan, which is not net of a valuation allowance but which does reflect any direct charge-off of the investment. There is no specific guidance on calculating the average recorded investment of an impaired loan, but the guidance does indicate that the month-end balances may be considered an appropriate method. The interest income recognized should be reported during the time within the period that the loans were impaired.



SUPPLEMENTAL PORTFOLIO REPORTING

To supplement the required GAAP annual portfolio disclosure requirements, most CDFIs also provide supplemental portfolio reports to investors and others external parties on an interim basis. One of the challenges investors have identified with those reports (which vary among CDFIs) is difficulty understanding the interrelationship of the portfolio quality indicators reported. For example, if a CDFI reports its balance of past due loans and its balance of loans on non-accrual, are the loans on non-accrual a subset of or included in the past due loan balance?

The Working Group recommends reporting on the credit quality indicators identified in “Loan Quality Report” chart on an interim basis in the format shown below so that external parties can more readily understand the interrelationship of these categories.

The Working Group believes that reporting on these indicators in this format provides sufficient information to analyze the current credit quality of a CDFI portfolio. The CDFI would not include this chart in the audited financials but would include it in any management discussion or interim (e.g., quarterly) reporting. CDFIs can add notes to the chart to explain any unique circumstances. While most loans on non-accrual and impaired status will be in the 90+ days past due category, it is possible that they are current or in some other category. Understanding that interrelationship will help outside parties understand the condition of the portfolio. CDFIs may also want to include an additional column for total outstanding TDRs. Currently GAAP only requires a reporting of changes in TDR balances within a given reporting year.

Loan Quality Report

Principal Amount (\$)	Total Portfolio	Non-Accrual (Subset of Total)	Impaired (Subset of Total)	TDR-optional (Subset of Total; Subset of Impaired)
Current	\$4,925,000	\$0	\$25,000	\$25,000
31-60 days past due	\$100,000	\$0	\$0	\$0
61-90 days past due	\$200,000	\$0	\$0	\$0
>90 days past due	\$275,000	\$275,000	\$275,000	\$275,000
Totals	\$5,500,000	\$275,000	\$300,000	\$300,000

Note: Each category (Non-accrual, impaired, and TDR) is a subset of the total portfolio. Loans are often included in more than one category, so that the columns can not be added together. All TDR loans are also impaired. All non-accrual loans are impaired. Not all impaired loans are non-accrual or TDR.

*If there are loans that are >90 days past due and not on non-accrual, the CDFI may want to note why the CDFI chose not to put the loan on non-accrual.

As noted above, CDFIs modify loans (e.g., extend loan term due to short delay in government reimbursement) in the normal course of business for reasons other than borrower financial deterioration and/or hardship. While CDFIs should track and monitor impaired loans and TDRs per GAAP requirements, not all CDFIs currently track and report on loans that are modified that are not considered impaired and/or TDRs. Thus, these modified loans are not included in the reporting templates presented above as the Working Group believes that reporting on TDRs, past due loans, non-accruals, and impaired loans is sufficient to determine credit quality.

On an interim basis, CDFIs also typically report on charge-offs in their portfolio as supplemental information. The Working Group recommends reporting on the following information related to charge-offs.



Net Charge-off Report

	2013	Q1 2014
Gross Charge-offs	\$50,000	\$10,000
Recoveries	(\$10,000)	\$0
Net Charge-offs	\$40,000	\$10,000

VII. CONCLUSION

While this paper seeks to standardize definitions and reporting related to CDFIs' credit portfolios, this is the beginning of an ongoing dialogue on this topic that we will continue to expand with experience and discussion. The Working Group encourages CDFIs to adopt the recommendations and guidance presented in this paper and to share this paper with their auditors in an effort to improve consistency and transparency in the presentation of the CDFI financial statements and loan portfolio metrics.

SUMMARY OF PERFORMANCE COUNTS WORKING GROUP RECOMMENDATIONS

Throughout this paper, there is discussion and recommendations on a number of topics related to loan portfolios and credit quality. Below is a summary of the significant Working Group recommendations.

- The Working Group recommends standard definitions for loan portfolio and credit quality terms, and when there are terms that have the same meaning as another term, the Working Group recommends a standard term for use in the CDFI industry. (See Section II: Lending Portfolio Terms and Definitions)
- The Working Group recommends five terms all CDFIs should use in their audited financial statements to describe credit portfolio performance: Current Loans; Past Due Loans; Non-accrual Loans; Impaired Loans; TDRs. (See Section II: Lending Portfolio Terms and Definitions)
- The Working Group recommends CDFIs should not use the term "Cash Loan Loss Reserve" and that a Cash Loan Loss Reserve should not replace the need for an ALL. (See Section III: Accounting for the Allowance and Provision for Loan Loss)
- There are two primary acceptable approaches to presenting the PLL on the SOA—present PLL in the revenue section as part of "Net Financing Income" or present PLL as part of operating expenses. The Working Group recommends CDFIs adopt the first approach. (See Section III: Accounting for the Allowance and Provision for Loan Loss)
- The Working Group recommends investors not stipulate minimum percentages for ALL, as this practice could result in ALL amounts that are not GAAP-compliant or cause other non-recommended accounting practices. (See Section III: Accounting for the Allowance and Provision for Loan Loss)
- The Working Group recommends a proposed standard Loan Quality Report when reporting to external stakeholders on an interim basis, such that external parties can more readily understand the interrelationship of different credit quality indicators. (See Section VI: Loan Portfolio Reporting Standards)

The Working Group will publish papers on additional topics in the future. Over time, we expect this effort to benefit the industry overall by making it easier for funders, investors, and other key stakeholders to understand the industry's financial statements—ultimately leading to new sources of capital and resources for the CDFI industry.



APPENDIX A

Performance Counts Working Group and Advisors

OFN would like to thank the following CDFIs for their participation in the Working Group. One or more individuals from these organizations met to review the issues and arrive at the recommendations and guidance presented in this paper. These recommendations are endorsed by the Working Group members

Working Group

- Chicago Community Loan Fund
- Community Reinvestment Fund
- Corporation for Supportive Housing
- Craft3
- Fahe
- Florida Community Loan Fund
- Low Income Investment Fund
- New Hampshire Community Loan Fund
- Nonprofit Finance Fund
- Opportunity Finance Network
- Opportunity Fund
- The Progress Fund
- The Reinvestment Fund
- Self-Help Ventures Fund

Additionally, a number of experts provided accounting advice and guidance to the Working Group to ensure that the information and recommendations presented in this paper are compliant with GAAP and other accounting guidance.

Accounting Advisors

- Alexander, Aronson, Finning & Company
- CohnReznick LLP
- Novogradac & Company LLP

OFN is coordinating with Aeris to ensure that this effort is complementary to the data collection platform that Aeris has developed.

The Working Group also received input from many other CDFIs, CDFI funders and investors, and industry advisors. OFN appreciates the feedback from these various parties, which contributed to the final paper content.

Finally, the Working Group would like to thank consultant Mary Vasys for her contribution to the initiative.



APPENDIX B

Other Accounting Resources Related to Loan Portfolio and Credit Quality

Below are links to additional accounting resources related to loan portfolio and credit quality items discussed in this paper.

- The different FASB pronouncements and other authoritative accounting literature have been captured in one source: The FASB Accounting Standards Codification. The information related to receivables is captured in FASB 310.
http://ofn.org/sites/default/files/resources/PDFs/Publications/ASC_310.pdf
- The accounting standards for TDR are set forth in ASC Subtopic, 310-40, *Receivables – Troubled Debt Restructurings by Creditors*. In April 2011, FASB issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, to clarify issues related to TDRs. http://ofn.org/sites/default/files/resources/PDFs/Publications/ASU_2011-02-310.pdf
- In January 2014, FASB issued ASU 2014-04 related to *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. http://ofn.org/sites/default/files/resources/PDFs/Publications/ASU_2014-04-310.pdf
- Accounting Insights: New Expanded Disclosures about Credit Quality of Financing Receivables and Allowance for Credit Losses Required as Early as 2010. A publication of McGladrey & Pullen, LLP. September 2010
http://ofn.org/sites/default/files/resources/PDFs/Publications/McGladrey-Sample-credit_quality_financing_receivables_credit_losses.pdf



NOTES

[illegible]



OPPORTUNITYFINANCE NETWORK 

We Believe in Opportunity.
For All. **OFN.ORG**

For more information on Performance Counts:
<http://ofn.org/performance-counts>



PERFORMANCE COUNTS
Best Practices for CDFI Financial Statements and Management