



Amplifying Our Collective Voice

7th Annual Native CDFI Capital Access Convening
June 28-30, 2022 • Virtual

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Simplifying Loan Loss Reserves

June 28th, 2022

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Webinar Etiquette



- Utilize chat box or Q&A box
- Utilize mute and unmute
- Participate in activities
- **Have fun!**



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Agenda



- Introductions
- Basics of Loan Loss Reserve
- Accrued Loan Loss Reserve
- Case Studies
- Finance Side of Accrued Loan Loss Reserve
- Test Your Knowledge
- Q & A



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Today's Objectives



- Recognize the importance of a Loan Loss Reserve
- Calculate and Establish an Accrued Loan Loss Reserve
- Identify and Utilize a Risk Rating Rubric

Trainer Introductions



Florence Sterling-Ludka
Chief Financial Officer



Daniel Lee Sharp
Director of Finance



Jamie Olson
Director of Lending



Alexandra Shaughnessy
Lending & Investment Officer



Mikeala Purvis
Lending Assistant



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What is an Accrued Loan Loss Reserve?



Accrued LLR is an amount that is recorded on the balance sheet to offset the full value of the loans receivable in order to account for the risk associated with each loan.

The changes in the Accrued LLR amount is recorded on the income statement as loan loss expense.

Why is having an Accrued Loan Loss Reserve important?

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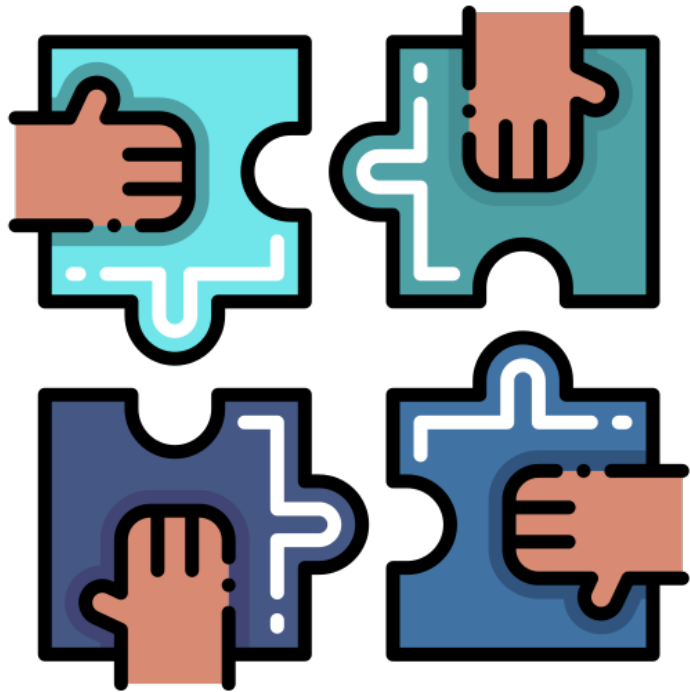
How do you get your Accrued Loan Loss Reserve?



Your Accrued Loan Loss Reserve is driven by loan policy and board approval.

You calculate your Accrued Loan Loss Reserve after every loan based on the assigned risk rating for each borrower at the time of underwriting.

Who is responsible for the Accrued Loan Loss Reserve?



- Lending responsibilities
- Accounting responsibilities
- How often to review or update
- Joint effort between departments that requires cooperation

How do I calculate my Accrued Loan Loss Reserve?



- Know the Loan Risk Rating and Loan Loss Reserve policies within your loan policy.
- During loan underwriting, assess the risk of the loan and set the loan risk rating.
- Review the loan portfolio report periodically to verify all risk rating adjustments and new loans booked are assigned the appropriate risk rating.
- Review loan delinquency reports and collection efforts of delinquent loans to assess potential charge-offs and adjust risk ratings accordingly.

Example Consumer Loan Risk Rating Rubric

Rating	Credit FICO Score (Character)	Income Stability (Conditions)	Debt-to-Income (Capacity)	Loan-to-Value (Collateral)	Liquid Assets (Capital)
1 (Very Strong – 2% LLR)	>720	5+ years or Fixed	<33%	≤80%	6x payment
2 (Strong – 5% LLR)	675-720	3-4 years	33-37%	81-85%	5x payment
3 (Average – 10% LLR)	620-674	1-2 years	38-42%	86-90%	4x payment
4 (Weak – 40% LLR)	560-619	6-12 months	43-50%	>90%	3x payment
5 (Very Weak – 100% LLR)	<560	0-5 months	>50%	No Collateral	2x payment or less
Score	1	1	3	2	1
Average Risk Rating					



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How would you rate this borrower?

Case Studies

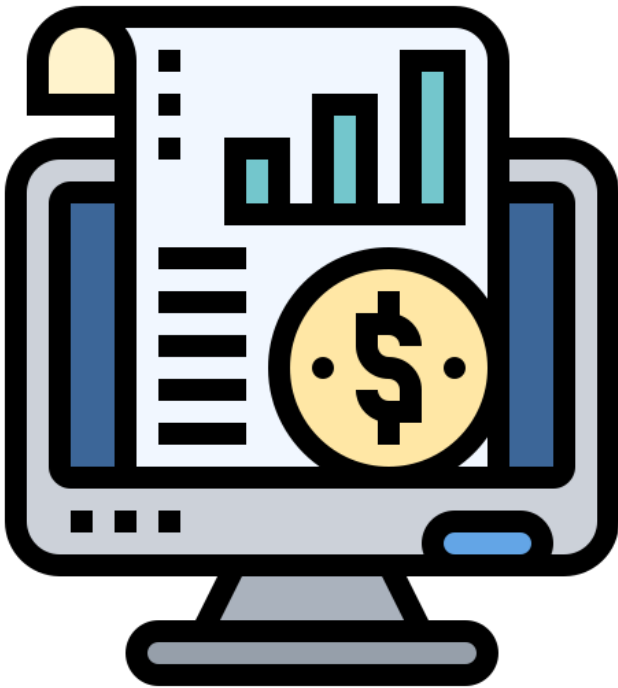
5-Minute Break



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Finance Side of Accrued Loan Loss Reserve



This section covers the accounting actions of loan loss reserve, including:

- Establishing LLR
- Decreasing LLR
- Increasing LLR
- Writing Off a Loan with your LLR

New Loans & Initial Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

January 31st, 2022

Notes Receivable	42,800
Accrued Loan Loss Reserve	0
Total Assets	42,800
Total Liabilities	0
Unrestricted Net Assets	42,800
Change in Net Assets (Net Income)	0
Total Liabilities & Net Assets	42,8000

Income Statement

January 31st, 2022

Revenue	0
Total Revenue	0
Loan Loss Reserve Expense	0
Total Expenses	0
Net Income	0



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New Loans

Risk Rating Allocation

Loan Number	Loan Balance	Risk Rating	LLR %	LLR \$
1	\$3,000	1	2%	\$60
2	\$2,800	3	10%	\$280
3	\$15,000	3	10%	\$1500
4	\$10,000	3	10%	\$1,000
5	\$12,000	2	5%	\$600
Total	\$42,800		8.0374%	\$3,440



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Establishing Accrued Loan Loss Reserve

Journal Entry

ACCOUNT	DEBITS	CREDITS	DESCRIPTION
Loan Loss Reserve Expense	\$3,440.00		Establishing LLR
Accrued Loan Loss Reserve		\$3,440.00	Establishing LLR



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New Loans & Initial Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

March 31st, 2022

Notes Receivable	42,800
Accrued Loan Loss Reserve	(3,440)
Total Assets	39,360
Total Liabilities	0
Unrestricted Net Assets	42,800
Change in Net Assets (Net Income)	(3,440)
Total Liabilities & Net Assets	39,360

Income Statement

March 31st, 2022

Revenue	0
Total Revenue	0
Loan Loss Reserve Expense	3,440
Total Expenses	3,440
Net Income	(3,440)



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Decreasing Accrued Loan Loss Reserve



- Why would the Loan Loss Reserve decrease?

Decreasing Accrued Loan Loss Reserve



- Why would the Loan Loss Reserve decrease?
 - Repayment of Loans
 - Re-evaluation of Current Loans
 - Writing Off of a Loan (Treat this Separately)
- What does the journal look like?
- What changes on the financial statements?

Decreasing Accrued Loan Loss Reserve

Risk Rating Allocation

Loan Number	Loan Balance	Risk Rating	LLR %	LLR \$
1	\$3,000	1	2%	\$60
2	\$2,800	3	10%	\$280
3	\$15,000	3 2	10% 5%	\$1,500 \$750
4	\$10,000	3 2	10% 5%	\$1,000 \$500
5	\$12,000	2 1	5% 2%	\$600 \$240
Total	\$42,800	-	4.2757%	\$3,440 \$1,830



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Decreasing Accrued Loan Loss Reserve

Do The Math

Previous LLR Amount	3,440	
New LLR Amount	1,830	
Change in LLR	<hr/> 1,610	(Decrease)



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Decreasing Accrued Loan Loss Reserve

Journal Entry

ACCOUNT	DEBITS	CREDITS	DESCRIPTION
Accrued Loan Loss Reserve	\$1,610.00		Decreasing LLR
Loan Loss Reserve Expense		\$1,610.00	Decreasing LLR



Decreasing Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

May 31st, 2022

Notes Receivable	42,800	
Accrued Loan Loss Reserve	(3,440)	Decrease 1,610
Total Assets	39,360	
Total Liabilities	0	
Unrestricted Net Assets	42,800	
Change in Net Assets (Net Income)	(3,440)	
Total Liabilities & Net Assets	39,360	

Income Statement

May 31st, 2022

Revenue	0	
Total Revenue	0	
Loan Loss Reserve Expense	3,440	Decrease 1,610
Total Expenses	3,440	
Net Income	(3,440)	



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Decreasing Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

May 31st, 2022

Notes Receivable	42,800
Accrued Loan Loss Reserve	(1,830)
Total Assets	40,970
Total Liabilities	0
Unrestricted Net Assets	42,800
Change in Net Assets (Net Income)	(1,830)
Total Liabilities & Net Assets	40,970

Income Statement

May 31st, 2022

Revenue	0
Total Revenue	0
Loan Loss Reserve Expense	1,830
Total Expenses	1,830
Net Income	(1,830)



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Increasing Accrued Loan Loss Reserve



- Why would the Loan Loss Reserve increase?

Increasing Accrued Loan Loss Reserve



- Why would the Loan Loss Reserve increase?
 - New Loans
 - Re-evaluation of Current Loans
 - Economic Conditions
- What does the journal look like?
- What changes on the financial statements?



Increase in Accrued Loan Loss Reserve

Risk Rating Allocation

Loan Number	Loan Balance	Risk Rating	LLR %	LLR \$
1	\$3,000	1	2%	\$60
2	\$2,800	3 5	10% 100%	\$280 \$2,800
3	\$15,000	2 4	5% 40%	\$750 \$6,000
4	\$10,000	2 3	5% 10%	\$500 \$1,000
5	\$12,000	1 2	2% 5%	\$240 \$600
Total	\$42,800	-	24.4393%	\$1,830 \$10,460



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Increasing Accrued Loan Loss Reserve

Do The Math

Previous LLR Amount	1,830	
New LLR Amount	10,460	
Change in LLR	<hr/> 8,630	(Increase)



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Increasing Accrued Loan Loss Reserve

Journal Entry

ACCOUNT	DEBITS	CREDITS	DESCRIPTION
Loan Loss Reserve Expense	\$8,630.00		Increasing LLR
Accrued Loan Loss Reserve		\$8,630.00	Increasing LLR



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Increasing Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

July 31st, 2022

Notes Receivable	42,800	
Accrued Loan Loss Reserve	(1,830)	Increase 8,630
Total Assets	40,970	
Total Liabilities	0	
Unrestricted Net Assets	42,800	
Change in Net Assets (Net Income)	(1,830)	
Total Liabilities & Net Assets	40,970	

Income Statement

July 31st, 2022

Revenue	0	
Total Revenue	0	
Loan Loss Reserve Expense	1,830	Increase 8,630
Total Expenses	1,830	
Net Income	(1,830)	



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Increasing Accrued Loan Loss Reserve

Financial Statements

Balance Sheet

July 31st, 2022

Notes Receivable	42,800
Accrued Loan Loss Reserve	(10,460)
Total Assets	32,340
Total Liabilities	0
Unrestricted Net Assets	42,800
Change in Net Assets (Net Income)	(10,460)
Total Liabilities & Net Assets	32,340

Income Statement

July 31st, 2022

Revenue	0
Total Revenue	0
Loan Loss Reserve Expense	10,460
Total Expenses	10,460
Net Income	(10,460)



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Writing Off a Loan



- Why would we write off a loan?

Writing Off a Loan



- Why would we write off a loan?
 - Exhausted all means of collection
- AND**
- No reasonable expectation of recovery of the asset
- What does the journal look like?
- What changes on the financial statements?

Writing Off a Loan

Risk Rating Allocation

Loan Number	Loan Balance	Risk Rating	LLR %	LLR \$
1	\$3,000	1	2%	\$60
2	\$2,800	5	100%	\$2,800
3	\$15,000	4	40%	\$6,000
4	\$10,000	3	10%	\$1,000
5	\$12,000	2	5%	\$600
Total	\$42,800 \$40,000	-	24.4393% 19.15%	\$10,460 \$7,660



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Writing Off a Loan

Do The Math

Previous LLR Amount	10,460	
New LLR Amount	7,660	
Change in LLR	<hr/> 2,800	(Decrease)



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Writing Off a Loan

Journal Entry

ACCOUNT	DEBITS	CREDITS	DESCRIPTION
Accrued Loan Loss Reserve	\$2,800.00		Write Off Loan
Notes Receivable		\$2,800.00	Write Off Loan



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Writing Off a Loan

Financial Statements

Balance Sheet

December 31st, 2022

Notes Receivable	42,800	Decrease 2,800
Accrued Loan Loss Reserve	(10,460)	Decrease 2,800
Total Assets	32,340	
Total Liabilities	0	
Unrestricted Net Assets	42,800	
Change in Net Assets (Net Income)	(10,460)	
Total Liabilities & Net Assets	32,340	

Income Statement

December 31st, 2022

Revenue	0	
Total Revenue	0	
Loan Loss Reserve Expense	10,460	No Change
Total Expenses	10,460	
Net Income	(10,460)	



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Writing Off a Loan

Financial Statements

Balance Sheet

December 31st, 2022

Notes Receivable	40,000
Accrued Loan Loss Reserve	(7,660)
Total Assets	32,340
Total Liabilities	0
Unrestricted Net Assets	42,800
Change in Net Assets (Net Income)	(10,460)
Total Liabilities & Net Assets	32,340

Income Statement

December 31st, 2022

Revenue	0
Total Revenue	0
Loan Loss Reserve Expense	10,460
Total Expenses	10,460
Net Income	(10,460)



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Check Your Knowledge

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Questions for the CFO

What else do you want to know about Loan Loss Reserves?



What are your take-aways?

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Thank you for attending!



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