

**Audited Financial Statements,
Supplementary Information,
and Compliance Reports**

Carolina Small Business Development Fund

Years Ended June 30, 2018 and 2017

Audited Financial Statements, Supplementary Information, and Compliance Reports

Carolina Small Business Development Fund

Years Ended June 30, 2018 and 2017

Audited Financial Statements

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Independent Auditors' Report

Board of Directors
Carolina Small Business Development Fund
Raleigh, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of Carolina Small Business Development Fund (a nonprofit organization), which comprise the statements of financial position as of June 30, 2018 and 2017, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Carolina Small Business Development Fund as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Independent Auditors' Report--Continued

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of federal and state awards, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2018, on our consideration of Carolina Small Business Development Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Carolina Small Business Development Fund's internal control over financial reporting and compliance.

Romeo, Wiggins & Company, L.L.P.

Raleigh, North Carolina
December 18, 2018

Statements of Financial Position

Carolina Small Business Development Fund

June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
OPERATING FUNDS:		
General deposits	\$ 1,457,425	\$ 1,157,562
Operating deposits	<u>1,607,104</u>	<u>1,978,590</u>
Total operating funds (cash and cash equivalents)	3,064,529	3,136,152
COMMITTED LOAN SUPPORT FUNDS:		
Small business lending	5,958,165	6,387,526
OTHER COMMITTED SUPPORT FUNDS:		
SEDA - for CDCU lending	171,262	179,962
Mortgage loans - GCCU	<u>140,428</u>	<u>143,763</u>
	311,690	323,725
Less: Reserve on at-risk deposits/mortgage loans	<u>(50,000)</u>	<u>(50,000)</u>
Total other committed support funds	261,690	273,725
LOANS RECEIVABLE:		
Loans - small business lending	30,209,030	24,102,488
Less: Loan loss reserves	<u>(2,404,592)</u>	<u>(2,289,736)</u>
Total loans receivable	27,804,438	21,812,752
GRANTS RECEIVABLE	688,178	1,158,565
OTHER RECEIVABLES	72,695	55,148
PREPAID EXPENSES	72,943	49,291
FIXED ASSETS:		
Leasehold improvements	3,508	3,508
Equipment and computers	205,194	202,952
Furniture and fixtures	<u>81,859</u>	<u>81,859</u>
	290,561	288,319
Less: Allowance for depreciation	<u>(206,082)</u>	<u>(175,852)</u>
Total fixed assets	<u>84,479</u>	<u>112,467</u>
TOTAL ASSETS	<u>\$ 38,007,117</u>	<u>\$ 32,985,626</u>

See independent auditors' report and notes to financial statements.

Statements of Financial Position--Continued

Carolina Small Business Development Fund

June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 98,707	\$ 33,716
Accrued vacation	94,318	66,959
Other accrued expenses	6,230	7,889
Notes payable	<u>23,855,492</u>	<u>18,711,909</u>
TOTAL LIABILITIES	24,054,747	18,820,473
NET ASSETS		
Unrestricted net assets:		
Available for general use	3,205,802	3,382,413
Board-designated:		
Contingency reserve	1,104,585	954,585
Small business lending	6,655,413	6,843,589
At-risk deposits/mortgage loans	261,690	273,725
Property and equipment, net	<u>84,479</u>	<u>112,467</u>
Total unrestricted net assets	11,311,969	11,566,779
Temporarily restricted net assets	<u>2,640,401</u>	<u>2,598,374</u>
TOTAL NET ASSETS	<u>13,952,370</u>	<u>14,165,153</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 38,007,117</u>	<u>\$ 32,985,626</u>

See independent auditors' report and notes to financial statements.

Statement of Activities

Carolina Small Business Development Fund

Year Ended June 30, 2018

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT, REVENUES, AND OTHER INCOME:			
Grant income	\$ 2,581,510	\$ 2,067,391	\$ 4,648,901
Contributions	12,617		12,617
Special events revenue	154,672		154,672
Dividend income	35,891	95	35,986
Mortgage interest	7,172		7,172
Loan closing/servicing revenue	85,131	8,583	93,714
Repayment of bad debt	50,861		50,861
Business loan interest	1,594,075	152,832	1,746,907
Origination fees	123,772	5,260	129,032
Membership fees	8,500		8,500
Other income	7,059		7,059
Net assets released from restrictions due to satisfaction of:			
Purpose restrictions	2,122,134	(2,122,134)	-
Time restrictions	70,000	(70,000)	-
	<u>6,853,394</u>	<u>42,027</u>	<u>6,895,421</u>
TOTAL SUPPORT, REVENUES, AND OTHER INCOME			
EXPENSES:			
Program services	5,808,391		5,808,391
Support services:			
Management and general	1,239,764		1,239,764
Fundraising	60,049		60,049
Total support services	<u>1,299,813</u>		<u>1,299,813</u>
	<u>7,108,204</u>	<u>-</u>	<u>7,108,204</u>
TOTAL EXPENSES			
CHANGE IN NET ASSETS	(254,810)	42,027	(212,783)
Net assets, beginning of year	<u>11,566,779</u>	<u>2,598,374</u>	<u>14,165,153</u>
NET ASSETS, END OF YEAR	<u>\$ 11,311,969</u>	<u>\$ 2,640,401</u>	<u>\$ 13,952,370</u>

See independent auditors' report and notes to financial statements.

Statement of Activities

Carolina Small Business Development Fund

Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Total
SUPPORT, REVENUES, AND OTHER INCOME:			
Grant income	\$ 2,563,490	\$ 2,811,926	\$ 5,375,416
Contributions	5,017		5,017
Special events revenue	92,565		92,565
Dividend income	40,746	64	40,810
Mortgage interest	13,353		13,353
Loan closing revenue	58,894	4,680	63,574
Repayment of bad debt	54,663		54,663
Business loan interest	1,328,274	168,379	1,496,653
Origination fees	72,683	4,855	77,538
Membership fees	13,500		13,500
Other income	2,721		2,721
Net assets released from restrictions due to satisfaction of:			
Purpose restrictions	3,520,951	(3,520,951)	-
Time restrictions	103,567	(103,567)	-
TOTAL SUPPORT, REVENUES, AND OTHER INCOME	7,870,424	(634,614)	7,235,810
EXPENSES:			
Program services	5,351,983		5,351,983
Support services:			
Management and general	1,020,925		1,020,925
Fundraising	62,110		62,110
Total support services	1,083,035		1,083,035
TOTAL EXPENSES	6,435,018	-	6,435,018
CHANGE IN NET ASSETS	1,435,406	(634,614)	800,792
Net assets, beginning of year	10,131,373	3,232,988	13,364,361
NET ASSETS, END OF YEAR	\$ 11,566,779	\$ 2,598,374	\$ 14,165,153

See independent auditors' report and notes to financial statements.

Statement of Functional Expenses

Carolina Small Business Development Fund

Year Ended June 30, 2018

	Program Services	Support Services	Total
PERSONNEL:			
Salaries	\$ 2,044,769	\$ 576,730	\$ 2,621,499
Employee benefits	303,418	85,580	388,998
Payroll taxes	166,170	46,866	213,036
Total personnel	<u>2,514,357</u>	<u>709,176</u>	<u>3,223,533</u>
OTHER EXPENSES:			
Interest expense	594,090		594,090
Marketing and newsletter	54,650	15,416	70,066
Bank fees	19,027		19,027
Telephone	57,843	16,313	74,156
Professional fees	69,353	28,922	98,275
Contract services	828,163	224,228	1,052,391
Subscriptions, sponsorships and dues	87,628	24,723	112,351
Staff travel	178,145	50,244	228,389
Seminars, conferences, and workshops	53,732	9,263	62,995
Board meeting expenses	18,720	8,847	27,567
Office supplies and expenses	45,557	12,343	57,900
Printing and copying	13,134	3,704	16,838
Software	38,916	10,963	49,879
Office occupancy	159,406	45,317	204,723
Insurance and bonding	13,590	3,834	17,424
Postage	8,527	2,405	10,932
Provision for losses on loans	710,884		710,884
Loan servicing fees	41,911	11,818	53,729
Legal expenses	140,325	39,581	179,906
Staff development	40,517	11,428	51,945
Fundraising expense		60,049	60,049
Grant repayment	80,000		80,000
Miscellaneous expenses	75		75
Total other expenses	<u>3,254,193</u>	<u>579,398</u>	<u>3,833,591</u>
Total operating expenses before depreciation	5,768,550	1,288,574	7,057,124
Depreciation	<u>39,841</u>	<u>11,239</u>	<u>51,080</u>
TOTAL EXPENSES	<u>\$ 5,808,391</u>	<u>\$ 1,299,813</u>	<u>\$ 7,108,204</u>

See independent auditors' report and notes to financial statements.

Statement of Functional Expenses

Carolina Small Business Development Fund

Year Ended June 30, 2017

	Program Services	Support Services	Total
PERSONNEL:			
Salaries	\$ 1,603,338	\$ 452,224	\$ 2,055,562
Employee benefits	247,064	69,686	316,750
Payroll taxes	139,801	39,430	179,231
Total personnel	<u>1,990,203</u>	<u>561,340</u>	<u>2,551,543</u>
OTHER EXPENSES:			
Interest expense	465,124		465,124
Marketing and newsletter	46,329	13,068	59,397
Bank fees	19,765		19,765
Telephone	47,890	13,506	61,396
Professional fees	31,489	8,881	40,370
Contract services	800,153	225,689	1,025,842
Subscriptions, sponsorships and dues	67,225	18,967	86,192
Staff travel	165,551	46,693	212,244
Seminars, conferences, and workshops	38,262	6,596	44,858
Board meeting expenses	14,102	6,665	20,767
Office supplies and expenses	41,677	11,292	52,969
Printing and copying	17,022	4,801	21,823
Software	12,270	3,456	15,726
Office occupancy	135,458	38,509	173,967
Insurance and bonding	16,858	4,756	21,614
Postage	6,351	1,791	8,142
Provision for losses on loans	1,240,997		1,240,997
Loan servicing fees	16,726	4,717	21,443
Legal expenses	111,646	31,492	143,138
Staff development	35,557	10,029	45,586
Fundraising expense		62,110	62,110
Miscellaneous expenses	569		569
Total other expenses	<u>3,331,021</u>	<u>513,018</u>	<u>3,844,039</u>
Total operating expenses before depreciation	5,321,224	1,074,358	6,395,582
Depreciation	<u>30,759</u>	<u>8,677</u>	<u>39,436</u>
TOTAL EXPENSES	<u>\$ 5,351,983</u>	<u>\$ 1,083,035</u>	<u>\$ 6,435,018</u>

See independent auditors' report and notes to financial statements.

Statements of Cash Flows

Carolina Small Business Development Fund

Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
OPERATING ACTIVITIES		
Change in net assets	\$ (212,783)	\$ 800,792
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	51,080	39,436
Provision for losses on loans	710,884	1,240,997
Interest expense added to borrowings	15,011	-
Changes in operating assets and liabilities:		
Grants receivable	470,387	(1,102,522)
Other receivables	(17,547)	(40,487)
Prepaid expenses	(23,652)	(49,291)
Accounts payable and accrued expenses	90,691	21,402
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,084,071</u>	<u>910,327</u>
INVESTING ACTIVITIES		
Decrease (increase) in committed loan support funds	429,361	694,847
Decrease in other committed support funds, net provision for losses	12,035	116,341
Small business loans funded	(11,069,149)	(8,469,019)
Principal payments received on small business loans	4,366,579	3,427,851
Purchases of fixed assets	(23,092)	(69,883)
NET CASH USED IN INVESTING ACTIVITIES	<u>(6,284,266)</u>	<u>(4,299,863)</u>
FINANCING ACTIVITIES		
Proceeds from new borrowings	5,834,000	2,485,629
Principal payments on borrowings	(705,428)	(112,955)
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>5,128,572</u>	<u>2,372,674</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(71,623)	(1,016,862)
Cash and cash equivalents (operating funds), beginning of year	<u>3,136,152</u>	<u>4,153,014</u>
CASH AND CASH EQUIVALENTS (OPERATING FUNDS), END OF YEAR	<u>\$ 3,064,529</u>	<u>\$ 3,136,152</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Interest paid	\$ 594,090	\$ 465,124
NONCASH INVESTING ACTIVITIES		
Charge-offs against loan loss reserves :		
Uncollectible loans	\$ 549,140	\$ 334,722
Withdrawal from mortgage escrow account	46,888	-
Charge-offs against reserve for at-risk deposits	-	19,857

See independent auditors' report and notes to financial statements.

Notes to Financial Statements

Carolina Small Business Development Fund

Years Ended June 30, 2018 and 2017

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Organization: Carolina Small Business Development Fund (the Organization/Carolina Small Business/previously known as The Support Center) is a statewide nonprofit and certified Community Development Financial Institution. The Organization's mission is to foster economic development in underserved communities by providing capital, business services and policy research to support small businesses.

In 2010, Carolina Small Business launched its Small Business Revolving Loan Fund Program (SBRLF), targeting underserved communities and populations that find it difficult to access capital. The Organization also provides financial training and technical assistance to start-ups and existing businesses and lending services to community-based organizations.

Carolina Small Business is the sole member of Carolina Capital Impact, Inc., a 501(c)3 nonprofit entity formed in March 2017. The subsidiary has no holdings and no activity to date.

Basis of Accounting: The accompanying financial statements are presented on the accrual basis of accounting.

Display of Net Assets by Class: The accompanying financial statements have been prepared in conformity with the disclosure and display requirements of FASB ASC 958-205, 210, 225. Accordingly, the Organization's financial statements present the following two classes of net assets: (a) unrestricted net assets and (b) temporarily restricted net assets. Temporarily restricted net assets are created only by donor-imposed restrictions on their use. All other net assets, including Board-designated or appropriated amounts, are legally unrestricted and are reported as part of the unrestricted class. In the event the Organization receives net assets that contain permanent, donor-imposed restrictions, it will present a third category of net assets.

Promises to Give: Unconditional promises to give are recognized as support or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Recognition of Support: The accompanying financial statements have been prepared in conformity with the provisions of FASB ASC 958-605. Grant awards are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence or nature of any donor restrictions. Certain of the Organization's grants are required to be reported as temporarily restricted support and are then reclassified to unrestricted net assets upon satisfaction of the time and/or purpose restrictions. Support from loan assistance programs is generally recognized upon closing of the funded loans or upon incurrence of other qualifying expenditures. State awards of \$2,500,000 were fully expended (or committed) and were recorded directly to unrestricted support for each of the years ended June 30, 2018 and 2017.

Cash Equivalents: The Organization considers its *operating funds* to be cash equivalents. Operating funds at June 30, 2018 and 2017 consist of amounts held in bank (credit union) checking (savings/master share) accounts, as well as certificates of deposit (share term certificates) with minimal penalties for early withdrawal. Refer also to *Note B--Significant Concentrations*.

Committed Loan Support Funds: Committed loan support funds are available for small business lending, and may be subject to certain restrictions of the donor or creditor agency. These funds are largely held in bank (credit union) checking accounts with various banks, but also include deposits in money market and master share accounts. Refer also to *Note B--Significant Concentrations*.

Other Committed Support Funds: Other committed support funds include SEDA deposits held in a share term certificate and amounts due under mortgages purchased from Generations Community Credit Union (now, part of Self-Help Credit Union). The share term certificate is carried at face value plus accrued earnings thereon. Other committed support funds are recorded net of an allowance for losses on at-risk funds. Refer also to *Note B--Significant Concentrations*.

Carolina Small Business Development Fund

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- Continued

Loans Receivable: Carolina Small Business originates, processes, and underwrites loan applications and funds, and holds and services small business loans in portfolio. Terms and rates of loans vary depending upon the borrower's capital requirements and management's assessment of risk. Loans are placed on non-accrual status if 90 days past due and not in the process of collection. Loans are secured by the borrower; however, the realizable value of the borrower's collateral is generally dependent upon the operating results of the borrower's small business. Loans may also be secured under guaranteed loan programs and may be sold in the secondary market. Refer also to *Note C--Loans Receivable/Loan Loss Reserves*.

Loan Loss Reserves: Carolina Small Business provides a provision for losses on loans sufficient to cover estimated credit losses inherent in the loan portfolio, as well as a provision for losses on loans identified as impaired. Funded loan loss reserves are also maintained in compliance with specific funding or program guidelines.

Management utilizes historical losses and loss migration in estimating credit losses in the performing loan portfolio. Historical losses are adjusted for any qualitative or environmental factors that may cause estimated losses to differ from historical loss experience. Non-performing loans are individually evaluated for impairment and specific reserves allocated to cover any estimated impairment. Refer also to *Note C--Loans Receivable/Loan Loss Reserves*.

Grants Receivable: Grants receivable at June 30, 2018, consists primarily of amounts due from federal and state agencies and financial institutions. The Organization has provided no provision for uncollectible accounts since management believes all amounts are collectible. Receivables are unsecured and, except for \$100,000 due in September 2019, are expected to be collected within a year.

Fixed Assets: Fixed assets are recorded at cost at the date of purchase or at fair market value at the date of donation. In the absence of donor stipulations regarding how long the contributed assets must be used, contributions of fixed assets are recorded as unrestricted. Depreciation is computed over the estimated useful lives of the respective assets on a straight-line basis. Fixed asset purchases greater than \$1,000 are capitalized, with purchases below that threshold expensed as incurred.

Fair Value of Financial Instruments: The carrying values of operating funds, accounts receivable, payables and accrued expenses are considered to approximate the fair values of such at June 30, 2018 and 2017, due to the short-term maturity of these financial instruments. Committed loan support funds and other committed support funds are carried at fair value as further described in *Note H--Fair Value Measurements*.

Loans receivable are carried at face value, less loan loss reserves. Notes payable are carried at face value. Carolina Small Business makes and receives loans with stated interest rates that are consistent with community development market rates. Therefore, management believes the net carrying values of loans receivable and notes payable approximate the fair values of these financial instruments.

Functional Allocation of Expenses: The Organization allocates its expenses on a functional basis among its various programs and support services. Expenses that can be identified with a specific program and support service are allocated directly thereto. Certain indirect expenses are allocated to programs based on estimated usage and/or benefit.

Use of Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of support, revenues and expenses during the reporting period. Actual results could differ from these estimates. Refer also to *Note C--Loans Receivable/Loan Loss Reserves* as pertains to a significant estimate.

Carolina Small Business Development Fund

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- Continued

Pending Adoption of ASU 2016-14: On August 18, 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU are intended to improve financial statement presentation by not-for-profit organizations by providing more relevant information about their resources and the changes in those resources to their donors, grantors, creditors, and other users. There are qualitative and quantitative requirements in a number of areas, including net asset classes, investment return, expenses, liquidity and availability of resources, and presentation of operating cash flows. The standard will be effective for the fiscal years beginning after December 15, 2017. Management is currently in the process of evaluating the impact of adoption of this ASU on the financial statements.

NOTE B--SIGNIFICANT CONCENTRATIONS (including subsequent events)

Deposit Risk: Carolina Small Business maintains operating deposits and other support funds at various financial institutions, the financial condition and credit ratings of which are monitored by the Organization’s management on an ongoing basis. Deposit accounts are eligible for up to \$250,000 of insurance coverage per bank (credit union) provided by the Federal Deposit Insurance Corporation (National Credit Union Administration). Deposits in excess of federally insured limits approximated \$7,425,000 at June 30, 2018, though the Organization has incurred no loss as a result of such.

Support Risk: Carolina Small Business was appropriated \$2,500,000 by the North Carolina General Assembly to provide small business loans and financial training to start-ups and existing businesses and lending services to community-based organizations for each of the fiscal years ended June 30, 2018 and 2017. This appropriation represented approximately 36% and 35% of the Organization’s total support and revenues for the years ended June 30, 2018 and 2017, respectively. An appropriation of \$2,500,000 for fiscal 2018-2019 was approved subsequently during the 2018 Legislative Session.

NOTE C--LOANS RECEIVABLE / LOAN LOSS RESERVES

Loans receivable of \$30,209,030 (including 421 loans) and \$24,102,488 (including 384 loans) at June 30, 2018 and 2017, respectively, are due from small businesses in underserved communities throughout North Carolina. Outstanding loans at June 30, 2018 have terms ranging from one to twenty years and bear interest at rates ranging from 0% to 10.75%. (Refer also to *Note J--Commitments and Contingencies* as pertains to no-interest forgivable loans.)

Principal maturities of loans receivable approximate the following at June 30, 2018:

<u>Years Ending June 30</u>	
2019	\$ 7,662,802
2020	5,343,903
2021	3,691,238
2022	2,941,689
2023	3,962,700
Thereafter	<u>6,606,698</u>
	<u>\$ 30,209,030</u>

Charge-Offs: Charge-offs of \$549,140 and \$334,722 were taken against loans receivable for the years ended June 30, 2018 and 2017, respectively. Loans are charged-off when all or a portion of the loan balance is deemed uncollectible.

Loan Loss Reserves: Loans receivable at June 30, 2018 and 2017, are recorded net of a provision for losses on loans of \$2,404,592 (8.0%) and \$2,289,736 (9.5%), respectively, based on management’s estimates of inherent and probable credit losses. Management’s estimates are based largely on assessed risk ratings and the significance of nonperforming, past due, and restructured loans.

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE C--LOANS RECEIVABLE / LOAN LOSS RESERVES -- Continued

At June 30, 2018, loans receivable of \$2,534,970 (8.39%) are due under nonperforming loans, including \$649,541 considered delinquent (90 days or more past due and still accruing) and \$1,885,428 in nonaccrual status. At June 30, 2017, loans receivable of \$1,041,721 (4.32%) are due under nonperforming loans, including \$158,732 considered delinquent (90 days or more past due and still accruing) and \$882,989 in nonaccrual status.

A loan is placed on non-accrual status when the loan approaches 90 days past due, when it becomes likely the borrower cannot or will not make scheduled principal or interest payments, when full repayment of principal and interest is not expected, foreclosure action is initiated, or when the loan evidences loss characteristics.

Other credit risk factors for the loan portfolio are summarized below:

<u>Risk Rating</u>	<u>Loan Balance</u>	<u>31 – 60 Days</u>	<u>61 – 89 Days</u>	<u>90 Days or More</u>	<u>Total Past Due</u>	<u>Troubled Debt Restructures</u>
<i>June 30, 2018</i>						
Pass	\$ 25,117,393	\$ 514,238	\$ 259,465	\$ -	\$ 773,703	\$ 97,534
Watch	219,223	-	-	-	-	-
Classified	<u>4,872,414</u>	<u>209,216</u>	<u>505,150</u>	<u>1,730,509</u>	<u>2,444,875</u>	<u>1,652,825</u>
	<u>\$ 30,209,030</u>	<u>\$ 723,454</u>	<u>\$ 764,615</u>	<u>\$ 1,730,509</u>	<u>\$ 3,218,578</u>	<u>\$ 1,750,359</u>
<i>June 30, 2017</i>						
Pass	\$ 20,011,840	\$ 82,934	\$ 56,981	\$ -	\$ 139,915	\$ -
Watch	403,601	-	304,718	-	304,718	-
Classified	<u>3,687,047</u>	<u>414,555</u>	<u>368,053</u>	<u>933,687</u>	<u>1,716,295</u>	<u>1,607,297</u>
	<u>\$ 24,102,488</u>	<u>\$ 497,489</u>	<u>\$ 729,752</u>	<u>\$ 933,687</u>	<u>\$ 2,160,928</u>	<u>\$ 1,607,297</u>

The general characteristics for each risk rating is as follows:

Pass—Loans meeting Carolina Small Business’s normal underwriting criteria, including loans with more than average credit risk. Business is able to sustain normal, temporary setbacks, but may not be strong enough to sustain major setbacks. Borrower may be highly or fully leveraged. Only one reliable repayment source may exist.

Watch—Loans not posing an immediate credit risk, but the borrower may have a deteriorated situation or setback that will likely improve. Recent trends in the borrower’s operations and/or financial situation warrant close attention. Loans require more than normal supervision and attention from the lender.

Classified—Loans having a high probability of payment default, or they have other well-defined weaknesses that put at risk the possibility of the debt being fully repaid or liquidated. Classified loans are generally characterized by current or projected operational losses, inadequate debt service coverage, insufficient liquidity, or limited capital. Unless the deficiencies are corrected or remedied, these loans will probably result in some loss. Loans assigned to this risk rating require extensive monitoring.

Significant Estimate: Carolina Small Business has recognized a provision for losses on loans at June 30, 2018 and 2017, based on management’s best estimate of uncollectible loans. Management believes that loan loss reserves adequately provide for potential losses; however, it is at least reasonably possible that management’s estimate of potential losses may change significantly in the near term.

Carolina Small Business Development Fund

NOTE C--LOANS RECEIVABLE / LOAN LOSS RESERVES -- Continued

Federal Loan/Loan Guarantee Programs: Carolina Small Business receives support and/or financing for small business lending under several federal programs. Lending activity under these programs is summarized as follows.

USDA-Intermediary Relending Program (IRP). Loans receivable of \$1,897,683 at June 30, 2018, bear interest at rates ranging from 7.75% to 9.25%, and are recorded net of a funded reserve for losses of \$120,680 (6.4% of outstanding loans). The program requires the Organization to maintain funded reserves of at least 6.0% of outstanding loans. Charge-offs of \$52,849 and \$0 were made during the years ended June 30, 2018 and 2017, respectively. Loans receivable of \$466,815 have payments over 60 days past due at June 30, 2018. Refer to *Note D--Notes Payable* as pertains to pay-back of the loan funds.

USDA-Rural Micro-entrepreneur Assistance Program (RMAP). Loans receivable of \$625,959 at June 30, 2018, bear interest at rates ranging from 7.0% to 10.25%, and are recorded net of a funded reserve for losses of \$61,263 (9.8% of outstanding loans). The program requires the Organization to maintain funded reserves of at least 5.0% of outstanding loans. Charge-offs of \$46,993 and \$0 were made during the years ended June 30, 2018 and 2017. Loans receivable of \$88,994 have payments over 60 days past due at June 30, 2018. Refer to *Note D--Notes Payable* as pertains to pay-back of the loan funds.

SBA Intermediary Lending Pilot (ILP) Program. Loans receivable of \$879,657 at June 30, 2018, bear interest at rates ranging from 5.0% to 8.5%, and are recorded net of a funded reserve for losses of \$50,129 (5.7% of outstanding loans). The program requires the Organization to maintain funded reserves of at least 5.0% of outstanding loans. No charge-offs were made for the years ended June 30, 2018 and 2017, respectively. None of these loans have payments over 60 days past due at June 30, 2018. Refer to *Note D--Notes Payable* as pertains to pay-back of the loan funds.

Guaranteed Loan Programs. Carolina Small Business participates in certain guaranteed loan program in order to provide long-term financing to small business concerns that would otherwise not be available.

SBA Community Advantage Pilot Loan Program (CA) is a pilot loan program introduced by the U.S. Small Business Administration (SBA) to meet the credit, management, and technical assistance needs of small businesses in underserved markets. CA provides mission-oriented lenders access to 7(a) loan guaranties up to 85% for loans of \$250,000 or less. Approximately \$9,878,075 of the Organization's loans receivable at June 30, 2018, are guaranteed up to 75% or 85% by the CA program. The CA program requires the Organization to fund reserves of at least 5.0% of the unguaranteed portion of the CA loan portfolio, which approximates \$148,884 at June 30, 2018.

CA-guaranteed loans of \$2,595,362 were sold at a premium of \$195,520 in the secondary market during the year ended June 30, 2016. No such sales occurred during the years ended June 30, 2018 and 2017. The Organization is required to fund reserves of at least 3.0% of the guarantee on loans sold which approximates \$72,478. Carolina Small Business held \$221,362 in a PNC-funded loan loss account at June 30, 2018, satisfying both the 5.0% and 3.0% reserve requirements. Refer also to *Note K--Subsequent Events*.

Charlotte Community Capital Fund Program (CCCF) is a program to provide financing to small businesses within the Charlotte, North Carolina region that show promise, but do not meet one or more of participating lenders' normal underwriting criteria. CCCF provides participating lenders access to loan guaranties up to 85% for loans of \$150,000 or less. Approximately \$678,788 of the Organization's loans receivable at June 30, 2018, are guaranteed up to 85% by the Charlotte Community Capital Fund.

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE D--NOTES PAYABLE (including subsequent events)

Notes payable consist of the following:

Creditor	Principal Payments	Interest Rate	Interest Payments	Maturity Date	Collateral	Principal Balance	
						June 30, 2018	June 30, 2017
First Bank	Due in full at maturity	2.00%	Monthly	Dec. 2020	Unsecured	\$ 250,000	\$ 250,000
Mercy Investment Services	Due in full at maturity	3.00%	Quarterly	May 2019	Unsecured	500,000	500,000
Community One Bank	\$500,000 in Dec. 2018 and 2019	3.50%	Quarterly	Dec. 2019	Unsecured	1,000,000	1,000,000
Community One Bank	\$500,000 in Sep. 2019 and 2020	3.50%	Quarterly	Sep. 2020	Unsecured	1,000,000	1,000,000
TD Bank	Due in full at maturity	3.35%	Monthly	Jul. 2018	Unsecured	500,000	500,000
TD Bank	Quarterly beginning Jun. 2019, as subsequently amended	5.00%	Monthly	Mar. 2023	Unsecured	500,000	500,000
Woodforest National Bank	\$500,000 in Jun. 2020 and 2021	2.50%	Monthly	Jun. 2021	Unsecured	1,000,000	1,000,000
Woodforest National Bank	Due in full at maturity	3.00%	Monthly	Dec. 2027	Unsecured	525,000	-
Appalachian Community Capital	Due in full at maturity	3.1% (Cost of Funds + 1%)	Monthly	Oct. 2021	Unsecured	1,000,000	1,000,000
Appalachian Community Capital	Due in full at maturity	2.00%	Monthly	Dec. 2022	Unsecured	100,000	-
USDA RMAP	Monthly	2.00%	Monthly	Aug. 2034	Partially secured by RMRF deposits/loans receivable	476,084	483,924
USDA RMAP	Monthly beginning May 2019	2.00%	Monthly	April 2037	Partially secured by RMRF deposits/loans receivable	475,000	-
Bank of North Carolina	Due in full at maturity	3.00%	Quarterly	Feb. 2022	Partially secured by loans receivable	1,250,000	1,250,000
First National Bank	Due in full at maturity	3.00%	Monthly	Oct. 2022	Unsecured	1,100,000	-
Annie Casey Foundation	Requires mandatory prepayment in Dec. 2019 of any proceeds not advanced or committed for qualified loans. Otherwise, due in full at maturity.	3.00%	Quarterly	Dec. 2022	Unsecured	2,000,000	-
US SBA ILP	Quarterly	1.00%	Quarterly	Sep. 2031	Partially secured by ILP deposits/loans receivable	763,228	816,978
CNote Group, Inc.	Subject to quarterly withdrawals upon request, up to greater of \$500,000 or 10% of unpaid principal. Otherwise, due in full at maturity.	3.60% (variable)	Monthly	Aug. 2020	Unsecured	116,000	-
First Tennessee	Due in full at maturity	2.75%	Quarterly	Jan. 2028	Unsecured	500,000	-

Carolina Small Business Development Fund

NOTE D--NOTES PAYABLE (including subsequent events)--Continued

Creditor	Principal Payments	Interest Rate	Interest Payments	Maturity Date	Collateral	Principal Balance	
						June 30, 2018	June 30, 2017
Wells Fargo	Quarterly beginning Apr. 2026	2.00%	Quarterly	Apr. 2028	Unsecured	1,000,000	1,000,000
Wells Fargo	Quarterly beginning May 2024	2.00%	Quarterly	May 2026	Unsecured	500,000	500,000
Bank of America	Annually beginning Dec. 2020	3.25%	Quarterly	Dec. 2022	Partially secured by Borrower's title and interest in End Loans	1,000,000	1,000,000
Goldman Sachs	Quarterly beginning Jan. 2018	4.50%	Monthly	Dec. 2022	Partially secured by GS deposits/loans receivable	2,467,619	1,774,000
Opportunity Finance Network	Quarterly beginning Jun. 2018	3.75%	Quarterly	Sep. 2019	Partially secured by loans receivable	500,000	500,000
Opportunity Finance Network	Quarterly beginning Jun. 2018	3.75%	Quarterly	Sep. 2019	Partially secured by loans receivable	500,000	500,000
The Episcopal Church	Due in full at maturity	3.75%	Quarterly	Mar. 2018	Unsecured	-	250,000
PNC Bank	Quarterly beginning Jan. 2019, as subsequently amended	4.00%	Quarterly	Apr. 2021, as subsequently amended	Unsecured	500,000	500,000
PNC Bank--LOC	Due in full at maturity	3.00%	Quarterly	Apr. 2021	Unsecured	1,000,000	1,000,000
PNC Bank--LOC	Quarterly beginning Jan 2019, as subsequently amended	4.00%	Quarterly	Apr. 2021, as subsequently amended	Partially secured by \$300,000 minimum deposit account	1,500,000	1,500,000
USDA IRP	Annually	1.00%	Annually	Nov. 2040	Partially secured by IRP deposits/loans receivable	651,460	676,541
USDA IRP	Annually	1.00%	Annually	May 2030	Partially secured by IRP deposits/loans receivable	240,614	259,399
USDA IRP	Annually beginning Sep. 2019	1.00%	Annually	Sep. 2036	Partially secured by IRP deposits/loans receivable	625,000	625,000
USDA IRP	Annually beginning Jan. 2018	1.00%	Annually	Jan. 2046	Partially secured by IRP deposits/loans receivable	315,487	326,067
Total Notes Payable						\$ 23,855,492	\$ 18,711,909

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE D--NOTES PAYABLE (including subsequent events) -- Continued

Interest expense totaled \$594,090 and \$465,124 for the years ended June 30, 2018 and 2017, respectively.

Principal maturities of notes payable at June 30, 2018 approximate the following, after giving effect to the subsequent extensions noted previously herein:

<u>Years Ending June 30</u>	
2019	\$ 2,279,209
2020	3,595,410
2021	5,092,307
2022	3,340,677
2023	4,382,027
Thereafter	<u>5,165,862</u>
	<u>\$ 23,855,492</u>

Financial Covenants/Ratios: Certain of the preceding notes payable require the Organization to comply with various financial covenants and ratios over the terms of the related notes. The Organization met these commitments at June 30, 2018 and subsequent thereto, or has obtained acknowledgements accepting such.

Available to Borrow for Small Business Lending: At June 30, 2018, loan funds of \$2,500,000 (provided under the USDA Rural Housing Service-Community Facilities Direct Loan Program) are available to be drawn through December 13, 2021.

Subsequent Events: On August 1, 2018, the Organization entered into an agreement that resulted in net loan proceeds of \$915,000 for small business lending.

On August 28, 2018, loan funds of \$525,000 were committed by Bank of America Community Development Corporation for the Organization's veterans' loan program.

On October 1, 2018, loans funds of \$1,000,000 were committed by the USDA under its Intermediary Relending Program for small business lending.

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE E--TEMPORARILY RESTRICTED NET ASSETS/CONDITIONAL AWARDS

Net assets were released from restrictions upon satisfaction of donor-imposed purpose and/or time restrictions as follows:

	Years Ended June 30,	
	<u>2018</u>	<u>2017</u>
Small business lending*	\$ 629,408	\$ 2,672,394
Women's Business Center	298,826	239,655
People of Color/TSC CARES (lending/tta)	-	463,179
Training and technical assistance	131,118	62,863
NC Disaster Recovery Loan Program	1,009,314	82,860
General operations	<u>123,468</u>	<u>103,567</u>
	<u>\$ 2,192,134</u>	<u>\$ 3,624,518</u>

*State Economic Development Assistance Funds of \$2,389,200 were released from temporarily restricted net assets to unrestricted net assets in fiscal 2016-2017 since deemed to have no ongoing compliance requirements.

Temporarily restricted net assets are available for the following purposes at June 30:

	<u>2018</u>	<u>2017</u>
Small business lending	\$ 898,138	\$ 515,154
Training and technical assistance	363,434	25,000
NC Disaster Recovery Loan Program	1,365,329	2,058,220
General operations	<u>13,500</u>	<u>-</u>
	<u>\$ 2,640,401</u>	<u>\$ 2,598,374</u>

At June 30, 2018, support from awards for the following remains conditional:

Small business lending	\$ 1,918,906
Women's Business Center	27,798
Training and technical assistance	15,000
NC Disaster Recovery Loan Program	3,583,577
General operations	<u>33,466</u>
	<u>\$ 5,578,747</u>

No amounts pertaining to conditional awards are included in the accompanying financial statements.

Refer also to *Note K--Subsequent Events*.

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE F--OPERATING LEASES (including subsequent events)

The Organization leases its primary office space in Raleigh, North Carolina under an operating lease scheduled to expire in September 2020. The lease requires minimum rentals plus pro rata payments for common area maintenance. The Organization also leases office space for its Innovation and Entrepreneurship Center in Raleigh (opened in fiscal 2017), for its Western Women's Business Center in Asheville, and for a satellite office in Charlotte, North Carolina.

Rent expense under these leases approximated \$204,723 and \$173,967 for the years ended June 30, 2018 and 2017, respectively.

Future minimum rentals, including subsequent renewals, for leases having an initial term of one year or more are as follows:

<u>Years Ending June 30</u>	
2019	\$ 169,523
2020	123,020
2021	24,762
Thereafter	-
	<u>\$ 317,305</u>

NOTE G--EMPLOYEE BENEFIT PLAN

Carolina Small Business sponsors a 401(k) retirement plan. Employees are eligible to participate after attaining age 21 and completing one month of service. The Organization makes Safe Harbor matching contributions at the rate of 100% of a participant's elective deferrals up to 5% of the participant's Compensation for the plan year. Employer matching contributions totaled \$97,451 and \$70,227 for the years ended June 30, 2018 and 2017, respectively. The plan also provides for discretionary, nonelective employer contributions, though no such contributions were approved for the years ended June 30, 2018 and 2017.

NOTE H--FAIR VALUE MEASUREMENTS

Carolina Small Business applies U.S. generally accepted accounting principles (GAAP) for fair value measurements of financial assets that are recognized or disclosed at fair value in the financial statements on a recurring basis. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP also establishes a framework for measuring fair value and expands disclosures about fair value measurements.

FASB ASC 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value of financial instruments. This hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets and have the highest priority, Level 2 inputs consist of observable inputs other than quoted prices for identical assets, and Level 3 inputs have the lowest priority.

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE H--FAIR VALUE MEASUREMENTS--Continued

The following represents assets and liabilities measured (and carried) at fair value on a recurring basis by Carolina Small Business:

<u>June 30, 2018</u>	<u>Fair Value</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Operating funds	\$ 1,315,900	\$ -	\$ 1,315,900	\$ -
Committed loan support funds	1,364,939	1,364,939	-	-
Other committed support funds	273,821	-	171,262	102,559
Loans receivable	30,209,030	-	30,209,030	-
Notes payable	<u>23,855,492</u>	-	<u>23,855,492</u>	-
Total	<u>\$ 57,019,182</u>	<u>\$ 1,364,939</u>	<u>\$ 55,551,684</u>	<u>\$ 102,559</u>

<u>June 30, 2017</u>	<u>Fair Value</u>	(Level 1)	(Level 2)	(Level 3)
Operating funds	\$ 812,602	\$ -	\$ 812,602	\$ -
Committed loan support funds	2,666,110	2,666,110	-	-
Other committed support funds	285,856	-	179,962	105,894
Loans receivable	24,102,488	-	24,102,488	-
Notes payable	<u>18,711,909</u>	-	<u>18,711,909</u>	-
Total	<u>\$ 46,578,965</u>	<u>\$ 2,666,110</u>	<u>\$ 43,806,961</u>	<u>\$ 105,894</u>

Level 1: Committed loan support funds include holdings in money market and money market share accounts, the carrying value of which approximates the fair value.

Level 2: Operating funds and other committed support funds include holdings in share term certificates and certificates of deposit (with interest rates ranging from 1.05% to 3.0% and maturities ranging from July 2018 to November 2022) the carrying values of which approximate the fair values based on current market rates for financial instruments of similar size and remaining maturities. The carrying values of *loans receivable* and *notes payable* approximate the fair values of such based on community development market rates for financial instruments with similar terms and remaining maturities.

Level 3: Other committed support funds include mortgages purchased from GCCU, the fair value of which approximates principal due from borrowers, less a loan loss reserve. Given the delinquent status of these loans when purchased from GCCU and the lack of comparable market data for properties similar to those securing these mortgages, management considers the fair value of these outstanding mortgages to be based on Level 3 inputs.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3):

	Year Ended	
	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Beginning balance, beginning of year	\$ 105,894	\$ 284,910
Reduction due to sale of OREO property	-	(166,300)
Net increase in allowance for loan loss	-	(9,338)
Collections on mortgages purchased from GCCU	<u>(3,335)</u>	<u>(3,378)</u>
Ending balance, end of year	<u>\$ 102,559</u>	<u>\$ 105,894</u>

Notes to Financial Statements--Continued

Carolina Small Business Development Fund

NOTE H--FAIR VALUE MEASUREMENTS -- Continued

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Carolina Small Business believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a significantly different fair value measurement at the reporting date.

NOTE I--TAX STATUS

Carolina Small Business is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and the applicable state tax statutes. It has also been determined that Carolina Small Business is not a private foundation as described in Section 509(a) of the Internal Revenue Code. Filings for tax years ending subsequent to June 30, 2014, remain open and subject to examination.

NOTE J--COMMITMENTS AND CONTINGENCIES

The Organization has committed to repay one-half of principal collected on certain disaster recovery loans. At June 30, 2018, loans receivable of \$861,760 are subject to this repayment provision. Principal maturities are scheduled as follows at June 30, 2018: \$63,959 in fiscal 2019; \$116,161 in fiscal 2020; \$132,811 in fiscal 2021; \$91,707 in fiscal 2022; \$87,630 in fiscal 2023; and \$369,492 thereafter.

The Organization participates in a forgivable disaster loan program whereby one-third of no-interest loan principal is forgiven at the end of years one, two, and three if certain requirements are met. At June 30, 2018, loans receivable of \$300,000 are outstanding under this program, with first anniversaries occurring in March and April 2019. If not forgiven, repayment of these loans is due in full as defined by agreement within the three-year term.

Financial assistance from various awarding agencies is subject to special audit. Such audits could result in claims against Carolina Small Business for disallowed costs or noncompliance with grantor restrictions. Management is aware of no disallowable costs or other instances of noncompliance with grantor restrictions that may have a direct and material effect on the accompanying financial statements. Consequently, no provision has been made for liabilities, if any, that may arise from special audits by grantor agencies.

NOTE K--SUBSEQUENT EVENTS (not otherwise disclosed herein)

In July 2018, CA-guaranteed loans of \$2,030,771 were sold in the secondary market at a premium of \$77,426. In September 2018, CA-guaranteed loans of \$493,974 were sold in the secondary market at a premium of \$19,135.

Management has evaluated subsequent events through December 18, 2018, the date on which financial statements were available for issue. All subsequent events for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed.

SUPPLEMENTARY INFORMATION

Schedule of Federal and State Awards

Carolina Small Business Development Fund

Year Ended June 30, 2018

Grantor/ Pass-through Grantor/ Program Title	CFDA #	Pass-through Entity Identifying Number	Federal Expenditures	State Awards	
				Support	Expenditures
<u>FEDERAL AWARDS:</u>					
<u>U.S. Department of Agriculture, Rural Development:</u>					
<i>Intermediary Relending Program (IRP):</i>					
Loans due to federal agency at beginning of fiscal year	10.767		\$ 1,887,007		(*)
<u>U.S. Department of Agriculture, Rural Development:</u>					
<i>Rural Microentrepreneur Assistance Program (RMAP):</i>					
Training and technical assistance to micro-borrowers			59,562		
Loans taken (including \$280,500 of loans made)			475,000		
Loans due to federal agency at beginning of fiscal year			483,924		
	10.870		<u>1,018,486</u>		(*)
<u>U.S. Department of Housing and Urban Development:</u>					
<i>CDBG--Entitlement Grants Cluster/Community Development Block Grant Program for Entitlement Communities:</i>					
<u>City of Asheville, North Carolina:</u>					
<i>Opportunity Asheville: WWBC - Business Training and Access to Capital in the City of Asheville</i>	14.218	FY 2017-18	85,000		
<i>Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii:</i>					
<u>North Carolina Department of Commerce:</u>					
<i>CDBG Business Recovery Assistance Program:</i>					
Small business lending			300,000		
Program expenses		CDBG-DR	116,423		
	14.228	17-R-3002	<u>416,423</u>		(*)
<u>U.S. Small Business Administration:</u>					
<i>Women's Business Ownership Assistance:</i>					
SBAHQ-16-W-0005/0001			41,624		
SBAHQ-16-W-0005/0002			122,202		
	59.043		<u>163,826</u>		
<i>Prime Technical Assistance</i>	59.050		127,410		
<i>Intermediary Loan Program (ILP):</i>					
Loans due to federal agency at beginning of fiscal year	59.062		<u>816,978</u>		(*)
TOTAL FEDERAL EXPENDITURES			<u>\$ 4,515,130</u>		
<u>STATE AWARDS:</u>					
<u>State of North Carolina Special Appropriation of State General Fund:</u>					
North Carolina Department of Commerce:					
Small business lending (including committed funds)			\$ 300,000	\$ 300,000	
Loan loss reserves (committed)			100,000	100,000	
General operations			<u>2,100,000</u>	<u>2,100,000</u>	
		NC Grant ID 56509	<u>2,500,000</u>	<u>2,500,000</u>	(*)
<u>State of North Carolina Appropriation under The Disaster Recovery Act of 2016:</u>					
The Golden Leaf Foundation:					
<i>North Carolina Disaster Recovery Loan Program:</i>					
Small business lending (loans placed)			-	865,522	
Program expenses			-	104,581	
		FY2017-149	<u>-</u>	<u>970,103</u>	(*)
TOTAL STATE AWARDS			<u>\$ 2,500,000</u>	<u>\$ 3,470,103</u>	

(*) Awards having compliance requirements that could have a direct and material effect on the Organization's financial statements.

See independent auditors' report as pertains to supplementary information and notes to schedule of federal and state awards.

Notes to Schedule of Federal and State Awards

Carolina Small Business Development Fund

Year Ended June 30, 2018

NOTE A--BASIS OF PRESENTATION

The accompanying schedule of federal and state awards (the Schedule) includes the federal and state grant activity of Carolina Small Business Development Fund for the year ended June 30, 2018. The information in the Schedule is presented in accordance with the requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Organization, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Organization.

NOTE B--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following, as applicable, either the cost principles contained in Office of Management and Budget Circular A-122, *Cost Principles for Non-Profit Organizations*, or the cost principles contained in Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

NOTE C--FEDERAL LOAN / LOAN GUARANTEE PROGRAMS

The following federal loan programs are administered by the Organization, with balances and transactions relating to these programs included in the Organization's basic financial statements. Loans outstanding at the beginning of the fiscal year and loans taken during the fiscal year are included in the federal expenditures presented in the Schedule. The balance of loans due to the federal agencies at June 30, 2018 consists of:

<u>CFDA #</u>	<u>Program Name</u>	<u>Outstanding Balance June 30, 2018</u>
10.767	USDA IRP	\$ 1,832,561
10.870	USDA RMAP	951,084
59.062	US SBA ILP	763,228

Loans receivable from borrowers of approximately \$9,878,075 are guaranteed (up to 75% or 85%) under the SBA Community Advantage Pilot Loan Program at June 30, 2018.

Loans receivable from borrowers of approximately \$678,788 are guaranteed (up to 85%) under the Charlotte Community Capital Fund Program at June 30, 2018.

NOTE D--INDIRECT COST RATE

The Organization has elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

COMPLIANCE REPORTS



Independent Auditors' Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

Board of Directors
Carolina Small Business Development Fund
Raleigh, North Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Carolina Small Business Development Fund (a nonprofit organization), which comprise the statement of financial position as of June 30, 2018, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 18, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Carolina Small Business Development Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of Carolina Small Business Development Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and questioned costs, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2018-001 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2018-002 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Carolina Small Business Development Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with

those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Carolina Small Business Development Fund's Response to Findings

Carolina Small Business Development Fund's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Carolina Small Business Development Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Romeo, Wiggins & Company, L.L.P.

Raleigh, North Carolina
December 18, 2018



Independent Auditors' Report on Compliance
for Each Major Program and on Internal Control
Over Compliance Required by the Uniform Guidance

Board of Directors
Carolina Small Business Development Fund
Raleigh, North Carolina

Report on Compliance for Each Major Federal Program

We have audited Carolina Small Business Development Fund's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Organization's major federal programs for the year ended June 30, 2018. The Organization's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Carolina Small Business Development Fund's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Organization's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Carolina Small Business Development Fund's compliance.

Opinion on Each Major Federal Program

In our opinion, Carolina Small Business Development Fund complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

Report on Internal Control Over Compliance

Management of Carolina Small Business Development Fund is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Organization's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Carolina Small Business Development Fund's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Romeo, Viggino & Company, L.L.P.

Raleigh, North Carolina
December 18, 2018

Schedule of Findings and Questioned Costs

Carolina Small Business Development Fund

Year Ended June 30, 2018

Section I - Summary of Auditors' Results

Type of auditors' report issued on financial statements: *Unmodified*

Internal control over financial reporting:

- ◆ Material weakness(es) identified? X yes no
- ◆ Significant deficiency (ies) identified? X yes none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major federal award programs:

- ◆ Material weakness(es) identified? yes X no
- ◆ Significant deficiency (ies) identified? yes X none reported

Noncompliance material to major federal award programs? yes X no

Type of auditors' report issued on compliance for major federal programs: *Unmodified*

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? yes X no

Identification of major federal programs:

<u>CFDA Number(s)</u>	<u>Program Name</u>
10.767 14.228	USDA Intermediary Relending Program HUD Community Development Block Grants/ State's program and Non-Entitlement Grants in Hawaii

Dollar threshold used to distinguish between type A and type B programs: \$750,000

Auditee qualified as low-risk auditee? X yes no

Schedule of Findings and Questioned Costs--Continued

Carolina Small Business Development Fund

Year Ended June 30, 2018

Section II - Financial Statement Findings

Finding 2018-001: Recognition of Grant Support

Criteria: The Organization's accounting policies, as well as its grantors, financial institutions, and other lenders, require the Organization to prepare its financial statements in accordance with U.S. generally accepted accounting principles. These standards require that support from reimbursement grants be recognized in the period in which the qualifying expenses are incurred.

Condition: During our audit, we noted that the Organization recognized support from certain reimbursement grants prior to the incurrence of qualifying expenses.

Cause: Management recognized support from the aforementioned reimbursement grants at the time of award, based on the understanding that qualifying expenses would be incurred prior to June 30, 2018. Due to evolving guidelines for a loan fund program and a reduction in salaries allocable to grants, certain qualifying expenses under these reimbursement grants will be incurred after June 30, 2018.

Effect: The Organization's internally-generated financial statements for the year ended June 30, 2018, overstated grant support by approximately \$804,000. Management corrected this misstatement by posting adjustments proposed in connection with our audit. Requested drawdowns of grant funds were limited to expenses incurred.

Recommendation: We recommend that management re-emphasize the importance of maintaining the accounting records in accordance with GAAP on an ongoing basis to ensure the reliability and relevance of the Organization's in-house financial statements.

Views of responsible officials and planned corrective actions: We agree with the finding. Management is committed to maintaining the Organization's accounting records in accordance with GAAP to ensure that the financial information derived therefrom is accurate and available in a timely manner. In response to the finding, a policy was put in place requiring that reimbursement grants be monitored to ensure that support is recognized only when the allowable expenses are incurred or related loans are placed. We are in the process of reviewing our accounting policies and procedures for other updates that may be necessary to ensure that support and revenues are consistently recognized in accordance with GAAP.

Schedule of Findings and Questioned Costs--Continued

Carolina Small Business Development Fund

Year Ended June 30, 2018

Section II - Financial Statement Findings--Continued

Finding 2018-002: Maintenance of Loan Files

Criteria: The Organization administers its small business lending program in accordance with its Loan Policy & Procedures Manual. Funds for small business lending are provided by various federal and state grants, financial institutions, and foundations. These providers may place additional requirements on the extension and servicing of loans. To effectively administer its small business lending program, the Organization requires that a loan file be maintained for each loan. The file is required to include, among other things, an application package, approvals for loans and loan modifications, executed loan and security agreements, updated financial information of the borrower, and documentation of collection efforts on past due loans.

Condition: We reviewed 33 loan files that were judgmentally selected from loans outstanding at June 30, 2018. We noted numerous instances in which the files were missing updated financial information from the borrower. Management was generally able to provide a verbal update as to the borrower's current financial situation. We also noted several instances in which files were missing approvals for loans. Management was able to provide evidence of approvals in most of these cases. A few files lacked approvals for loan modifications and two loans were operating under modification agreements that expired during the first calendar quarter of 2018. We also noted two instances in which fees charged borrowers exceeded fees allowed by the grantor agency. In both instances, the Organization subsequently returned the excess fees to the borrowers.

Cause: The Organization has experienced significant growth in its portfolio of small business loans, going from 384 loans outstanding at June 30, 2017 to 421 loans outstanding at June 30 2018. Loans processed in fiscal 2017-2018 include more loans to veterans and disaster relief victims, both of which require more extensive marketing and monitoring efforts. The Organization also experienced an increase in nonperforming and past due loan balances during fiscal 2017-2018, requiring management to devote more time to monitoring and collection efforts. We believe many of the deficiencies noted in the preceding paragraph may be attributed to time constraints on management and staff.

Effect: Certain of the selected loan files omitted documentation required by the Organization's policies and procedures.

Recommendation: We recommend the Organization re-emphasize the importance of maintaining loan files in accordance with its policies and procedures for such. We further encourage management to redefine roles and responsibilities for updating and monitoring loan files to ensure the files are well-organized and contain all required documentation.

Views of responsible officials and planned corrective actions: Management agrees with the finding. As a priority, management is currently reviewing all of the credit administration department practices and procedures as they specifically relate to loan file maintenance, loan closing procedures, loan modifications, transaction approval procedures, financial statement tracking, and periodic client follow-up responsibilities. This process includes the redefining of roles within the credit administration area with the specific purpose of providing clear direction and expectations to all departmental associates. Over the course of the current fiscal year, management has enhanced the loan documentation origination process, redesigned the loan advance approval procedures, and continues to tweak the virtual loan file management system. Prior to June 30, 2019, management expects to develop an enhanced and automated internal transaction approval system, a more robust loan documentation exceptions reporting system, and a more comprehensive loan modification management process. Additionally, management is actively reviewing our vendor management practices (i.e. our existing contract with our current SBA loan service provider) to determine where efficiencies can be gained by redirecting certain tasks through the vendor.

Schedule of Findings and Questioned Costs--Continued

Carolina Small Business Development Fund

Year Ended June 30, 2018

Section III - Federal Award Findings and Questioned Costs

We have no such findings to report.

Summary Schedule of Prior Audit Findings

Carolina Small Business Development Fund

Year Ended June 30, 2018

No findings were reported in connection with the prior audit.