

PN-ABQ-707  
06030

Consultancy Report  
***Malawi Rural Finance Company (MRFC) Policy and Procedures Manual***

***Malawi: Smallholder Agricultural Credit Administration***  
***Contract Number: 511-0617-3-10117***

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September 1993

**Malawi Rural Finance Company (MRFC)**

**Policy and Procedures Manuals**

**Executive Summary**

<b>Volume I:</b>	<b>Credit</b>
<b>Volume II:</b>	<b>Finance and Accounting</b>
<b>Volume III:</b>	<b>Personnel</b>
<b>Volume IV:</b>	<b>Internal Audit</b>

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**EXECUTIVE SUMMARY**

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## **ABBREVIATIONS**

<b>ADMARC</b>	- Agricultural Development and Marketing Corporation
<b>DEMATT</b>	- Development of Malawi Traders Trust
<b>IDA</b>	- International Development Association
<b>IFAD</b>	- International Fund for Agricultural Development
<b>MIS</b>	- Management Information System
<b>MoA</b>	- Ministry of Agriculture
<b>MRFC</b>	- Malawi Rural Finance Company
<b>MUSCCO</b>	- Malawi Union of Savings and Credit Cooperatives
<b>POSB</b>	- Post Office Savings Bank
<b>SACA</b>	- Smallholder Agricultural Credit Administration
<b>SEDOM</b>	- Small Enterprise Development Organization of Malawi

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## EXECUTIVE SUMMARY

### 1.0 BACKGROUND AND INTRODUCTION

In 1988, the IDA/IFAD Smallholder Agricultural Credit Project initiated the Smallholder Agricultural Credit Administration (SACA) as a department under the Ministry of Agriculture (MoA). Through the establishment of SACA, all individual donor-supported credit services were able to be consolidated and managed more efficiently within a single department. Although SACA has achieved notable success, its activities are still heavily subsidized by the Government and are not sustainable. Therefore, the conversion of SACA into a private limited liability finance company will increase the coverage and depth of Malawi's rural financial services and improve the policy and institutional framework of the entire financial sector.

This Manual is part of a system of manuals covering the specific policies and procedures for the Malawi Rural Finance Company (MRFC). Based on SACA's existing policies, the aim of this manual is to enable the MRFC Management and Board of Directors to communicate with staff, the current policies and procedures used by MRFC in all of its operations.

### **1.1 Mission and purpose of MRFC**

The mission of the Malawi Rural Finance Company (MRFC) is to foster economic growth, increase food security, reduce poverty, provide off-farm employment, and protect the natural resource base; to establish a rural financial institution which will commercialize and expand the activities currently carried out by the Smallholder Agricultural Credit Administration (SACA); to provide a full range of financial services to rural households and business enterprises on a competitive and sustainable basis; and to improve the policy and institutional framework for rural financial activity throughout Malawi.

The MRFC will carry out this mission through direct and broad-based lending and the provision of financial services to the rural sector, including women. The MRFC will also attempt to assist the Government of Malawi in improving policy by supporting the development of linkages between the formal and informal financial sectors, and strengthening related non-financial institutions serving the rural sector.

### **1.2 Operating philosophies**

MRFC will operate using standard business practices, acting on a profit-making basis, and organized through a branch system of individual profit centers.

MRFC is dedicated to providing high-quality customer service. MRFC staff will carefully and continually listen to the customer, work to understand the customer, and respond creatively within the laws of Malawi and the rules, regulations and policies of the organization. It is the intent of the Board that MRFC services be perceived as valuable, reliable, dependable and carried out in a professional and caring manner.

### **1.3 Inter-institutional relationships**

The MRFC will interface and, in fact, rely on several organizations and institutions to ensure access to financial services for citizens in rural areas. The Ministry of Agriculture (MoA), with its extensive network of development projects at all levels, will continue to play a vital role in supporting MRFC beneficiaries with extension services and farmer club formation and training. The specific role of the Ministry of Agriculture, especially as it relates to club training and follow-up, will be developed by the MRFC Management Committee and approved by the Board of Directors. Although credit will be separated from extension the two areas will be co-dependent and inter-related.

In addition to the MoA, the relationship between MRFC and other agencies, organizations and parastatals including but not limited to Reserve Bank of Malawi; National Bank of Malawi; Commercial Bank of Malawi; ADMARC; MUSCCO; Malawi Mudzi Fund; SEDOM; etc. will also be established.

DEMATT will be responsible for the business advisory training of MRFC clients who are in need of basic bookkeeping and business management instruction. A clear policy on the exact scope and basis on which DEMATT services will be used by the MRFC will be developed and approved by the Board.

#### **1.4 System of Manuals (organization of information)**

##### **1.4.1 Organization and structure of manuals**

These policies and procedures are arranged into five (5) separate manuals. Each manual will address specific areas of MRFC operations as detailed below:

Executive Summary. This provides a brief summary of the general overall policies of the MRFC. These policies are designed to provide the general guidelines for credit delivery and management; accounting and financial systems; personnel; and internal audit systems. Further details of MRFC policies and procedures on these topics can be found in their respective manuals (Vols I-IV).

Volume I - Credit Policies and Procedures. This volume provides specific guidance on MRFC lending policy, credit administration, recovery guidelines, credit supervision and follow-up.

Volume II - Finance and Accounting Policies and Procedures. This volume provides details of the MRFC financial and accounting systems, including guidelines for general and loan accounting as well as other financial procedures.

Volume III - Personnel Policies and Procedures. This volume contains specific rules and regulations concerning personnel and human resource development.

Volume IV - Internal Audit Policies and Procedures. This volume contains specific rules and regulations concerning the internal audit of both the financial and credit operations of the MRFC.

#### **1.4.2 Responsibility for manuals**

The Director of Personnel and General Administration, will have general responsibility for developing and maintaining the MRFC manual system. S/he will incorporate and periodically update the manuals to reflect all policies and procedures initiated by the General Manager and approved by the Board of Directors.

The MRFC Board of Directors is responsible for approval of all company policies. New manuals may be added to this system as deemed appropriate by

the Board or management. The various manuals will be updated periodically to reflect changes approved by the Board.

## **2.0 GENERAL CREDIT POLICY**

MRFC will make seasonal production loans, term loans and offer other financial services deemed necessary by the Board of Directors to accomplish the purposes set out in this policy and subject to the terms and conditions detailed in these policies.

### **2.1 Interest rate policy**

Fees and interest charges will be established at prevailing market rates.

### **2.2 Eligible Borrowers**

Eligible borrowers will include all private sector producers of agricultural products including individuals, groups, clubs, or other entities authorized to borrow and engaged in productive enterprises in rural areas.

Management will develop credit procedures and programs that comply with these policies. In addition, management will devote the necessary resources to appropriately train MRFC credit personnel and to develop training programs, or assist with the implementation of training programs for borrowers.

### **2.3 Lending Policy**

Seasonal loans will be based on a completed application and shall be reviewed at least annually. Medium-term loans will not exceed 60 months. All MRFC loans will be technically and financially sound.

#### **2.3.1 Basis of approval**

The basis for credit decisions for all MRFC loans will be the five credit factors.

These are:

- (1) Character, management and marketing ability.
- (2) Financial position.
- (3) Repayment capacity and cash flow.
- (4) Loan purpose and structure.
- (5) Collateral available.

It is recognized by the Board of Directors that many existing and potential customers of MRFC do not have access to bankable collateral. Nevertheless, consideration of collateral shall not be ignored.

#### **2.4 Credit Reserve Fund**

Borrowers from MRFC, whether they are individuals or groups, shall be required to pledge an amount equal to not less than 10 (ten) percent of the total amount of loan approved held in an interest bearing account maintained in the name of the borrower. This requirement shall not be a reason for disapproval as applicants may apply for a term loan to meet the credit reserve fund requisite. The primary purpose of the "Credit Reserve Fund" is to reduce the risk of default.

The Management Team of MRFC will develop specific and detailed procedures concerning the operation of the Credit Reserve Fund.

#### **2.5 Appraisal Policy**

Appraisal procedures will be developed by management that evaluates collateral and measures loan risk. The procedures for determining the value of collateral, when necessary for term loans, will include at least two of the following approaches: (1) an

assessment of resale value, in the event of foreclosure (market value); (2) cost of new construction; or (3) production value (income) to the operation. Procedures for evaluating the operation of projects will generally include preparation of a cash flow statement to determine repayment capacity and schedule repayments, a feasibility study, and an environmental impact assessment. Credit standards for appraising seasonal production loans will be developed at the level of the credit decision (either agency- or branch-level).

## **2.6 Credit Administration Policy**

Credit administration standards will be developed and implemented that establish lending procedures for completing credit applications, evaluating and analyzing the loan request, disbursing inputs and loan proceeds, monitoring the borrowers progress, and recovering repayments. Loan application procedures will reflect the five credit factors for appraising a sound loan (see Section 2.2.1).

Evaluation and analysis procedures will vary by the loan type, borrower credit history, and type of business enterprise, as set forth in the appraisal policy. Procedures for disbursement of inputs and loan proceeds will be coordinated with the appropriate individual agencies.

Procedures for monitoring the borrowers progress will include inspection of crops and/or livestock and meetings with club officials or members. The loan monitoring procedures will include appropriate actions for all levels of credit management and supervision, from the Branch Manager to the Agency Loan Officers. Procedures for the scheduling and collection of repayments will also include appropriate controls of cash, deposits and periodic progress reports at all levels of the MRFC.

## **2.7 Credit Supervision Policy**

Effective credit supervision provides portfolio management, balances the credit risk with the specific needs of the borrower, and delegates credit decisions to the branch or agency-level closest to the borrower. These policies and related procedures for credit supervision recognize that agriculture and businesses that rely on agriculture are volatile and subject to a variety of market, weather and production risks. Procedures for risk management must balance the borrower needs with prudent credit controls to insure that decisions are appropriate and timely. Procedures for delegating credit authority shall establish accountability at all levels. The amount of delegated authority for credit staff and committees will be based on past technical training, credit experience, and demonstrated performance.

## **2.8 Loan Servicing Policies**

It is the policy of MRFC to collect the full amount of principal, interest and fees due for all loans. Borrowers who are able to pay must pay on time and in full.

### **2.8.1 Foreclosure**

As a last resort, court actions including but not limited to, foreclosure may be required to collect a loan. When a borrower, be it a club or an individual, fails to pay in accordance with the repayment terms or shows a significant loss of ability to repay, alternative options for loan recovery process should be immediately assessed. Branch Managers will recommend the appropriate action to the Management Committee for approval.

### **2.8.2 Loan Restructuring**

Restructuring of loans will only be considered when borrowers fail to pay their loans due to factors beyond their control. Normally the losses suffered are the result of some natural disaster such as drought or flood. Loans may be rescheduled over a maximum period of three years for a complete loss and a shorter period may be considered for a partial loss. The interest rate may also

be adjusted for the rescheduled loan. Branch Managers will recommend the terms and conditions for all restructured loans to the Management Committee.

## **2.9 Credit Manual**

The Credit Manual (Volume I) contains the specific policies and procedures that apply to all aspects of credit operations.

## **3.0 GENERAL FINANCE AND ACCOUNTING POLICY**

The Board of Directors and management recognize that MRFC is a limited liability, for-profit company. As such, MRFC shall comply with the Business Name Registration Act of 1922, the Companies Act of 1984, and the Capital Market Development Act of 1990.

It is further recognized that MRFC is an independent commercial company that is financed primarily through private investment and retained earnings. MRFC shall conduct its business and financial operations to build and maintain a sound capital structure and provide earnings sufficient to cover all costs and, when appropriate, pay dividends to its stockholders. The elements of the MRFC Finance and Accounting Management system shall consist of the following:

### **3.1 General Accounting Policy**

MRFC shall have a comprehensive accounting system to ensure that the assets and liabilities of MRFC are properly safeguarded, correctly valued and fully recorded in the books of account; all transactions entered into by MRFC are recorded in the books of account; and that the Board of Directors and management are provided with comprehensive, timely and reliable information on the financial performance of MRFC.

### **3.2 General Credit and Loan Accounting Policy**

MRFC shall also have a comprehensive loan accounting system that ensures that: all loans are accounted for; MRFC management is provided with financial and statistical information regarding the loan portfolio in a timely, accurate fashion; information is provided to MRFC management and staff to assist in the timely collection of outstanding loans; and to provide procedures whereby amounts can be properly written-off when all collection procedures have failed.

### **3.3 Funds Management/Cash Control Policy**

MRFC shall have a system of funds management and cash control to ensure that: all monies received and paid are accurately accounted for and controlled; proper recording

and smooth processing of all monetary transactions takes place; all cash is correctly receipted and approved procedures are adhered to; all cash receipts are promptly banked; receipts are issued only for monies received; receipts are correctly processed in the books of account and the cash position is not materially misstated at any particular accounting date; only authorized payments are made for valid MRFC business; and that expenditures are accurately recorded and reported to management.

There shall be annual audited financial statements and monthly management reports which enable the Board and Audit Committee to appraise the financial performance and status of MRFC and to take corrective action where necessary.

### **3.4 Finance and Accounting Manual**

The Finance and Accounting Manual (Volume II) contains the specific policies and procedures that apply to all levels of MRFC operations.

## **4.0 GENERAL PERSONNEL POLICY**

The employees of MRFC represent its most important asset. The image of MRFC is the image reflected by its staff both within and outside normal hours of work.

The management of MRFC has developed a Human Resource Management System so as to furnish general guidance in the development of personnel programs.

The objective of the Human Resource Management System and related personnel policies is to provide the general guidelines by which employees conduct themselves in serving customers and the public. MRFC intends to provide a healthy work environment in which each individual staff member can develop pride and gain personal satisfaction from their work while contributing to the attainment of MRFC objectives, aims and purposes.

The elements of the Human Resource Management System consist of the following:

#### **4.1 Job Descriptions**

Job descriptions describe the qualitative and quantitative elements of the position and are required for every job in MRFC. Job descriptions provide the basis for determining hiring specifications and evaluation of employees' performance.

#### **4.2 Recruiting and Selection**

Strategies and procedures have been developed to assist supervisors in recruiting and selecting the best qualified persons available for employment. Emphasis is placed on

ability to perform the work assigned, potential for greater responsibilities, employment history and loyalty to the interests of MRFC.

#### **4.3 Compensation and Salary Administration**

The compensation plan provides for an established salary range for each position level. The ranges provide administrative control of salaries and a means of maintaining equity in pay relationships among various positions. The objectives of the salary administration program are:

- To attract, retain and motivate qualified personnel at all responsibility levels by maintaining a competitive range of salaries.
  
- To provide incentive through a program of performance reviews and merit increases which will reward and encourage competent employees to improve their performance.
  
- To maintain salary relationships between positions which recognize the important relative differences in position requirements of education, knowledge, skill, judgment, experience, and accountability for decisions and supervision.

The General Manager will review (or cause to be reviewed) the salary ranges annually and assure the compensation plan remains competitive and operates in the best interests of the employees and MRFC.

#### **4.4 Employee Benefits**

The employee benefits program consists of various kinds of leave detailed in the Personnel Manual. The general objective of employee benefits shall be to maintain and improve the health, morale, stability and effectiveness of employees.

#### **4.5 Performance Evaluation**

The performance of every employee will be appraised at regularly scheduled intervals (at least annually). The objectives of the performance review program shall be:

- a. To answer for the employee the questions, "How am I doing in my job?"; "What can I do to improve my performance?"; and "Where can I go from here within MRFC?"
- b. To stimulate and encourage individual development to meet present and future needs of MRFC.

- 
- c. To help the employee determine where improvement is needed, and to suggest a program of development designed to improve performance in key areas of responsibility.
  - d. To commend the employees in areas of superior performance.
  - e. To promote better understanding and maintain fairness and impartiality in employee relations.
  - f. To provide a factual basis for merit salary adjustments, promotions, transfers and terminations.
  - g. To assist management by providing facts to be used in evaluating overall performance of MRFC.

#### **4.6 Training and Development**

Training programs for the development of specific skills relevant to MRFC's purposes will be developed and implemented. Employees will be encouraged to attend such training courses. Technical training will be developed and required for all levels of staff.

Development programs, or those intended to enhance skills and impart knowledge for employees with demonstrated potential will also be developed or offered.

#### **4.7 Non-Discrimination**

MRFC employment policies are based on principles of neutrality in politics, race and religion. Therefore, employment policies provide equal opportunity to all and no discrimination on the basis of sex, age, handicap, color, ancestry or place of birth will be allowed.

#### **4.8 Compliance with Malawi Laws**

MRFC adheres to all working regulations, conditions and standards prescribed by the laws of Malawi.

#### **4.9 Legislation, By-laws and Operating Policies**

Every employee of MRFC is responsible for being familiar with the appropriate sections of the Companies Act, the Rules thereunder, the By-laws of MRFC and all operational policies applying to his/her area of responsibility. Nothing contained in these policies

shall limit the powers of the Companies Act or any other statutes applicable to employment or to the operations of MRFC.

#### **4.10 Personnel Manual**

The Personnel Manual (Volume III) contains the specific policies and cite the terms and conditions of service with MRFC which apply to all employees whether temporary, part-time, on probation or permanent staff.

### **5.0 INTERNAL AUDIT POLICIES**

There shall also be an Internal Auditor and internal audit staff whose sole responsibility is to audit the credit and financial policies, programs and procedures of every phase of the operations of MRFC. The Senior Internal Auditor shall provide a monthly report directly to the Audit Committee of the Board of Directors of the MRFC. All MRFC assets and accounts will be subjected to both external and internal audits with formal reports and findings submitted.

These internal audit policies shall ensure all that evaluating and reporting will be conducted under the supervision the Chief Internal Auditor. In addition, an audit program shall be prepared annually to designate the schedule to be followed and scope of audit to be made in each area of operations.

### **5.1 General features of the internal audit system**

It is the policy of the MRFC to have an Audit Committee of the Board of Directors that will be responsible for ensuring that the necessary and proper internal controls and audits are in place, and the assets of MRFC are properly safeguarded and valued.

The policy establishes the authority for the Internal Audit Department to perform a series of audits throughout the operations of the MRFC.

### **5.2 General Internal Audit Policy**

It shall be the duty of the Internal Audit Department to audit the quality of the operations of the MRFC, including the internal controls and operations of all departments. Special attention will be paid to the quality of the loan portfolio, loan-related assets, and the quality of credit administration in each level of operations. The Chief Internal Auditor shall adopt policies defining audit criteria and provide for the issuance of reports to the Audit Committee of the MRFC Board of Directors.

These policies shall ensure an audit program be prepared annually to designate the schedule to be followed and scope of audit to be made in each area of operations.

### **5.3 Internal Audit Manual**

The Internal Audit Manual (Volume IV) contains the specific policies and procedures used by the MRFC in its internal audit operations.

## **6.0 MRFC MANAGEMENT INFORMATION SYSTEM \*\*\*\***

This section on the Management Information System for MRFC remains in progress. The development of a comprehensive MIS program will significantly increase the efficiency and effectiveness of the MRFC. However, as this volume is in its initial stages, this area has not yet been addressed. Some specific areas that should be considered in developing the MIS include, but are not limited to, the following:

**6.1 Philosophy and Objectives of the MIS**

**6.2 Use of Data Processing**

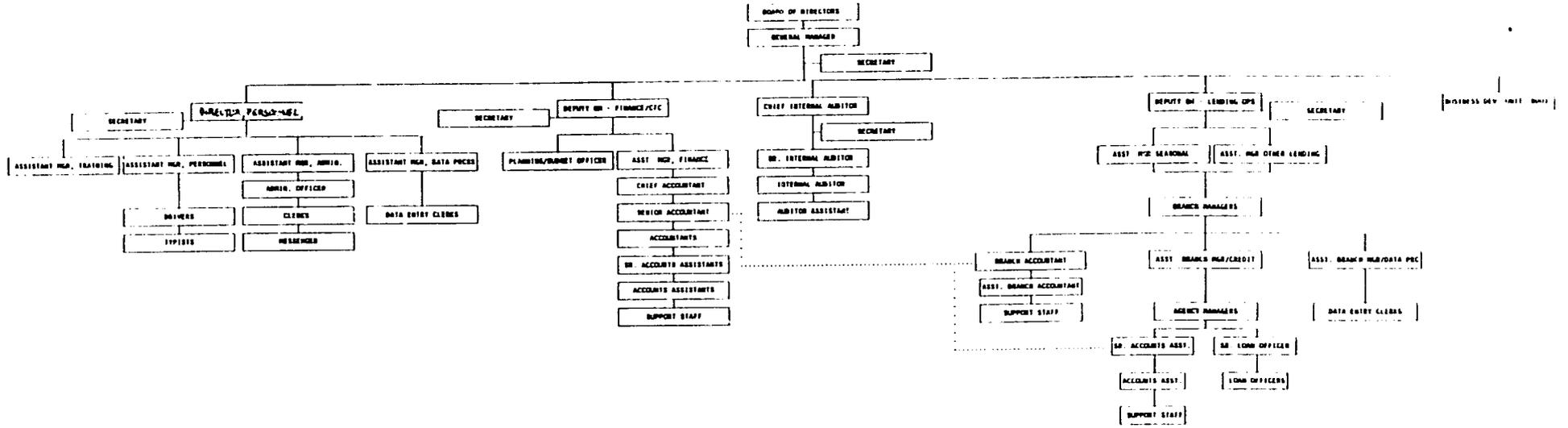
**6.3**

**6.4**

Approved by the General Manager on \_\_\_\_\_.

Approved by the Board of Directors on \_\_\_\_\_.

WALSH RURAL FINANCE COMPANY (WRFC)  
DRAFT ORGANIZATIONAL CHART



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**Malawi Rural Finance Company (MRFC)**

**Policy and Procedures Manual**

**VOLUME I: Credit**

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## **ABBREVIATIONS**

<b>ADD</b>	- Agricultural Development Division
<b>ADMARC</b>	- Agricultural Development and Marketing Corporation
<b>BDU</b>	- Business Development Unit
<b>CDR</b>	- Court Deposit Receipt
<b>LO</b>	- Loan Officer
<b>PDO</b>	- Purchase/Delivery Order
<b>POSB</b>	- Post Office Savings Bank
<b>PSO</b>	- Purchase/Sale Order
<b>SLO</b>	- Senior Loan Officer

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## CREDIT POLICIES AND PROCEDURES

This Manual is an official document of the Malawi Rural Finance Company (MRFC) which details the policies and procedures related to the extension and collection of loans. The purpose of this Manual is to provide detailed information on MRFC credit policy and to guide MRFC employees in the application of various procedures and regulations. This Manual constitutes current credit policies and standards that have been developed by MRFC as currently practiced.

The Deputy General Manager - Lending has the primary responsibility for maintaining this manual. He shall report proposed changes to and obtain the concurrence of the General Manager and the MRFC Board of Directors for all such changes. He or his designate shall review the Manual at least annually to decide what changes or revisions, if any, should be made to the Manual.

Each employee is encouraged to provide their suggestions relating to this Manual to the Deputy General Manager - Lending.

### 1.0 CREDIT ADMINISTRATION

Credit administration is the implementation and application of structured processes for extending credit to meet the needs of borrowers and maintain sound, constructive loans. Credit

administration includes the philosophy, standards, and procedures for managing the loan portfolio and the individual loan.

Credit administration has two major functional responsibilities - credit management and loan administration. The credit management function deals with issues of overall portfolio management and supervision of the loan administration function. The loan administration function concerns the relationship between the borrower and the credit staff, as well as the process for making a credit decision.

### **1.1 Supervision of the Loan Administration Function**

The primary management tool for controlling credit risk is the supervision of the lending staff. Management must ensure that a proper relationship exists between the borrower and the credit staff. Supervision of this relationship will ensure that: adequate information is provided by the applicant; lending decisions are based on an appropriate analysis of the five credit factors; the Loan Officer adequately verifies the borrower's information; borrower performance and loan repayment are closely monitored; and timely corrective action is taken, if needed.

The assignment of specific loans to each Loan Officer makes this supervisory responsibility more effective and emphasizes the Loan Officer's authority, responsibility, and accountability for individual loan performance.

### **1.2 Credit Administration Performance**

Credit administration performance measures how well management, credit staff, and support staff are performing their responsibilities. There is a distinct difference between the risk of nonpayment created by some weaknesses in the borrower's credit performance and the relative risk created by poor credit administration practices.

### **1.3 Credit Risk Management**

The risk level in each loan relates to the probability that principal and interest will be collected by the lender. According to sound business principles, the level of risk in the loan portfolio must be in line with the financial risk bearing-ability and managerial resources of the MRFC to absorb such risk. Excessive risk endangers the viability of the institution. Therefore, credit risk management requires the use of conservative lending practices and sound financial management of the MRFC.

#### **1.4 Management Responsibility**

Management must effectively communicate the credit administration procedures to all levels of the credit staff and monitor their use. Credit staff must understand the credit procedures and use them in their lending decisions. Training in credit analysis and loan administration will improve the understanding and use of procedures which will result in better credit decisions being made.

#### **1.5 Loan Officer Responsibility**

The Loan Officer and Senior Loan Officer are responsible and accountable for the loan administration of assigned loans. The use of other experts to assist with this function (Extension Assistants, Veterinary Officers, Appraisers, Clerical Staff, etc.) does not relieve the Loan Officers of this responsibility.

#### **1.6 Loan administration procedures**

Loan administration is a structured set of procedures used by the credit staff to process and collect loans. These procedures will help credit officers to establish the communication and documentation needed to ensure that borrowers are aware of their required performance and repayments. Procedures need to be tailored to the size,

complexity, and creditworthiness of the borrower. The loan administration process will generally consist of five steps:

- (1) Gathering information from the borrower.
- (2) Verifying and reconciling this information for accuracy and completeness.
- (3) Analyzing the information in a systematic way.
- (4) Evaluating the credit-worthiness of the applicant by evaluating the five credit factors.
- (5) Monitoring and collecting the loan.

#### **1.6.1 Gathering Information**

The applicant is responsible for providing the necessary information for a credit decision. The information provided must meet the Loan Officer's requirements as determined by the size, risk, and complexity of the loan request. Any applicant who fails to provide the required information will be denied credit. The information gathering step of the loan administration process is the initial stage for all subsequent borrower/Loan Officer relations. It is the Loan Officer's duty to establish a professional relationship with all potential and existing clients.

### **1.6.2 Verification**

The Loan Officer must verify the information provided by the applicant. This will ensure accurate analysis and informed credit decisions. The verification process must be sufficient enough to convince the Loan Officer or Senior Loan Officer the information is correct. The verification step should show: the existence, ownership, value, productive capabilities, and physical condition of assets; the level of crop or livestock production and marketing practices of the applicant; and sources of repayment and collateral available to support the loan.

### **1.6.3 Analysis**

Credit analysis includes a thorough review of the five credit factors and the applicant. The aim is to identify and assess credit risk. The analysis should include the production costs, anticipated prices, historical and projected yields, and potential markets. Contingencies must be anticipated including possible changes in consumption habits, production and transportation patterns, government programs and foreign trade opportunities. Certain cases, such as new agricultural or cooperative ventures, may require an independent feasibility study to review the project, its likely success, rate of return, and projected cost.

#### **1.6.4 Decision**

The success of the lending institution is ultimately decided by the effectiveness with which the credit staff makes and executes credit decisions. Sound credit decisions involve correctly analyzing all credit factors, determining risk and structuring the loan properly.

#### **1.6.5 Loan Closing**

The loan closing step will ensure that loan requirements are presented in a way that is clearly understood by the borrower. In addition, the Loan Officer must insure that the borrower receives the inputs, livestock or loan proceeds that were requested. A loan closing checklist will help the Loan Officer with this step.

#### **1.6.6 Loan Servicing**

The purpose of loan servicing is to monitor the borrower's performance. This step may include visiting the borrower, conducting financial analysis and on-site inspections. The purpose is to evaluate the borrower's ability to repay the loan. The Loan Officer's relationship with the borrower is a key element of collecting the loan.

## **2.0 DELEGATED LENDING AUTHORITY**

Credit decisions should occur as close to the borrower as possible, to be consistent with sound business practices. Delegation of lending authority will depend on the level of technical credit skills, loan size and complexity, and demonstrated credit judgment.

### **2.1 MRFC Management**

MRFC management shall establish written lending authority for each Branch and Agency Manager as well as implement a program to periodically review delegation levels and adjust them when warranted, according to demonstrated performance.

### **2.2 Branch Manager**

Each Branch Manager will develop a plan for re-delegating authority and frequently monitor the use of the delegated authorities and adjust them based on performance.

### **2.3 Agency Manager**

Similar to the Branch Manager, each Agency Manager will also develop a plan for re-delegating authority and regularly monitor the use of the delegated authorities and adjust them based on performance.

### **2.4 Lending Committees**

#### **2.4.1 Management Committee (Headquarters)**

The MRFC Management Committee shall consist of the following members:

- General Manager - Chairperson
- Deputy G.M., Lending - Secretary
- Deputy G.M., Finance - Member
- Designated Branch Managers - Ex officio

The Management Committee shall have the full lending authority of the MRFC.

#### **2.4.2 Branch Loans Committee**

The Branch Loans Committee shall consist of the following members:

- 
- |                                   |               |
|-----------------------------------|---------------|
| • Branch Manager                  | - Chairperson |
| • Asst. Branch Manager(s), Credit | - Secretary   |
| • A minimum of two borrowers      | - Members     |

For loans within its delegated authority, the Branch Loans Committee will consider each application on its own merit. Credit decisions will be to either approve the application in part or in whole, or to reject the application based on the information provided by each applicant.

For loans that exceed their delegated authority, the Branch Loans Committee will only recommend either approval or disapproval. The recommendation and complete application will then be forwarded to the MRFC Management Committee for a credit decision.

The Chairperson of the Branch Loans Committee will document and make the final comments regarding the credit decision. The Secretary of the Branch Loan Committee will inform the Agency Manager of the credit decision and the reasons for any disapprovals.

### 2.4.3 Agency Loans Committee

Similar to the Branch Loans Committee, the Agency Loans Committee shall consist of the following members:

- Agency Manager - Chairperson
- Agency Senior Loan Officer(s) - Secretary
- A minimum of two borrowers - Members

For loans within their delegated authority, the Agency Loans Committee will consider each application on its own merit. Credit decisions will be to either approve the application in part or in whole, or to reject the application based on the information provided by each applicant.

For loans that exceed their delegated authority, the Agency Loans Committee will only recommend either approval or disapproval. The recommendation and complete application will then be forwarded to the Branch Office for a credit decision.

The Chairperson of the Agency Loans Committee will document and make the final comments regarding the credit decision. The Secretary of the Agency Loan Committee will then inform the assigned Loan Officer of the credit decision. It

is the Loan Officer's responsibility to notify the applicants of the committee's decisions.

### **3.0 SCOPE OF LENDING**

It is the borrower's responsibility to pay the loan in full while it is the lender's responsibility to supervise loans. Time spent on proper supervision of unmatured loans will usually result in less defaulters.

Credit decisions will always be based on the five credit factors of character, capital, capacity, collateral, and conditions. A sound loan is one that is made to a responsible individual or group with integrity and a creditable operating history, or the equivalent characteristics if it is a new business. The loan amount and repayment terms should be within the borrower's cash flow. In addition, the management practices of the borrower and collateral must be sufficient to protect the MRFC against a loss.

#### **3.1 Five Credit Factors**

The five credit factors are a check list for appraising a sound loan. These factors and are the fundamentals of a prudent credit decision. The size and complexity of the loan will usually decide the importance of each area. For example, the character factor is

more important for a Seasonal Loan than is collateral. However, repayment capacity and collateral become more important for medium term loan applications. The five credit factors of character, capital, capacity, collateral, and conditions are further described below with possible questions that the Loan Officer should be able to answer:

### 3.1.1 Character

The Borrower - Has he been honest and truthful in the past? Are inputs or borrowed funds used for the purposes intended? Does he keep good records and does he have a good reputation?

Management Ability - Has the business been profitable? Does his business planning include costs and estimated market prices? Does the amount of credit requested match the probable needs, and has he considered all possible risks?

Marketing ability - Does he market his crop or livestock at the proper time? Is his production in the condition that will bring the best price?

### **3.1.2 Capital and Financial Progress**

Financial Position - How much capital does the borrower control? Is it in a savings account or invested in farm equipment or other assets?

Net worth - What is the net worth and will it support the credit request? Has net worth been increasing? Will the applicant need a co-signer?

Debt - Can the borrower pay all debts? Will other lenders interfere with the repayment of MRFC's loan?

### **3.1.3 Capacity for Repayment**

Cash flow - Will repayments come totally from profits of the operation?

History - What is the earnings history of the borrower?

Income - What is the potential of the business? What are the expected annual expenses? What funds are needed to pay other debts? How will family living expenses be paid?

Projected repayment - is there still profit after deducting all expenses, including the loan payment, from total income?

#### **3.1.4 Collateral**

Reserve Fund required - Does the borrower have the required cash in savings to meet the 10 percent Credit Reserve Fund borrowing requirement?

Seasonal loan - Collateral is less important to the credit decision for seasonal loans that repay each year. However, the 10 percent Reserve Fund requirement still applies.

Term loan - Is the value of the collateral properly appraised? Will its value protect MRFC against a loss if repayment or management practices deteriorate? Does the borrower keep his farm implements in good working condition? Are livestock in good health? Is there additional collateral that could be pledged?

#### **3.1.5 Conditions of the Loan**

Purpose - Will the loan be used to generate income? Is it for operating expenses or for capital investment?

Seasonal loans - Is repayment from this season's production of this operation? next season's?

Term - Is the repayment from profits? Does the repayment schedule match the cash flow of the operation? Is the loan period less than the life span of the collateral asset acquired?

### **3.2 Eligibility**

MRFC shall make seasonal production loans, medium term loans, working capital loans, and offer other financial services, deemed necessary by the MRFC Board of Directors to foster economic growth and to improve the accessibility to financial services in the rural sector on a sustainable basis.

#### **3.2.1 Lending Programs**

Lending programs shall include seasonal production credit, medium term loans, and other financial services related to lending. Eligible beneficiaries include: smallholder farmers clubs; women and women's development programs; cohesive groups; private sector individuals or other legal entities; small estate holders up to 30 hectares; and small to medium scale enterprises. Seasonal loans

shall be reviewed at least annually. Medium term loans will be made for a maximum of 60 months. All loans will be technically and financially sound.

### **3.2.2 Reserve Fund Collateral requirement**

The collateral required to become a borrower from MRFC is a Credit Reserve Fund of at least 10 percent of the loan request. This requirement shall not be a reason for disapproval since applicants may apply for a medium term loan to meet this requirement. The borrower will open a savings account at an approved financial institution and the account will be pledged to MRFC. The interest earned will be credited to the account. The required balance and interest income can be paid to the borrower after the loan and interest charges are paid.

### **3.3 Farmers' Clubs**

A farmer's club is an association of individuals having common interests such as the pooling of resources for common use; producing similar crops or livestock; catchment area conservation or acquisition of credit. While the size of the Farmers' Club is not important, it is recommended that a club should consist of a minimum of ten (10) and a maximum of thirty (30) members for ease of administration. It is important to note

that the responsibility for assessing the individual member's eligibility and credit-worthiness rests with the club officers.

### **3.3.1 Women's Participation in Credit Programs**

With the growing awareness of the importance of women's participation in all areas of integrated rural development, it is necessary to understand the role that MRFC can play in increasing women's involvement in rural finance and credit programs. The emphasis therefore shall be on:

- a. Encouraging women to become more actively involved in credit programs, either as independent borrowers in their own right or as members of a family.
  
- b. Giving wives of borrowers the opportunity to increase their participation in credit programs so that they share equal responsibility for inputs. They should also be encouraged to become club members, take an active role in the discussions and activities of the club, and know how to derive maximum benefit from the inputs received.

- c. Permitting women to take up seasonal credit packages through clubs as heads of households, i.e., wives of husbands who are away on "off farm" business or wives of polygamous husbands.
- d. Encouraging women who wish to take up credit to integrate themselves into existing Farmers' Clubs or alternatively, form their own clubs.
- e. Involving women borrowers fully in credit management training.
- f. Encouraging women to take out medium term loans either as individuals or through clubs.

### **3.3.2 Eligibility of Clubs**

Clubs should be evaluated using the five credit factors before extending credit. In addition, there are several criteria that clubs must meet in order for them to be eligible for credit. These include:

- a. Organization - the club should be well organized and should have an acceptable written constitution;

- b. Clubs should be willing to follow all the recommendations and advice given to them by MRFC and extension staff;
  
- c. Membership - the club should have at least ten but not more than 30 members. Village headmen may be asked by the Loan Officer to certify that the club members are bona fide residents of their village.
  
- d. Clubs may not have more than one outstanding seasonal loan at any one time. They will not be issued a new seasonal loan until the club has repaid their existing loan in full.

### **3.3.3 A Self-Managing Club**

In addition to the above requirements, clubs that are "self-managing" reduce the loan servicing and collection requirements of MRFC staff. The following are characteristics of a "self-managing" club:

- a. Have literate and trained club officers, especially the Treasurer and Secretary;

- b. Keep a record of club activities - minutes of meeting, rules and regulations, income and expense receipts and records, debtors and creditors, and loan repayments;
- c. Have a savings account to earn interest, mobilize savings, and serve as a cushion for when crops are poor;
- d. Be able to reconcile loan records with MRFC records; and
- e. Have minimum supervision by MRFC credit staff.

### **3.4 Small Estate Holders**

Small estate holders are eligible for both seasonal and medium term loans from MRFC. Small estate holders are individuals with members that operate up to 30 hectares. Loans to these individuals may have differences in quantity or types of inputs. Loan administration, application, and approval procedures for seasonal and medium term loans to small estate holders shall be the same as with smallholders.

Again, credit decisions will be based on the five credit factors. However, because of the size and/or risk involved these loans may require additional analysis of repayment

capacity. Additional information may be required when a seasonal loan request includes payment of labor or other monthly expenses. In this case, the applicant should provide past records to assist in preparing a more realistic cash flow projection.

### **3.5 Small and Medium-Scale Enterprises**

Individual rural small and medium-scale enterprises are eligible to apply for seasonal and medium term loans. However, given their scope of operations, these clients may have to provide additional information. They may be required to provide the information to complete a projected cash flow, a projected income statement, and a current balance sheet. Standard MRFC loan application, analysis and approval procedures for seasonal and medium term loans will remain the same.

### **3.6 Other Financial Services**

Other financial services offered by MRFC shall be approved by the Board of Directors. These services, when approved, may be offered to persons eligible to borrow in the rural sector. Procedures will then be developed and included in this section of the manual.

### **3.7 Credit Recovery**

It is extremely important that borrowers repay their loans, including interest so that loanable funds of MRFC are not depleted. It is vital for existing and future borrowers to have a dependable source of loan funds in the future.

#### **3.7.1 Credit recoveries by Club Officers.**

In the case of farmers clubs, officers shall be fully responsible for collecting repayments from members. Farmers' club officers should be advised to issue receipts to members for every collection. The club officers will then make repayments to the Loan Officer. Club officers shall also be responsible for keeping records of each individual member's accounts.

#### **3.7.2 Handling of money by the Loan Officers**

On receipt of money from a club, the Loan Officer will issue an MRFC Repayment Receipt. The receipt will be prepared in triplicate. The three copies of the receipt should be distributed as follows:

Copy 1 - Senior Accounts Assistant at the Agency Office who will forward them to the Branch office,

- Copy 2 - Club Treasurer as an official receipt,**
- Copy 3 - retained in the Receipts book for audit purposes.**

### **3.8 Legal Action against Defaulters**

It is not MRFC's intention to take defaulters to court. Legal action is regarded only as the last resort when all other measures to collect the loan have been taken. When it is deemed necessary by the Branch Manager to take a borrower to court, an MRFC officer will be designated to collect the debt.

The Loan Ledger must be audited to confirm the loan balances for each debtor. These debtors will then be listed on the List of Debtors and be recommended for court action.

The list will be presented to court and copies distributed as follows:

- Copy 1 - Traditional Court for registration of case(s)**
- Copy 2 - Assistant Branch Accountant for filing in the court matters file,**
- Copy 3 - retained by the Loan Officer as applicable.**

Once Civil Cause numbers have been allocated by the Court, the MRFC Officer will note the Civil Cause Number. Details of repayments through the Court will be transferred to the loan Ledger.

### **3.8.1 Farmers' Club repayment at Court.**

After collecting the debt from the defaulter the Traditional Courts will instruct MRFC to take over the money. A Loan Officer will then collect the money from the Court on behalf of the MRFC. The procedure to be followed is outlined below:

- (1) The Loan Officer will collect repayments from the Traditional Courts by signing the Court Deposit Receipt.
  
- (2) A MRFC Repayment Receipt shall be written for the amount received - indicating to which season the repayment relates. The Court Deposit Receipt number shall be quoted on top of the Repayment Receipt. The Loan Ledger should then be updated accordingly.
  
- (3) Finally, the debtor's copy of the Repayments Receipt will be attached to the Court Deposit Receipt and both documents filed in the Court Matters File.

### **3.8.2 Repayment at an Agency Office instead of Court**

If, after Court action, there is a genuine need for debtors to pay money at the Agency Office or another designated center due to long distances or for other reasons, the following procedure should be followed:

- (1) The designated Loan Officer should quote the Civil Cause Number and the season to which payment relates on the Repayment Receipt form;
- (2) The Loan Officer shall then present such receipts to the Court Clerk for proper recording and updating;
- (3) The Loan Officer must then sign the Court Deposit Receipt as having received repayments from the Court on behalf of the MRFC;
- (4) The Loan Officer shall ensure that no copy of the Court Deposit Receipt is given to the borrower because the debtor will have already been given an MRFC Repayment Receipt. The Loan Officer should then file the Court Deposit Receipt in the Court Matters File.

### **3.9 Foreclosure Procedures**

Foreclosure means repossession of items purchased with borrowed funds, together with property pledged as security, up to the value of the outstanding loan. Foreclosure is necessary when it becomes clear that the borrower has failed to meet his legal obligations for repayment or has taken some action or actions that will jeopardize complete recovery of the loan, including interest.

#### **3.9.1 Livestock Loans**

In the case of livestock loans, foreclosure may also become necessary when the farmer fails to provide proper management of the livestock resulting in a decrease in productive performance. In those cases, a qualified Veterinary Officer must confirm the livestock's lack of fitness. If reconditioning of the livestock is required, a veterinarian should be consulted for proper care of the animal(s). The costs of reconditioning will be added to the cost of the livestock before they are sold.

### 3.9.2 Repossession Notice

When foreclosing any loan, the Branch Manager or his designate should complete the Evidence of Repossession form. When filling in this form, the Branch Manager should ensure that:

- a. The loan account number, name of borrower, village, district and Agency in which the borrower resides are properly recorded.
- b. The names and quantities of items being repossessed are correct or, in the case of livestock, that the sex and tag numbers of the animals are given,
- c. The Loan Officer, witnessed by the Village Headman or any prominent person within the village, signs on behalf of the MRFC. The borrower's or club's representative must sign the forms to confirm that the items listed on the form have been seized by MRFC.
- d. Where the foreclosure concerns a deceased borrower or an individual who cannot be located, his heir or close relative should sign. Lacking any such persons, it is essential that the Loan Officer signs, witnessed by the Village Headman.

### **3.10 Repossession of Deceased Estates**

In the case of the death of a borrower, immediate action should be taken to repossess the items that were purchased with credit funds if the family is not able to repay the loan or make appropriate arrangements. Usually an effort should be made to transfer the items to the deceased's next of kin or closest relative. They must agree to take over the asset and accept responsibility for repayment of the remaining loan balance.

If the next of kin do not wish to take over the asset or it is apparent they are unfit, or will not be able to make the loan payments, the asset should be repossessed and sold.

Four copies of the Evidence of Repossession form should be filled in and distributed as follows:

- Copy 1 - borrower's next of kin**
- Copy 2 - District Commissioner**
- Copy 3 - Branch Accountant**
- Copy 4 - Registrar General**

In the case of a deceased farmer or one who has left the country, the original copy should be given to the Village Headman. The Branch Manager shall decide who will manage the repossessed items until they are sold for cash.

### 3.11 Loan Rescheduling

The Board of Directors will approve all recommendations for rescheduling of individual loans. This will only be considered when the borrower fails to pay his loan due to factors beyond his control. Normally the losses suffered are the result of some natural disaster such as drought or flood. The policy shall be to reschedule the loan over a maximum of three years so enable the borrower to repay the debt and continue current operations. The interest rate may be adjusted. A shorter period may be considered for a partial loss.

When a natural disaster occurs the Branch Manager should report the extent of the damage and the number of borrowers that may be affected to the MRFC Management Committee. Once the harvest has been completed, the actual extent of the losses should be determined by the Branch Manager. The Branch Manager will recommend the terms of rescheduling for each individual borrower.

After Board approval, the Branch Manager will reschedule the outstanding balances. The borrower should then be asked to sign a term loan agreement for the rescheduled debt. This should detail the reasons for the default, the size of the shortfall, over how many years the deficit has been rescheduled, the annual instalment due, and if a club, the individual members who have not repaid their loans.

## **4.0 SEASONAL LOAN ADMINISTRATION**

Seasonal loans should be repaid from the production and income during the normal course of business. These loans shall mature at the end of the regular business cycle and are expected to be paid in full each year at maturity.

### **4.1 Application Procedures**

Seasonal loan applications will be completed and signed by the applicant and a guarantor, if necessary. The required loan form is the MRFC Seasonal Loan Application, listing requested inputs. The Loan Officer will inspect the farmstead, if necessary, and write his comments recommending a course of action. The completed application will then be forwarded to the Senior Loan Officer (SLO), responsible for seasonal loans at the Agency office. The SLO will complete the credit analysis, prepare a loan closing checklist, if necessary, and forward to the Agency Manager for review.

The application shall then be presented to the Agency Loans Committee. The Agency Loans Committee can approve the request if it is within their delegated lending authority. For requests that exceed the delegated authority, the completed application and a recommendation for action will be forwarded to the Branch Office. The Loan Officer will then be notified of the credit decision who will inform the applicant. The Loan

Officer and applicant will coordinate and schedule the loan closing. The loan closing consist of delivery of the inputs requested.

After approval, the Agency Office will attach a purchase order ("A" Form or PSO) and deliver these to the supplier requesting delivery. The Agency Office will prepare the Promissory Note that lists the inputs and other items requested by the borrower. The Promissory Note should be signed by the borrower as evidence of receipt of the loan proceeds (or inputs). The vendor will then present a copy of the invoice to the Agency for payment.

#### **4.1.1 Applicant**

The applicant will complete the MRFC Application and the Seasonal Loan Application form. A Seasonal Loan Application is the only form required for a repeat or existing borrower. The Loan Officer should assist applicants to insure the information is complete and accurate. Applications for the summer crop should be received by September each year, and by April for the winter crop.

Upon completion of the loan application form, the applicant endorses the document either with his signature or thumb print. All Club Officers will sign the application if the request is from a club or group. Credit staff should assure

applicants that any information they give shall be treated in confidence and not divulged to third parties without the applicant's permission.

New clubs or groups will also include a list of members. Loan Officers will decide if repeat loans to clubs require a list of members.

Some individuals, businesses, or small estate holders that apply for a seasonal loan may have to provide additional information. This may include a projected cash flow, a projected income statement, and a current balance sheet.

#### **4.1.2 Loan Officer responsibilities**

The Loan Officer is responsible for gathering and verifying the information necessary for the credit decision. He may assist the applicant in completing the necessary application form(s). The Loan Officer will perform the initial inspection of the farmstead or location of the operation. If the type of loan request is new, or the Loan Officer is not familiar with the loan purpose, he may request assistance from the Agency Manager who will locate a specialist. The specialist may be from the Business Development Unit of MRFC or an external consultant.

A feasibility study, coordinated by the Loan Officer and Agency SLO, may be necessary. The Loan Officer will complete the comment section of the application, which may be separate from the application form. Comments should address the character of the applicant and information about the loan purpose. Comments regarding the applicant's managerial ability or any other useful parameters should be frank and realistic. After making his comments, the Loan Officer will then forward the application form to the SLO at the Agency Office.

#### **4.1.3 Analysis of Application**

The SLO at the Agency Office will complete the analysis required for a credit decision, prepare a loan closing checklist, if necessary, and forward to the Agency Manager. The format of the required information will be comments concerning the relative areas of the five credit factors. Some larger seasonal loans to individuals or small estate holders may also require a projected cash flow, a projected income statement and a current balance sheet. The projected cash flow and income statement may be completed using average historical market prices and a conservative approach for expenditures.

## **4.2 Approval**

Loan requests that are within the delegated lending authority of the Agency will be reviewed by the Agency Manager and presented to the Agency Loans Committee for consideration. A record of loan actions will be forwarded to the Branch Office. The secretary of the Agency Loans Committee will inform the Loan Officer of their decision. The Loan Officer shall then inform the applicant.

Loan requests that exceed the Agency's delegated lending authority will be presented to the Agency Loans Committee for recommendation. The completed application and the Agency Loans Committee recommendations will be forwarded to the Branch Office. Applications shall be reviewed by the Assistant Branch Manager - Credit and presented to the Branch Loans Committee for consideration. The Branch may act if the application is within their lending authority or make a recommendation if the application must be submitted to the MRFC Management Committee.

## **4.3 Disbursement**

### **4.3.1 Purchase/Sale Order**

The Agency will prepare a Purchase Sale Order (PSO Form) or "A" Form and attach the loan application which lists the approved inputs and the delivery point.

It is important to note that "A" forms and PSO forms are accountable documents that should be under the control of the Senior Accounts Assistant. Additional information on this process is contained in the Finance and Accounting Manual (Volume II).

The Senior Accounts Assistant is responsible for the completion of the Promissory Note listing the inputs or other supplies to be delivered to the borrower. The completed Promissory Note will then be forwarded to the Loan Officer.

#### **4.3.2 Promissory Note**

Promissory notes shall list the delivered quantities of inputs. This is the legal document that binds the borrower and is legal proof that the items were delivered by the supplier. A copy of the signed form and an invoice shall be presented to the Branch office by the supplier for payment.

Both the Loan Officer and borrower will sign the Promissory Note. The borrower signs as agreeing to pay the loan and accepting the quantity of inputs. The Loan Officer signs to verify the quantities delivered by the supplier and authorizing the Branch Office to pay for the quantities delivered. The form will be completed in triplicate and distributed as follows:

Copy 1 - Supplier for remittance to the Branch

Copy 2 - Borrower

Copy 3 - Agency for use and forward to Branch

#### **4.3.3 Farmers' Club Issue and Promissory Note**

After delivery of inputs, all Club Officers will sign the MRFC Promissory Note. The club should have a copy of its loan request to verify delivery and to compare the quantities on the Promissory Note.

Club Officers will then distribute the inputs to individual members. The Club shall have its own Promissory Note that each member will sign or thumbprint for the issue of inputs. MRFC staff may help in determining the loan balance of each member.

The Loan Officer should place a copy of the Club's Promissory Note in the related loan file. This is an important form for the club since it provides details of what inputs have been supplied to each member and verifies receipt of the items listed because the individual has signed.

#### **4.4 Procedures for reporting**

##### **4.4.1 Borrowers' List**

The Loan Officer should record all Promissory Note forms on the Borrowers' List, which detail the daily inputs that have been issued from ADMARC's markets or other suppliers. The Loan Officers are required to prepare three (3) copies of the Borrowers' list to be distributed as follows:

Copy 1 - Branch Accountant.

Copy 2 - Agency

Copy 3 - Retained in the book.

##### **4.4.2 Loan Repayment Ledger**

After disbursement, it is necessary to open a Loan Repayment Ledger for each borrower using all the information from the Promissory Note. This ledger will be needed to record the repayments of borrowers. Entries of repayments will be recorded and the new balance brought forward. This information will eventually originate and be maintained at the Branch Office when computerized. The Agency will be provided with a new ledger after each transaction. Repayments shall be recorded and the ledger retained until a revised sheet is forwarded by the Branch.

### **4.4.3 Uptake Progress Report**

While purchases are being issued, field staff at the Agency are required to report on the progress of uptake and the status of the credit funds using the Input Uptake form and the Credit Fund Allocation form as follows:

- a. The Input Uptake form records will list the borrowers and details the type and value of inputs issued. This information is extracted from the Purchase Sale Order (or "A" form) and the Promissory Note.
  
- b. The information on the value of inputs is extracted from this form and converted to the loan balance (value of inputs plus interest). The forms are produced in duplicate and distributed as follows: -
  - Copy 1 - Accounts Assistant at the Agency
  - Copy 2 - Retained in the book
  
- c. The Agencies shall consolidate the information received from the Loan Officers and report to the Branch.

- d. The Branches will produce consolidated reports by the Agencies Input Uptake by volume and value. MRFC Headquarters will then consolidate all the Branch reports.

## **5.0 MEDIUM TERM LOAN CREDIT ADMINISTRATION**

Loans to finance capital assets, projects, or to finance the collateral required to borrow from MRFC are structured on a medium term basis. The term of the loan is jointly determined by the repayment capacity of the applicant and the economic life of the collateral. As a rule, the shorter the repayment period, the lower the credit risk. Term debt should be repaid from income, not the liquidation of assets. The operation must be profitable even when production or markets are below average. Medium term loan decisions will be based on the same five credit factors as seasonal loans. However, the cash flow and collateral factors are more important for medium term loans than seasonal loans.

Medium term loans can have maturities up to 60 months. Clubs, individuals, or others that meet the eligibility requirements to borrow from MRFC can apply for a medium term loan.

## 5.1 Application Procedures

Medium term loan applications will be completed and signed by the applicant and a guarantor, if necessary. The Loan Officer will inspect the farmstead or business and write his comments, recommending a course of action. The completed application will be forwarded to the Senior Loan Officer (SLO). The SLO will complete the credit analysis, determine the repayment schedule, prepare a loan closing checklist, and forward the application to the Agency Manager for review.

The application will then be presented to the Agency Loans Committee. The Agency Loans Committee can approve the request if it is within their delegated lending authority. For requests that exceed their delegated authority, the completed application and a recommendation for approval or disapproval will be forwarded to the Branch Office. The Loan Officer will be notified of the credit decision who will inform the applicant.

The Loan Officer and applicant shall coordinate and schedule the loan closing. The loan closing shall consist of a final inspection of the operation by the Loan Officer and delivery of the assets listed on the loan application form. Payment

to the vendor will be with a PSO or "A" Form completed by the Agency Manager.

### **5.1.1 Applicant**

The applicant will complete the medium term loan application forms - the MRFC Application and a Medium Term Request. An MRFC application is not required if the applicant is a current borrower. The Loan Officer may help applicants to insure the information is complete and accurate. On completion of the application form, the applicant endorses the document either with his signature or thumb print. In addition, the Village Headman or any other prominent member of the village/area must sign as a witness for the individual applicant or for the club/group.

Some applications may also require the signature of a guarantor for the loan to be approved. MRFC staff must never sign as the witnesses or the guarantor. Credit staff should assure farmers that any information they give shall be treated in confidence and not be divulged to third parties without the applicant's permission.

Some individuals, businesses or small estate holders may also need to complete a projected cash flow, a projected income statement and a current balance sheet. The size, purpose and repayment terms of the request will dictate what information is to be provided.

### 5.1.2 Loan Officer responsibilities

The Loan Officer is responsible for gathering and verifying the information necessary for the credit decision. He may help the applicant in completing the application form(s). The Loan Officer will perform the initial inspection of the farmstead or business. If the type of operation is new or the Loan Officer is not familiar with the loan request, he may request assistance from the Agency Manager who will locate a specialist. The specialist may be from the Business Development Unit of MRFC or from an outside source. A feasibility study, coordinated by the Loan Officer and Agency SLO, may be necessary. If some assets are to be purchased with the loan proceeds, an appraisal of value and economic life may be required.

The Loan Officer will then complete the comment section of the application, which may be separate from the application form. Comments should address the character of the applicant and information about the loan purpose. Comments

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regarding the applicant's financial standing, managerial ability, and any other information useful to assessing his creditworthiness should be frank and realistic.

After making his comments, the Loan Officer will then forward the application form and other information to the SLO at the Agency Office.

### **5.1.3 Analysis of Application**

The SLO at the Agency Office will complete the analysis required for a credit decision, determine a repayment schedule, calculate the repayment amount, prepare a loan closing checklist and forward to the Agency Manager. The format of the required information will be comments concerning the five credit factors, a projected cash flow, and a projected income statement.

The projected cash flow and income statement must be completed using the average historical market prices and a conservative approach for expenditures. Financial information shall be presented monthly or at the end of the normal operating cycle. This will depend on frequency of the applicant's receipt of cash payments from the operation.

The SLO should insure that an appraisal to verify the value and life span of the collateral. An appraisal is required when the Loan Officer or SLO cannot

document the value and life span from past knowledge or experience. The purpose of the appraisal is to value the collateral in case of foreclosure.

A feasibility study, if necessary, should also present a clear picture of the type of operation. The purpose is to ascertain whether the enterprise is a viable one and will enable the borrower to meet his loan obligations. Additional information or the opinion of other experts maybe requested by the SLO. This will be coordinated with the Agency Manager and the Loan Officer.

The life span of implements is an important factor when scheduling loan repayments. The figures listed below are given as a guideline for the expected life span of the following equipment: Farm Cart up to 10 years; Ploughs up to 15 years; Ridgers up to 15 years; Cultivators up to 15 years; Sprayers up to 5 years. It should be noted however, that the actual life span for all farm implements depends on the way they are treated and cared for.

The SLO will recommend a repayment schedule and the Branch Accountant will calculate a repayment amount. The repayment schedule will be based on the applicant's cash flow, the loan amount, and the expected life span of the loan purpose. The repayment schedule, if approved, will then be sent to the Branch

Accountant to calculate the amount of each repayment. This information will also be used to prepare the Bill of Sale and the Loan Ledger.

A loan closing checklist will be prepared by the SLO. It will include the necessary steps for the loan analysis, approvals, disbursement, and the repayment amount and schedule. The completed information will be forwarded to the Agency Manager for his review and approval.

#### **5.1.4 Approval**

Loan requests that are within the delegated authority of the Agency will be reviewed by the Agency Manager and presented to the Agency Loans Committee for consideration. A record of loan actions, approval or disapproval, will be forwarded to the Branch Office. The Secretary of the Agency Loans Committee will inform the Loan Officer of its decision. The Loan Officer will then inform the applicant.

Loan requests that exceed the Agency's delegated lending authority will be presented to the Agency Loans Committee for a recommendation. The completed application and the Agency Loans Committee recommendations will then be forwarded to the Branch Office. The application will be reviewed by the

Assistant Branch Manager, Credit and presented to the Branch Loans Committee for consideration. The Branch may act if the application is within their lending authority or make a recommendation if the application must be approved by the MRFC Management Committee.

## 5.2 Disbursement

Disbursement of the approved loan will be coordinated by the Loan Officer assigned the loan. He will coordinate the schedule with the borrower, supplier, and Agency Manager. The Agency Manager is responsible for the loan disbursement (although this may be delegated to another staff member) by completing a MRFC Bill of Sale Draft and a PDO. The Agency Manager or Loan Officer shall arrange to purchase the items approved on the loan purpose and schedule delivery by the supplier. Procedures for issuing should be the same as that for seasonal loans. The Loan Officer should notify suppliers that payment will be with a PDO. When suppliers will not accept a PDO, the Loan Officer should pursue the matter with the Agency Manager. The Agency Manager may then arrange for the items to be purchased through the respective Branch.

Applicants who can afford to do so should be encouraged to make a down payment on equipment. This will reduce the size of their loan. Advance payments are only valid if

paid before disbursement. Payments made after disbursement will be regarded as normal repayments.

The following is a recommended disbursement schedule for some loan purposes:

Farm Implements	-	March to July
Stall Feeders	-	April to June
Cotton Sprayers	-	October to December
Dairy Cows	-	January to December

#### **5.2.1 MRFC Bill of Sale Draft**

The MRFC Bill of Sale Draft is a legal and confidential document that binds the Borrower and the MRFC. The amount of the draft will always coincide with the amount of the approved loan. In addition, the Bill of Sale Draft acts as a delivery notice, stipulates the schedule of repayments for the borrower, and itemizes the loan collateral as well as any other property pledged as security against the loan. This form is used by the Branch Office to officially register the loan with the Register General.

The MRFC Bill of Sale Draft must be signed by the Loan Officer, the borrower, and the guarantor if required for loan approval. The borrower must sign in the

presence of a Village Headman, an established Government Officer, or any other eminent local leader. Agency Offices will keep the Bill of Sale Draft in the loan file.

Any personal property pledged as security for the loan in the Bill of Sale shall be subject to seizure in the case of foreclosure.

The Agency Accounts Assistant should prepare the Bill of Sale in three copies. All property pledged as security against the loan will be listed on the schedule and the schedule of repayments by the borrower. The forms should be distributed as follows:

- Copy 1 - Branch
- Copy 2 - Borrower
- Copy 3 - Agency

### **5.3 Reporting**

The loan ledger showing the principal balance, interest due, the payments made, and the schedule and amount of payments shall be maintained by the Agency and Branch accounting personnel. Instructions for maintaining the loan ledger are in the Finance and Accounting Procedures Manual.

The first repayment for a medium term loan is generally due one year from the date of disbursement. Some medium term loans may have a more frequent repayment schedule. However, borrowers should be encouraged to make payments immediately after selling their production regardless of the due date.

As with seasonal credit the Loan Officer will issue an MRFC Credit Repayment receipt to the borrowers who repay money through him. A receipt presented to the borrowers should be distributed as follows:

- Copy 1 - Agency Office to forward to Branch
- Copy 2 - Borrower
- Copy 3 - retained in the book for audit purposes

The Loan Officer will present the amount of payment together with the Branch Office receipt copy to the Agency Accounts Assistant. This person will then enter the amount recovered and the receipt number in the Loan Repayment Ledger and update the balance due. Repayments should be entered later in the Daily Repayment Sheet. A monthly report of medium term loan repayments should be included with the seasonal loan repayments.

## **5.4 Medium Term Loan Programs**

### **5.4.1 Reserve Fund Loan**

The collateral required to become a borrower from MRFC is a Reserve Fund of at least 10 percent of the loan request. MRFC applicants may apply for a medium term loan to meet this requirement if the Loan Officer verifies that the applicant does not have the funds. The term of the request should not exceed two years and payments can be monthly or annually. The applicant must open a savings account at an approved Bank or financial institution. Loan proceeds will be deposited in the borrower's account. The account will be pledged to MRFC by the bank and the borrower may not withdraw the funds. Interest earned will be credited to the borrowers account. The saving account can be paid to the borrower when his loan is paid in full and authorized by the Agency Manager.

### **5.4.2 Stall Feeding Loans**

Stall Feeding loans are considered separately because their requirements are different from normal seasonal and medium term loans. These loans are issued to farmers who are situated close to abattoirs. Stall feeders are issued primarily for fattening. The loan is repayable in five to six months during which time the animals are expected to put on sufficient weight to be able to be sold for a profit.

To be eligible for a stall feeding loan, farmers should have good managerial ability and be considered creditworthy. They should also have an adequate and reliable supply of feed and water for the stock, construct a Khola of required standards, and identify a source of steers,

The loan amount will include the cost of the animals, based on their grade and quality plus transport costs, insurance, and interest charges. The farmer is required to sign the Fatstock Agreement form that stipulates the conditions of the loan, namely:

(1) The agreed number of animals to be delivered to the borrower. The details and cost of the steers will be recorded on the MRFC Bill of Sale Draft.

(2) The borrower is expected to tend, feed, house and manage the feeders on his property to the satisfaction of the Agency Manager. The animals must be in an acceptable condition for slaughter in accordance with the agreed arrangements.

(3) When the feeders are delivered, the Branch or Agency Office will receive payment for the value of each animal that was fit for slaughter based on the cold dressed weight and the grade. Within fifteen days of receipt of such monies, the MRFC Branch will make a full cash payment to the Borrower for all cattle

delivered on his account less the total outstanding loan balance recorded on the Loan Ledger. The slaughter grades as notified by the Government Grader are binding on all parties.

(4) If, for whatever reason, in the opinion of the Loan Officer or Agency Manager the animals are subjected to any form of mismanagement, they will be repossessed by the Agency Office after a period of seven days notice, without recourse to law. MRFC may then dispose of the animals in the most appropriate way.

(5) When animals are repossessed in terms of clause (4) above, the borrower will be paid the full amount received for the animals by the Branch under clause (3) above, less all costs incurred by MRFC due to repossession of the animals.

(6) If the amount recouped because of a forced sale is less than the amount owed, the borrower shall pay the difference in cash to the Agency Office, plus any other amount still outstanding.

(7) Animals delivered to the borrower are not the responsibility of MRFC.

The borrower also has the responsibility to keep the animals free from ticks and other parasites at all times, and to notify the Loan Officer or Agency Manager immediately in the event of any of the animals being sick, injured or dead.

All animals remain the property of the MRFC until paid for in full, and the borrower shall not, except with the written consent of the Agency Manager, dispose, remove, slaughter or sell any of the animals. Agency Managers or their representatives must have access to the animals for the purpose of examining them, their management, or any other aspect which affects them.

#### **5.4.3 Dairy Loans**

Like other livestock production, dairying is a specialized and sophisticated enterprise that requires a high degree of managerial ability. To be eligible and to be approved for a medium term dairy loan from MRFC, a farmer must:

- a. Be a responsible person of mature age who has a proven interest in dairy farming;

- b. Farm within a designated "Milk Shed Area" where there are established bulking groups and have a reliable source of clean water and adequate feed for the animals;
- c. Establish at least 0.8 hectares of pasture; Construct a kholo and milk parlor of required standard;
- d. Apply and be approved for insurance coverage with the National Insurance Company (Loan Officer can provide form);
- e. Undergo a short course on dairy management and insure that all dairy cows will be certified by the Department of Veterinary Services as being healthy and as having the potential to produce milk. The Loan Officer must include this as a requirement for payment to the supplier.

The processing of dairy loans is the same as that for work oxen and other medium term loans. Dairy loans are issued as a package that consists of:

- 2 or more half-bred Friesian cows,
- 1 x sprayer,
- 1 x tin (5 liters) of an acaricide,
- 1 x milk churn,
- Fencing wire if necessary.

If supplies of sprayers, acaricide, milk churns and wire are not readily available, the Branch or Agency should purchase these items from other suppliers and included them as a package.

The repayment period for a dairy loan is three to five years. However the insurance and registration fee components of the loan are treated as a seasonal loan and must be paid within one year. The Branch Office will pay the insurance premium and stamp duty to the Insurance Company, as well as the registration fee to the Registrar General. Repayments will be scheduled monthly to match the cash receipts of the applicant. The repayment amount will be calculated by the Agency or Branch Office Accounts Assistants. A sample annuity method for annual payments is shown in the appendix.

Dairy Loans will be recovered direct through the Malawi Dairy Industry (MDI), if possible. However, if the MDI pays the bulking groups for their deliveries, repayment must be from the bulking group. Payments to MRFC will be at the Agency Office nearest the Bulking Group. For MDI payments, the Assistant Accountant will deduct 50 percent from the gross milk sales of each farmer as a loan repayment. The balance should be paid to the farmer. The following are repayment procedures:

(1) MDI will issue a cheque for the value of milk received to MRFC or to the Bulking Group. The cheque should be attached to the supplier's accounts sheets. It will show the amounts supplied by the bulking group. The supplier's accounts sheets should be reconciled to the records of the bulking group to determine each farmer's delivery. Convert kilograms to liters by multiplying the weight by 0.969 and value the deliveries in kwacha.

(2) The Agency should then deposit the cheque. A receipt will be completed for each borrower in the Bulking Group. The necessary accounting forms should be completed to record the 50 percent deduction as loan repayments and the amount payable to each farmer. Loan repayments should also be recorded in the individual borrower's Loan Ledger.

(3) The Branch will issue a cheque to the bulking group for the amounts due to the group. A copy of each borrower's receipt must be attached to the cheque.

(4) The Chairman and Treasurer of the bulking group will report at the Branch or nearest agreed place to collect the cheque. They will both sign all copies of the receipts issued for borrowers to acknowledge receipt of the cheque. The receipts will have the normal distribution.

(5) The Government Loans Board may request MRFC assistance in the collection of their loans. Branch Offices will coordinate MRFC assistance when possible.

The MRFC Bill of Sale Draft must also list a claim on calves in addition to the value of the purchased items. An additional agreement should be entered into with the farmer so any calves born to dairy cows will be added to the collateral list. Farmers should be advised that these calves remain the property of MRFC until the loan is repaid in full. No calves, including bull calves, should be disposed of without the written permission of the Agency Manager or his authorized representative.

Upon the death of a dairy cow and immediately upon receipt of the report, the Agency Manager should:

(1) Arrange for a veterinarian to take specimens and organize for the disposal of the animal.

(2) Advise the Insurance Company of the death of the animal and assist the borrower in processing the Insurance Company's Livestock Claim Form.

(3) Request the farmer to pay any recorded default installments up to the date of the cow's death if the cow has to be destroyed and the meat cannot be sold for consumption.

(4) Replace the dead animal when the insurance claim refunds have been received from the Insurance Company.

(5) If disposal of the cow is through sales of meat, replace the dead cow if the money realized from sales of meat is sufficient to buy another animal, and show the value of the meat sold on the Insurance Company's Livestock Claim form. If sales of meat do not cover the insured value of the dead cow, the Insurance Company will make up the difference and the money realized through sales of meat with the insurance claim refund should be used to replace the dead cow.

#### **5.4.4 Other livestock loans**

It is possible to provide creditworthy borrowers with loans to purchase other types of livestock such as breeding bulls, breeding cows, sheep, goats, and pigs. Applications for these types of loans will have to be considered on their own merits together with the five credit factors. As with other livestock loans the applicant must be a responsible and capable person with some knowledge of the

activity in which he intends to invest and must have the managerial ability to carry out the activity successfully.

It will also be necessary for the Loan Officer to provide the SLO at the Agency adequate information to properly complete the analysis and other necessary appraisal information. The analysis and other information of the proposal must establish that the investment is a viable one that will increase the applicant's income and permit him to repay his loan.

#### **5.4.5 Poultry loans**

Poultry farming is another of the more specialized enterprises requiring a high degree of managerial ability. To be eligible for a poultry loan the farmer must:

- a. Be a mature and capable person who has an interest in poultry keeping;
- b. Farm within a designated Poultry Project Area where there are established poultry farming clubs;
- c. Have a reliable source of clean water for the birds;
- d. Take a course on poultry management before the pullets are supplied.

The Department of Veterinary Services (Poultry Center and Egg Marketing Unit) will jointly issue the package to the farmer as and when required. The Loan Officer or Agency Manager will pay both units for the items issued. Poultry loans are issued as packages consisting of:

- 6 to 8 week old pullets (250 per flock),
- feeders and waterers,
- growers mash, up to the point-of-lay,
- layers mash for 1 month after laying has started,
- 4 cage units per 250 birds,
- fencing wire.

The repayment period for the initial loan package is up to five years. Payment should be scheduled monthly after the start of laying. The replacement of chickens and feed after the first month of laying are treated as seasonal credit and also could be scheduled monthly but no later than one year from disbursement. The repayment amount will be calculated by the Agency Accounts Assistant. Poultry loans are recovered by repayment from the borrower. The Agency Office should enter the loan repayments on the Loan ledger and complete a receipt for the repayment. Non-productive layers should be culled when egg production has dropped to a level where feed and other incidental operating expenses are not being covered.

Approved by the General Manager on \_\_\_\_\_.

Approved by the Board of Directors on \_\_\_\_\_.

## ANNEX

## MEDIUM TERM LOANS - ANNUITY FACTOR TABLE

(to be used when calculating annual repayment schedules)

Equal Installments of Principal and Interest per MK 1.00 borrowed

YEAR	INTEREST RATE							
	9%	10%	11%	12%	13%	14%	15%	16%
1	1.090	1.10	1.11	1.120	1.13	1.140	1.150	1.160
2	.568469	.57619	.583934	.591698	.599484	.607290	.615116	.622963
3	.395055	.402115	.409213	.416349	.423522	.430731	.437977	.445258
4	.308669	.315471	.322326	.329234	.336194	.343205	.350265	.357375
5	.257092	.263797	.270570	.27741	.284315	.291284	.298316	.305409
6	.222920	.229607	.236377	.243226	.250153	.257157	.264237	.271390

## 1. Example of a calculation annual payments using the annuity table:

Assuming that a loan of MK 1,158.13 has been approved to purchase a farm cart, a ridger and a plough, and that repayment is scheduled over five years. This calculation has to be done in two stages. The first step is the annual instalment is calculated and second, the schedule of repayment is deduced:

**Step 1 - Annual Instalment calculation**

Select the annuity factor for a 15% interest rate over a five year period from Table I, i.e. 0.298316.

Use this factor to calculate the annual instalment as follows:

$$\begin{aligned}\text{annual instalment} &= \text{total loan} \times \text{annuity factor} \\ &= \text{MK } 1,158.13 \times 0.298316 \\ &= \text{MK } 345.49\end{aligned}$$

**Step 2 - Schedule of repayment calculation**

Once the annual instalment has been established the repayment schedule is calculated as shown below. In this example it is assumed that the Year 1 outstanding balance = MK 1,158.13 (loan amount)

The annual instalment is = MK 345.49, as calculated in Step 1.

**Year 1:**

(i) Calculate the interest due as follows:

$$\begin{aligned}\text{interest due} &= \text{outstanding balance} \times 15\% \\ &= \text{MK } 1,158.13 \times 15\% \\ &= \text{MK } 173.72\end{aligned}$$

(ii) Calculate the principal due as follows:

$$\begin{aligned}\text{principal due} &= \text{annual instalment} - \text{interest due} \\ &= \text{MK } 345.49 - 173.72 \\ &= \text{MK } 171.77\end{aligned}$$

**Year 2:**

(i) Calculate the outstanding balance due as follows:

$$\begin{aligned}\text{principal due} &= \text{outstanding balance from Year 1} - \text{principal paid} \\ &= \text{MK } 1,158.13 - 171.77 \\ &= \text{MK } 986.36\end{aligned}$$

(ii) Calculate the interest due in Year 2 as follows:

$$\begin{aligned}\text{interest due} &= \text{outstanding balance for Year 2} \times 15\% \\ &= \text{MK } 986.36 \times 15\% \\ &= \text{MK } 147.95\end{aligned}$$

(iii) Calculate the principal due in Year 2 as follows:

$$\begin{aligned}\text{principal due} &= \text{annual instalment} - \text{Year 2 interest} \\ &= \text{MK } 345.49 - 147.95 \\ &= \text{MK } 197.54\end{aligned}$$

**Year 3:**

(i) Calculate the outstanding balance due as follows:

$$\begin{aligned}\text{principal due} &= \text{outstanding balance from Year 2} - \text{principal paid} \\ &= \text{MK } 986.36 - 197.54 \\ &= \text{MK } 788.82\end{aligned}$$

(ii) Calculate the interest due in Year 3 as follows:

$$\begin{aligned}\text{interest due} &= \text{outstanding balance for Year 3} \times 15\% \\ &= \text{MK } 788.82 \times 15\% \\ &= \text{MK } 118.32\end{aligned}$$

(iii) Calculate the principal due in Year 3 as follows:

$$\begin{aligned}\text{principal due} &= \text{annual instalment} - \text{Year 3 interest} \\ &= \text{MK } 345.49 - 118.32 \\ &= \text{MK } 227.17\end{aligned}$$

**Year 4:**

(i) Calculate the outstanding balance due as follows:

$$\begin{aligned}\text{Principal due} &= \text{outstanding balance from Year 3} - \text{principal paid} \\ &= \text{MK } 788.82 - 227.17 \\ &= \text{MK } 561.65\end{aligned}$$

(ii) Calculate the interest due in Year 4 as follows:

$$\begin{aligned}\text{interest due} &= \text{outstanding balance for Year 4} \times 15\% \\ &= \text{MK } 561.65 \times 15\% \\ &= \text{MK } 84.25\end{aligned}$$

(iii) Calculate the principal due in Year 4 as follows:

$$\begin{aligned} \text{principal due} &= \text{annual instalment} - \text{Year 4 interest} \\ &= \text{MK } 345.49 - 84.25 \\ &= \text{MK } 261.24 \end{aligned}$$

#### Year 5:

(i) Calculate the outstanding balance due as follows:

$$\begin{aligned} \text{principal due} &= \text{outstanding balance from Year 4} - \text{principal paid} \\ &= \text{MK } 561.65 - 261.24 \\ &= \text{MK } 300.41 \end{aligned}$$

(ii) Calculate the interest due in Year 5 as follows:

$$\begin{aligned} \text{interest due} &= \text{outstanding balance for Year 5} \times 15\% \\ &= \text{MK } 300.41 \times 15\% \\ &= \text{MK } 45.06 \end{aligned}$$

(iii) Calculate the principal due in Year 4 as follows:

$$\begin{aligned} \text{principal due} &= \text{annual instalment} - \text{Year 5 interest} \\ &= \text{MK } 345.49 - 45.06 \\ &= \text{MK } 300.43 \end{aligned}$$

The repayment schedule for the five year period is summarized in Table II below:

**TABLE II**  
**Annual Repayment Summary**

Year Due	Principal	Interest Paid	Principal Paid	Total Payment
i	1,158.13	173.72	171.77	348.49*
2	986.36	147.95	197.54	345.49
3	788.82	118.32	227.17	345.49
4	561.65	84.25	261.24	345.49
5	300.41	45.06	300.41	345.47
Totals		569.30	1,158.13	1,727.43

\*Note: The annual repayment for year I includes the K3.00 registration fee for the Bill of Sale. This fee can be paid in cash.

It is extremely easy to calculate the annual instalment payable and the total amount of interest that will be paid on a capital loan for any repayment period. All that is needed is the annuity table and a pocket calculator. This information is useful when a loan appraisal is being undertaken and when a applicant is being advised as to what repayment periods best suit his financial position.

The calculations are performed as follows:

- (i) Annual instalment = original cost of the item x the relevant annuity factor  
 (ii) Total amount payable = annual instalment x repayment period  
 (iii) Total interest payable = total amount payable - original cost of the item

Examples for a number of repayment periods are given in Table III below.

**TABLE III**

**Annual installments for different repayment periods**

Cost of item (MK) (a)	Repayment period (b)	Factor @ 15% (c)	Annual payments (d)	Total Paid (b X d)	Total Interest (e - a)
1,158.13	2 years	0.615116	712.38	1,424.76	266.63
1,158.13	4 years	0.350265	405.65	1,622.60	464.47
1,158.13	6 years	0.264237	306.62	1,836.12	677.99

**Notes:**

- annual instalment = principal plus interest
- the longer the repayment period the smaller the annual installment
- the longer the repayment period the greater the total interest paid.

**2. EFFECTS OF UNDER AND OVER PAYMENTS**

Farmers should be encouraged to pay their installments in full when due because. Under payment increases their commitments in the following year(s) whilst over payments place them in an improved situation by reducing the installments due in following year(s). The example in Table III shows both situations.

Year 1: In the first year it is assumed that the borrower only repaid MK 149.67 out of a total instalment due of MK 345.49. This left him with an additional principal amount of MK 195.82 to pay off in the next year.

Year 2: In the second year the additional principal amount of MK 195.82 and interest thereon of MK 27.37 (195.81 x 15%), i.e. MK 225.19 is added to the instalment due in that year, giving a total balance due of MK 570.68 (345.49 + 225.19). It is assumed that the farmer paid off MK 649.76 on 19/5/87, thus exceeding the total amount due in that year by K 79.08.

Year 3: The overpayment is carried forward into the third year, thereby reducing the principal due by MK 79.08 and interest thereon of MK 11.86 (79.08 x 15%) respectively. Thus the instalment due in 1988 comes down to MK 254.55.

It is then assumed that the farmer was able to repay MK 816.20 on 27/7/88, which meant he overpaid the total instalment due by MK 561.65, thereby enabling him to repay the fourth year's instalment in full. Because the loan was repaid in full in advance, interest charges for the fourth and fifth year are waived.

TABLE IV

	<u>Amount Due</u>			<u>Amount Paid</u>			
	Total	Prin.	Inter.	Payment		over/(under)	
	Principal	Due	Due	Due Date		Amount	Amount
Year 1	1158.13	171.77	173.72	345.49	2/5/86	149.67	(195.82)
Year 2	986.36	197.54	147.95	345.49			
Add:							
underpay.	196.82	195.82	29.37	225.19			
	-----	-----	-----				
	1182.18	393.36	177.32	570.68	9/5/87	649.76	79.08
							Overpaid
Year 3	788.82	227.17	118.32	345.49			
LESS:							
overpay.	(79.08)	(79.08)	(11.86)	(90.94)			
	-----	-----	-----				
	709.76	148.09	106.46	254.55	22/7/88	816.20	561.65
							overpaid

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Year 4	561.65	261.24	84.25	345.49
LESS:				
overpay.	(561.65)	(561.65)	(84.25)	(645.90)
	-----	-----	-----	-----
	-	300.41	-	300.41
		(overpaid)		(overpaid)

Year 5	300.41	300.41	-	300.41
LESS:				
overpay.	(300.41)	(300.41)	-	(300.41)
	-----	-----	-----	-----
	0	0	0	0

As a result of accelerated repayments the total amount paid by the farmer is MK1,615.63 instead of MK1,727.43. The details are as follows:

	Estimated Payment	Actual Payment	Savings
Capital	1,158.13	1,158.13	0
Interest*	569.30	428.13	141.17
Surcharge	-	29.37	(29.37)
	-----	-----	-----
	MK 1,727.43	MK 1,615.63	MK 111.80

\*see Tables II and III

The borrower would have saved MK 141.17 on interest had he not underpaid MK 195.82 in the first year. The MK 29.37 surcharge on the defaulted amount has reduced his savings to MK 111.80. The actual process of reducing the amount payable to the borrower is called "REBATE." However, if at the end of repayments the farmer is still found to have overpaid, the remaining overpayment should be refunded.

**3. SAMPLE DAIRY LOAN REPAYMENT SCHEDULE**

Assuming that the capital loan approved amounted to MK 572.00 and it was scheduled to be repaid over three years, the schedule of repayment would be as follows:

Year	Capital Sum	Interest	Principal	Instalment due
1	572.00	85.80	164.72	250.52
2	407.28	61.09	189.43	250.52
3	217.85	32.67	217.85	250.52
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		182.56	572.00	754.56

**Malawi Rural Finance Company (MRFC)**

**Policy and Procedures Manual**

**VOLUME II: Finance and Accounting**

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**ANNEXES**

- Balance Sheet
- Income Statement
- Source and Use of Funds
- Trial Balance

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## **ABBREVIATIONS**

<b>ADMARC</b>	- Agricultural Development and Marketing Corporation
<b>BA</b>	- Branch Accountant
<b>BCS</b>	- Batch Control Sheet
<b>BM</b>	- Branch Manager
<b>CDR</b>	- Court Deposit Receipt
<b>CFC</b>	- Chief Financial Controller
<b>DCR</b>	- Daily Cash Reconciliation
<b>LO</b>	- Loan Officer
<b>PCS</b>	- Petty Cash Summary
<b>PDO</b>	- Purchase/Delivery Order
<b>POSB</b>	- Post Office Savings Bank
<b>PSO</b>	- Purchase/Sale Order
<b>SLO</b>	- Senior Loan Officer

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## FINANCE AND ACCOUNTING POLICIES AND PROCEDURES

### 1.0 PURPOSE AND STRUCTURE OF THE MANUAL

This Manual is the official document of the Malawi Rural Finance Company (MRFC) which sets forth the basic policies and guidelines for the conduct of business and the accounting for its activities. The purpose of this Manual is to provide detailed information on MRFC finance and accounting policy and should guide employees of MRFC in the application of various regulations. This Manual constitutes current fiscal policies and standards that have been developed by MRFC as currently practiced.

These policies are designed to provide: accurate, current and complete disclosure of the financial result of all MRFC activities; records that adequately identify the source and application of funds for each activity; effective control over and accountability for all funds, property and other assets; comparison of actual outlays with budgeted amounts for each function; and procedures for determining the reasonableness, allowability of costs in accordance with the provisions of the policies and budgets.

The accounting procedures manual is divided into chapters, each dealing with a particular accounting area. Although each chapter is complete in itself, reference may be required to other volumes to give an overall picture of related systems.

## **1.1 Scope and Objectives**

The overall objectives of the accounting system are to ensure that: the assets and liabilities of MRFC are properly safeguarded, correctly valued and fully recorded in the books of account; all transactions entered into by MRFC are recorded in the books of account; and that management is provided with comprehensive, timely and reliable information on the financial performance of the Organization.

## **1.2 Accounting Principles and Policies**

The accounting principles and policies applicable to the MRFC are set out below:

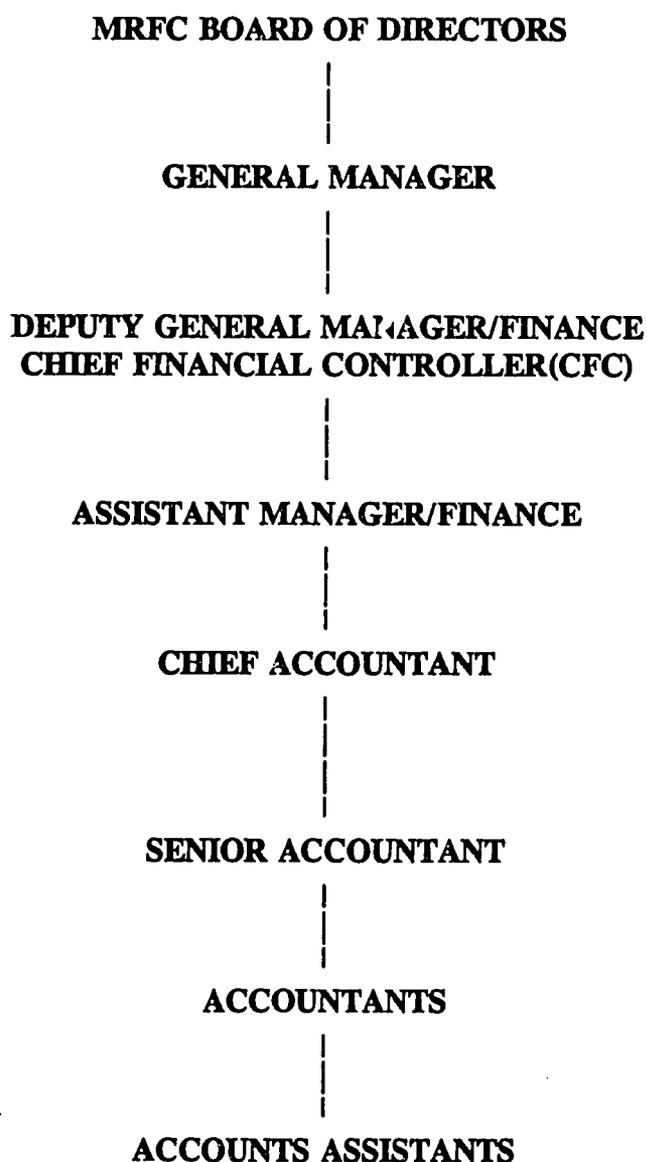
**Income - Subsidies received from donors for budget support are treated as income.**

**Fixed Assets and Depreciation - depreciation is provided on all fixed assets in equal annual installments at rates sufficient to reduce them to residual values over their expected useful lives. The rates of depreciation used are: Buildings at 2 percent; Furniture and Equipment at 20 percent; and Motor Vehicles at 25 percent.**

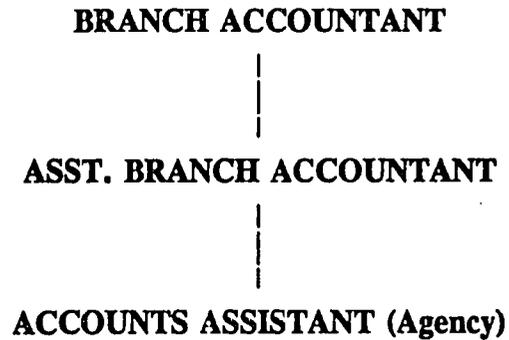
Stocks - stated at the lower of cost or net realizable value. Cost is arrived at on a first-in-first-out basis.

### 1.3 Organizational Structure (Finance\Accounting)

#### 1.3.1 Finance/MRFC - Home Office



**1.3.2 Finance/MRFC - Branch and Agency Office**



**1.4 Maintenance of this manual**

The Deputy General Manager - Finance has the primary responsibility for maintaining these policies. He shall report proposed changes to and obtain the concurrence of the Audit Committee of the MRFC Board of Directors for all such changes. He or his designate shall review the Manual at least annually to decide what changes or revisions, if any, should be made to the Manual.

Any duplication in this manual from the other manuals is for convenience and clarity. Each employee is encouraged to provide their suggestions relating to this Manual to the Deputy General Manager - Finance.

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## **2.0 PRESENTATION OF MANAGEMENT AND ANNUAL FINANCIAL STATEMENTS**

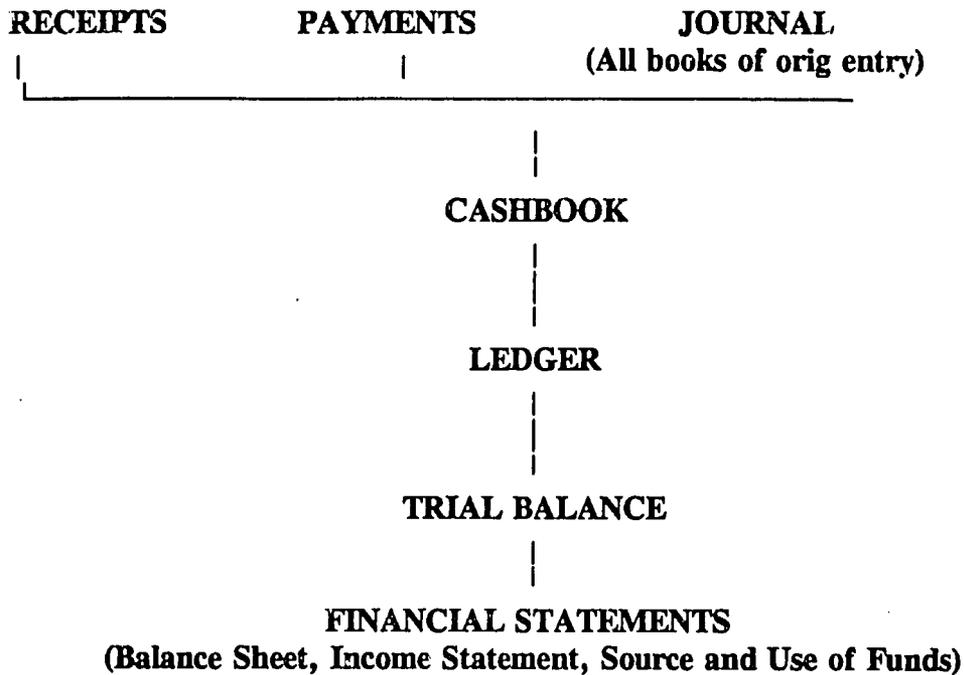
### **2.1 Objectives of the System**

The main objectives of preparing monthly management accounts is to enable senior management to appraise the financial performance and status of the MRFC and to take corrective action where necessary.

Annual financial statements shall be prepared and audited in accordance with the requirements of the directives of the MRFC Board of Directors.

### **2.2 Overview and Basic Features of the System**

An overview of the flow of transactions through the system to the production of the financial statements is as follows:



The basic features of the system are that it is controlled by the accounting department, management accounts and reports are prepared monthly, and audited financial statements are prepared annually.

## 2.3 Accounting Procedures

### 2.3.1 Monthly Management Accounts

Management accounts are prepared monthly and presented to the management and MRFC Board members. The purpose of the preparation of this financial information is to: inform management of the financial performance and status of the company; compare this performance with predetermined targets (i.e. budgets);

enable management to appraise overall and department performance; take corrective action where necessary; and to assist in the determination of MRFC's funding requirements.

The items provided in the package of financial information presented to the management are: the Income Statement, Explanations of variances against budget, Balance Sheet, and the Source and Use of Funds.

### **2.3.2 Accounting Principles**

Management accounts, although for internal use and not subject to external audit, must be prepared with adequate regard being given to the Generally Accepted Accounting Practices (GAAP). This should ensure that the concepts of accrual accounting and prudence are applied in the preparation of management accounts.

If the management accounts are properly prepared, there should be no material differences between the results shown in such accounts for a financial year and those reflected in the annual financial statements.

### **2.3.3 Timing of presentation**

In order for management to obtain maximum benefit from the monthly financial information, the management accounts must be made available at the earliest possible date.

The accounting department should therefore ensure that the management accounts are presented to management within 15 days of the end of the period to which the accounts relate.

### **2.3.4 Income Statement**

The format of the Income Statement is shown in the Annex. A full explanation of all variances appearing on the Income Statement (for both the current year and the year to date amounts) must be included with the monthly management accounts. This will enable management to evaluate the situation and take the appropriate corrective action.

### **2.3.5 Balance Sheet**

The format of the balance sheet is shown in the Annex. Where it is considered that any items require breakdown, explanatory notes must be attached to the Balance Sheet.

### **2.3.6 Source and Use of Funds Statement**

The format of the source and use of funds statement is shown in the Annex. The schedule shows details of actual cash movements for the current month and the forecast movements for the following six months.

## **2.4 Annual Financial Statements**

MRFC is required to prepare annual financial statements which are also required to be audited. The financial statements are prepared in accordance with the requirements of Generally Accepted Accounting Principles (GAAP) and the relevant International Accounting Standards and comprise the following: Balance Sheet, Income Statement, Statement of Source and Application of Funds, and Notes to the Financial Statements. These forms are further described below:

### **2.4.1 Balance Sheet**

The balance sheet sets out the state of affairs of the company at the Balance Sheet date. The format of the Balance Sheet is shown in the Annex.

### **2.4.2 Income statement**

The Income Statement is a financial summary of the results of the company for the year or period ended on the Balance Sheet Date. The format of the Income Statement is shown in the Annex.

### **2.4.3 Statement of Source and Use of Funds**

The statement of Source and Use of Funds is a summary of the means by which the transactions of the company were funded during the year (period), how the funds were applied and the change in liquid funds resulting from the transactions. An example of the statement is shown in the Annex.

#### 2.4.4 Notes to the Accounts

The following items must be the subject of notes to the accounts and where relevant, must be referred to on the Balance Sheet and the Income Statement.

Accounting Policies - The note must set out the principal accounting policies adopted by MRFC.

Bank and Cash Balances - A summary of bank and cash balances is shown in this note. The note must differentiate between savings, current and cash on hand balances.

Trust Funds - This note should set out the movements in Trust monies held during the year.

Debtors - The amount of debtors, differentiating between the types of debtors, is shown in this note. The balance shown should be net of any provision which may exist for bad or doubtful accounts.

Contributions/Subsidies Receivable - This note shows the amount of contributions/subsidies still to be received from outside sources at the end of the year.

Accrued Income - The amount and type of income still to be received is shown in this note.

Stocks - The breakdown of stocks on hand at the end of the financial year is shown in this note.

Investments - The cost of investments differentiating between the types of investments is shown in this note.

Fixed Assets - Details of the movements (additions, disposals, transfers and depreciation charges) by asset category must be shown in this note.

Creditors - A summary of current liabilities is shown in this note. The note should differentiate between the types of credit balances.

Capital Stock - All movements in capital stock during the year must be stated in the note. Details of capitalization issues should be included.

Capital Contributions - Contributions made by donor agencies during the year should be stated in this note.

Accumulated Surplus - All movements in accumulated reserves must be detailed in this note. Adjustments relating to prior years should be explained in detail.

### **3.0 GENERAL LEDGER**

#### **3.1 Objectives of the System**

The primary objectives of the General Ledger system are to ensure the accurate, thorough, and timely recording of all transactions; and to provide the basis for the preparation of annual and monthly financial information.

#### **3.2 Overview and Basic features of the System**

The General Ledger is a summary record of all the assets, liabilities, reserves, income and expenditure of MRFC.

The General Ledger shall be a comprehensive (and eventually computerized) chart of accounts has been established based on the requirements of the various user departments.

The key internal controls of the system are: sufficient control over input of information to ensure that data captured is accurate and complete; controls over the processing of information; and control over computer output to ensure that sensitive information is appropriately controlled.

### 3.3 General Ledger Accounting Procedures

Postings to the General ledger are made from the following sources: Daily Receipts Summary, Payment Vouchers, Petty Cash Summary, Salary Journal, and Journal. A brief description of each of these sources is given below:

Daily Receipts Summary (DRS) - is a summary of the receipts issued during the day. These are manually coded by the Accountant and posted into the General Ledger system.

Payment Vouchers - will be prepared for each cheque payment.

Petty Cash Summary (PCS) - is a summary of daily petty cash expenditure. These are manually coded by the Accountant and posted into the General ledger system.

Salary Journal - is a journal prepared from the monthly salaries spreadsheet.

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Journal - All journal entries are supported by a Journal Voucher. Prior to being recorded in the General Ledger, the following sections of the voucher must be completed by the person initiating the journal must sign and date it (initiator) and approved by either the Chief Accountant or the CFC. The journal is used as a posting source for correction of errors and mis-allocations, noting items which have not been accounted for by other means, and transfers.

### **3.3.1 Posting Procedures**

Documentation is batched into groups between eight and ten. A Batch Control Sheet (BCS) is prepared for each batch. The BCS records batch number and date, the range of vouchers included in the batch, and a manually computed batch total of the values of the vouchers included in the batch.

The details of each batch are recorded in a batch control book and should include the following: date and number of batch, description of documents in the batch, manually computed batch total, computer generated batch total, and differences between the above two figures with an explanation for this difference.

Data input is taken from the individual vouchers in each batch. Each voucher is stamped "posted" after it has been input. The initials of the operator and the date of posting are also noted.

### **3.3.2 Processing Procedures**

Transaction listings are printed for each session of data input. The transaction listing totals are recorded in the Batch Control Book and compared to the manually computed totals. Differences arising are explained and followed up.

### **3.3.3 Month End Procedures**

After all entries for the month have been recorded in the General Ledger, a Trial Balance is extracted and the balances of all control accounts are reconciled to subsidiary books and records. The Trial Balance is presented in the format shown in the Annex.

The following control accounts are maintained and reconciled to the record noted below:

---

<u>Control Account</u>	<u>Reconciled To</u>
Debtors	Subsidiary debtors ledger
Creditors	Subsidiary creditors ledger
Cash imprest account	Listing balances of all petty cash balances

### **3.3.4 Output Procedures**

The General Ledger system presently produces the following output: Trial Balance, General Ledger Account Activity Reports, Account Enquiry, Income Statement, and a Balance Sheet.

These are distributed to the appropriate personnel. A standard distribution checklist is used to ensure reports are given to the correct staff.

## **4.0 CASH RECEIPTS, DISBURSEMENTS AND PETTY CASH**

### **4.1 Objectives of the System**

The objectives of this system are to ensure that all monies received and paid are accurately accounted for and controlled, and that the proper recording and smooth processing of all monetary transactions takes place.

In addition, the system should ensure that all cash is correctly receipted and procedures are adhered to; all receipts are issued only for monies received and are correctly recorded in the books of account; the cash position is not materially misstated at any particular accounting date; only authorized payments are made for valid MRFC business; and that expenditures are accurately recorded and reported to MRFC management.

#### **4.2 Overview and Basic Features of the System**

The basic features of the system are that all significant accounting documentation is pre-numbered for control purposes; reconciliations of cash balances are conducted daily and bank Reconciliations are performed monthly; all payments are fully authorized; and that financial reporting takes place on a monthly basis.

The key internal controls relevant to this system include a separation of duties between handling cash and recordkeeping; preparation of regular independent bank statement reconciliations reviewed by the Senior Accountant; establishment of a formal policy for the authorization of expenditures; use of proper approved documentation to control purchases; and use of a formal budgeting and review system whereby management is made accountable for results and would be required to explain material variances between budget and actual.

### **4.3 Cash Accounting Procedures**

#### **4.3.1 Cash Receipts**

Cash is not received directly at MRFC Headquarters in Lilongwe. However, the Agency and Branch offices receive cash which is either deposited with MRFC Headquarters directly or through mail transfer.

All monies received by MRFC must be receipted. This ensures that all monies are recorded in the books of account. Monies may be received in any of the following forms - cash, cheques, postal orders, and mail transfers or bank deposit slips.

#### **4.3.2 Control of Receipt Books**

Receipt books shall be ordered by the Administrative Officer through the administrative support staff. When delivered from the printers, receipt books will be recorded in a stationary register, and kept in the MRFC storeroom until required for use.

Receipt books are only issued to the Accounts Assistants or Branch Offices on surrender of the completed receipt books. When a new book is issued, the details of the recipient and their signature are recorded in the stationary register.

#### **4.3.3 Mail Receipts**

All in-coming mail is opened and recorded in a mail register by the Accounts Assistants in the presence of at least one other MRFC official. All receipts (including mail transfers) are recorded in the register noting the following details: payer, amount, reasons for payment, and bank details.

#### **4.3.4 Daily Cash Reconciliations**

In conjunction with the preparation of the DRS the Agency Accounts Assistant prepares a Daily Cash Reconciliation (DCR). The DCR is a reconciliation of the receipts issued to the cash on hand. This is checked by the Agency Manager and evidenced as such.

The DRS, DCR, and second copies of the receipts are passed on to the Branch Accounts Department for final checking and posting to the cashbook and ledger and subsequent filing.

### **4.3.5 Banking**

All receipts are banked intact the following day. The Agency Accounts Department is responsible for this.

A bank deposit slip is prepared and notes the total cash to be deposited and details individual cheques to be deposited. The deposit slip is prepared in triplicate and all three copies are taken to the Bank for verification. After bank verification the copies are distributed as follows:

- Copy 1 - Bank**
- Copy 2 - Attached to the DRS, DCR and receipts and used by the Branch Accounts Department for posting.**
- Copy 3 - Remains in book**

The Branch Accountant reconciles the receipts per the mail register to the DRS at the end of the week. This check is evidenced in writing on the DRS and the mail register.

#### **4.3.6 Receipting Procedures**

The Accounts Assistant at MRFC headquarters completes a receipt for monies received from collections through the mail, Branch Offices, and direct cash payments.

All receipts are prenumbered, prepared in triplicate, and distributed as follows:

Copy 1 - Payer

Copy 2 - Retained by MRFC Headquarters

Copy 3 - Retained in receipt book

Daily Receipts Summary - At the end of the day a Daily Receipts Summary (DRS) is prepared. The Agency Manager initials the DRS.

The DRS also shows the breakdown of the receipts between cash, cheques, and mail transfers. Copies of the DRS are passed to MRFC Headquarters Senior Accountant and Assistant Manager - Planning and Budgeting, to enable them to update their records.

The DRS is manually coded by the Branch Accounts Assistant and used to update the manual revenue cashbook and the computerized general ledger. This is performed daily or when necessary.

#### **4.3.7 Revenue Cash Book**

To avoid mis-allocations, all receipts are deposited into the Operations current account and transferred at the end of each week. The revenue cashbook is written up daily from the DRS's.

#### **4.3.8 Mail Transfers**

Mail transfers occur when deposits are made directly into MRFC's bank accounts. MRFC should be notified of these upon receipt of the mail transfer from the Branch. Mail transfers are receipted as part of cash. All direct deposits are posted into the Operational Current Account.

### **4.3.9 Bank Reconciliations**

Bank statement reconciliations are performed monthly and checked by the Senior Accountant. Reconciliations are then prepared between the cashbook and bank statement and the cashbook and nominal ledger.

### **4.3.10 Cash Payments**

The majority of cash payments are made through the Operations current account and may include items such as salaries, vehicle operations, subsistence allowances, stationery, and creditors.

These payments can also consist of deposit withdrawals and short term investments of excess cash. Cheque signatories will be the same for each account.

### **4.3.11 Petty Cash**

Petty cash is maintained on an imprest basis of an amount to be determined by the General Manager. A petty cash book is maintained which is used to analyze expenditures.

Petty cash payments are supported by petty cash vouchers. All petty cash expenditure is authorized by the Chief Accountant. The following limits have been established:

- Amounts up to MK100 can be paid in cash
- Amounts between MK101 and MK200 can only be paid with special authorization
- Amounts above MK200 can only be paid by cheque.

When the petty cash balance is less than MK100 the Senior Accounts Assistant requests reimbursement from the Accountant.

The Accounts Assistant submits all petty cash vouchers to the Accountant for checking and reconciliation to cash on hand. The Accountant passes these on to the Senior Accounts Assistant for preparation of the payment voucher and cheque. The cheque is uncrossed and made payable to the petty cash holder. The petty cash holder then records the reimbursement in the petty cash book after cashing the cheque.

The Accountant will also perform checks of the petty cash balances once every week on a surprise basis.

## **5.0 INVESTMENTS**

### **5.1 Objectives of the System**

The Objectives of the system are to ensure that: excess cash on hand is placed in the highest income investments; investments are regularly reviewed to ensure the best return is being obtained; when investments mature they are reinvested timely; and income from investments is constantly monitored.

### **5.2 Overview and Basic Features of the system**

The basic features of the system shall include: a computerized investment register is regularly maintained and used to generate reports on investment maturity dates and accrued interest; monthly investment reports; and monthly reconciliations between the investment register and the general ledger. As a key internal control of the system, the Assistant Manager - Finance shall review investment reports on a monthly basis.

### **5.3 Investment Accounting Procedures**

#### **5.3.1 Investment**

The Deputy GM - Finance Manager and/or the Chief Financial Controller will invest any excess cash on hand based on MRFC's projected cash flow. The

capital market in Malawi is limited and investment yields are similar. This limits the scope of investments.

The portfolio should be spread between the various institutions to limit risk. The major investment institutions include the following: National Bank of Malawi, Leasing and Finance Corporation, Commercial Bank of Malawi, and the New Building Society. The rates of return will be negotiated where possible.

### 5.3.2 Accounting of Investments

A general ledger control account is maintained for investments. This is broken down into sub-accounts grouped according to period of investment. The period of investment ranges from 30 days to five years.

On a monthly basis the balances between the general ledger and the investment register are reconciled. The reconciliation is performed as follows:

Balance per Investment Register	XXX
Reconciling Items (i.e income)	<u>XXX</u>
Balance per General Ledger	<u>XXX</u>

The reconciliation is performed by the Accountant and reviewed by the Senior Accountant. This reconciliation is initialled as evidence of this check.

The investment register is maintained on a daily basis and an MRFC investment report shall be generated daily for management purposes.

## **6.0 DEBTORS**

### **6.1 Objectives of the System**

The main objectives of the debtors system are to: ensure that all debtors are accounted for; provide management with financial information regarding debtors and to assist in the collection of outstanding amounts; and provide procedures whereby amounts can be written off, when all other collection procedures have failed.

### **6.2 Overview and Basic Features of the System**

The debtors system is a module of the computerised accounting system. It can be fully integrated with the general ledger system.

The debtors system will be used to record reserves and fees from Farmers Clubs and Individual Borrowers. These are calculated as a percentage of Loans (Club/Individual) and are payable annually by each borrower. The debtors system can also record Audit fees from Clubs.

The key internal controls of the debtors system include: all credit sales and bad-debt write-offs authorised by management; monthly reconciliations between the general ledger control account and the debtors listing; regular management reviews and monitoring of debtors balances; establishment of set policies for credit sales; timely follow-up of any outstanding amounts.

### **6.3 Debtors Accounting Procedures**

#### **6.3.1 Credit Sales**

Credit sales include any fees and reserves from Farmers Clubs and Individual Borrowers. Credit invoices are prepared by the department responsible for providing any MRFC fee-based services. Credit sale invoice/fee request is prepared in triplicate and is distributed as follows:

- Copy 1**            - Club/Client.
- Copy 2**            - the Accounts department.

Copy 3 - remain in the book.

### **6.3.2 Accounts Processing**

The accounts department receives the second copy of the credit sales invoice.

These are batched (see Section 3.3.1 of this manual) and posted as follows:

- a. Debtors system - The credit sale invoices are posted individually to the relevant debtors accounts.
- b. General Ledger - The batch total is posted to the control account in the general ledger. The income is recorded as a credit against the respective income accounts.
- c. Invoices which have entered into the systems are stamped "posted" and initialled by the operator. This is to prevent entry duplication.
- d. On a monthly basis the total of the general ledger control account is reconciled to the debtors listing produced by the debtors system.

### 6.3.3 Reports

The following reports are produced on a monthly basis:

Debtors listing - This lists the balances of all the debtors accounts in the debtors ledger.

Debtors aging analysis - This report details the period of time that the balances have been outstanding.

Debtors statements - These are used to notify the Club/Clients of the amounts outstanding and any payments that have been received. The statements are produced in duplicate to be distributed as follows:

- Copy 1 - club/Client.
- Copy 2 - retained by MRFC to assist in follow-up of queries by Club/Clients.

Exception reports - These detail balances which have been outstanding for an extended period (ie., all balances outstanding for more than 90 days). The debtors listing and the debtors age analysis may be combined into a single report.

Management shall receive copies of the Debtors age analysis, and the Exception reports. These reports are used by management to formulate follow-up, supervision, audit, and collection procedures. The reports generated are also used by the departments responsible for providing the services to ensure that amounts credited been recovered.

Receipts from debtors are treated in the same manner as cash receipts.

#### **6.3.4 Bad Debts**

Balances which are not recoverable should be written off. Prior to the write-off of these, management should use other methods to aid in the collection, including written reminders, verbal reminders by Loan Officers and Agency or Branch Managers, and finally legal action.

Credit should not be extended to Clubs/Clients which have a history of bad debt write-offs. Bad debts should only be written-off with the approval and authority of MRFC Management.

## **7.0 CREDITORS**

### **7.1 Objectives of the System**

The objectives of the creditors system are to ensure that all creditors and liabilities have been taken into account, and to provide management with financial information regarding creditors. This will enable management to utilise creditors as a short term form of financing while maintaining credibility.

### **7.2 Overview and Basic Features of the System**

The creditors system shall be fully integrated with the general ledger and purchasing and inventory modules.

The key internal controls of the creditors system include: all credit accounts and purchases must be approved by management; regular reconciliation of the control account and the subledger; monthly reconciliation of creditors statements to the creditors listing; and regular review by MRFC management.

### **7.3 Creditors Accounting Procedures**

#### **7.3.1 Ordering and Receipt of Goods/Services**

The procedures for ordering and receipt of goods include the following documents: Local Purchase Order (LPO), suppliers invoice, and the Goods Received Note (GRN).

#### **7.3.2 Accounts Processing**

The accounts clerk receives the above documentation. These are then matched to ensure that goods ordered per the LPO agree to those supplied per the suppliers invoice; the prices quoted by the supplier agree to those charged on the invoice; and that the goods supplied as detailed on the GRN agree to those charged for on the suppliers invoice.

The suppliers invoice is grid stamped to provide evidence that the invoice has agreed with the GRN and LPO, the casts and extensions of the invoice are correct, and that the invoice has been authorised for payment and posted to the creditor's system.

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### **7.3.3 Batching and Input**

All invoices are batched into groups and a batch control sheet is prepared for each batch. The details of the batch are recorded in the batch control book. The batch of invoices is passed the computer department for data capture.

Invoice details are entered into the creditors module and after checking by the operator, posted to the relevant vendor accounts. The necessary nominal ledger entries are made. Although the general ledger and the creditors modules should be full integrated it is necessary to reconcile the balances of the two at the end of every month.

### **7.3.4 Creditors Reconciliations**

Creditors statements are received at the end of each month. These are then passed on to the accounts clerk who reconciles the balance of the creditors statement to the creditors balance in the creditors ledger. A standard reconciliation form is used. The Accountant then reviews the reconciliations and signs the form as evidence of this check.

### **7.3.5 Payment and Filing**

The creditors reconciliation will indicate the amount outstanding and requiring payment. Based on this a payment voucher is prepared by the accounts clerk. The procedures for authorising and preparing the payment voucher are detailed in Section 4.3 of the this manual.

Suppliers invoices, GRNs and LPOs are filed by supplier name. Creditors statements and reconciliations are filed separately. Three reports will be generated by the system - Creditors Account, Creditors Listing, and a Transaction listings.

## **8.0 PAYROLL**

### **8.1 Objectives of the System**

The objectives of the payroll system are to ensure that employees are paid according to agreed rates and scales, withholdings are paid to creditors in a timely manner, an accurate record is maintained of salaries and wages paid, and salary advances and loans are correctly recorded and deducted according to the relevant agreements.

## **8.2 Overview and Basic Features of the System**

All personnel records will be kept by the Personnel Department. A personnel policies and procedures manual has been established (see Volume 3: Personnel).

The main internal controls of the system include: authorization of all appointments and dismissals by the General Manager and the Director of Personnel/General Administration; personnel records maintained independently of the Accounts Department; pay sheet reviewed by the Chief Accountant and the General Manager - Finance; salary increases require approval from the relevant Head of Department and the General Manager; and staff loans and advances governed by an established policy.

## **8.3 Personnel Accounting Procedures**

### **8.3.1 Recruitment and Dismissal**

Recruitment and dismissals are the responsibility of the Personnel Department. Heads of Department make recommendations or place staffing requirements and the Personnel Department will be responsible for implementing them.

For staff appointments, dismissals, and salary increments the Personnel Department shall prepare a letter in triplicate. The copies of the letter are distributed as follows:

- Copy 1 - To employee.
- Copy 2 - Accounts Department.
- Copy 3 - Personnel records.

### **8.3.2 Deductions**

The monthly deductions are made from salaries and wages for items including taxation, pension, medical aid, and insurance policies.

### **8.3.3 Payroll Preparation**

The Accountant is responsible for preparing the payroll using appointment, dismissal and increment information from the Personnel Department and staff loan deduction details from the Finance Department. The pay sheet and employee pay slips are compiled and prepared from the above information as well.

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The payroll is checked by the Chief Accountant evidenced by his signing the pay sheet. The General Manager then reviews the pay sheet every month.

#### **8.3.4 Employee Payments**

Employees may be paid either by cheque or direct deposit into savings or current account.

The Accountant prepares the cheques and deposit forms. These are then checked by the Chief Accountant and the authorised signatories prior to distribution.

### **9.0 STORES**

#### **9.1 Objectives of the System**

The objectives of the stores system are to ensure that all stock transactions are properly and completely authorised, processed, recorded, and correctly valued. Also, the system shall ensure the most competitive prices are obtained for purchases and safeguard stock against loss, theft and damage.

## 9.2 Overview and Basic Features of the System

A separate store is maintained of all stock. This is physically secure and custodianship of the keys is controlled. The Stores Clerk is responsible for placing orders for stores, issuing stores items, physical control of stock, regular stock counts, and maintaining kardex and bin card records.

Formal ordering, receiving and issuing procedures will be established. The Accounts Department shall perform regular checks of stock balances and the Internal Audit Department will conduct regular checks of the accounts and physical stocks.

The key internal controls of the stock system are: physical control of stock with regular, complete stock counts reconciled timely with amounts recorded in the nominal ledger; established procedures for purchasing stock covering authorization and sourcing; maintenance of complete, up to date stock records; a central point for receiving and issuing stock; establishment of formal written stock count procedures; and adequate follow-up of variances between book balances and physical balances.

### **9.3 Stores Accounting Procedures**

#### **9.3.1 Physical Control**

The Stores Clerk is responsible for the general housekeeping and physical control of the stores. All stores are kept in secure and locked locations. The keys are kept by the Stores Clerk and duplicate keys are stored in the Accounts Department safe. Access to the stores is limited to the Stores Clerk.

#### **9.3.2 Ordering of Stock**

Orders are placed when a stock-out has occurred or special "one-off" purchases are made.

The Stores Clerk is responsible for preparing a Purchase Request Form (PRF) where any of the above occurs. These are submitted to the Administrative Officer for approval in preparation of an LPO (Local Purchase Order). The Stores Clerk is responsible for preparing LPOs which are used to order all stores items. There are no cash purchases. The LPO is a three part document and is distributed as follows:

- Copy 1 - supplier of goods/services.**
- Copy 2 - retained by the Stores Clerk in a holding file entitled 'Goods Ordered Not Received'.**
- Copy 3 - remains in the book.**

LPOs are controlled stationery, with unused books stored in a secure location and recorded in a stationery register. All issues must be signed for.

The following authorization levels are used for LPO's:

- a. The General Manager can authorize expenditure up to MK25,000 (amounts over MK25,000 are referred to the Executive Committee for authorization);**
- b. The Chief Accountant can authorize expenditures up to MK5,000. In the absence of the Chief Accountant the Operations Manager may authorize amounts up to this limit;**
- c. The Accountant may authorize expenditure up to MK1,000.**
- d. The Stores Clerk is required to obtain three quotations from suppliers for all orders. These are recorded on the PRF for future reference.**

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After determining the most competitive price, the first copy of the LPO is dispatched to the supplier.

At the end of each month the Accounts Department performs a sequence check on LPO numbers to ensure that all LPOs have been accounted for, and a review of the "Goods Ordered Not Received" file so that overdue orders can be followed-up.

### **9.3.3 Receipt of Stock/Services**

All goods/services are channelled through the Stores Clerk. The goods received are checked against the LPO by the Stores Clerk. This check is to ensure the goods received are correct in terms of quantity and quality.

For each receipt the goods/services a two part sequentially numbered Goods Received Note (GRN) is prepared. This is distributed as follows:

- Copy 1        - Retained and filed in Stores.
- Copy 2        - Attached to second copy of LPO and sent to the creditors Clerk in the Accounts Department.

The Creditors Clerk files the LPOs and GRNs in a "Goods Received Not Invoiced" (GRNI) holding file for subsequent matching to the suppliers invoice.

The GRNI file is reviewed by the Accountant monthly to ensure that all liabilities have been recognized. This review is evidenced in writing.

All suppliers invoices pass directly from reception where they are recorded in the mail register to the Creditors Clerk. The Creditors then Clerk matches the invoices with the related GRNs and LPOs which have been filed in the GRNI file.

Each invoice is grid stamped. This ensures that certain checking functions are preformed prior to the invoice being passed for payment. Invoices are then input to the computer as described in the Creditors section of this manual.

#### **9.3.4 Issues**

The Stores Clerk is responsible for issuing all stock items. An issue note is prepared for all stock issues. Issue notes are pre-numbered and treated as controlled stationery as for LPO's.

Issue notes are prepared in triplicate and distributed as follows:

- Copy 1 - the recipient of the stock items.
- Copy 2 - the Stores Department and used to update the bin cards and kardex on a daily basis.
- Copy 3 - Accounts Department for input to the inventory module and nominal ledger to ensure that stock is removed from inventory. The Accounts Department subsequently files this copy.

The recipient of the stock is required to sign all copies of the issue Note as evidence of having received the goods.

### **9.3.5 Stores Records**

The Stores Clerk is responsible for maintaining the Bin Cards and Kardex.

Bin Cards are attached to the shelf/bin of each stores item. These are updated daily from the issue notes and goods received notes. Kardex cards are maintained in the stores department for each stores item.

The Accounts Department maintains a record of all stock items in the inventory module of the accounting system. The stock system is updated using the Accounts copies of the issue notes and goods received notes.

### 9.3.6 Stock counts

The Stores Clerk performs stock checks on a weekly basis. This check is evidenced by signing the bin card.

The Accountant performs a monthly review of the bin cards to ensure that differences are being adequately explained. A physical check is also performed of approximately 20 items to ensure quantities agree to bin cards and kardex.

The Stores Clerk reconciles the kardex to the bin cards on a weekly basis and signs the kardex as evidence of having performed this check.

Every six months a full stock count is performed of all stores items. This is performed by the Stores Clerk and two people from the Accounts department.

The results of the stock count are compared to the balances in the nominal ledger and differences are followed-up.

## **10.0 FIXED ASSETS**

### **10.1 Objectives of the System**

The objectives of the Fixed Assets system are to ensure that: all purchases, disposals, transfers and write-offs of fixed assets are properly authorised and recorded; the proper valuation of all fixed assets; and vehicles are properly monitored and usage controlled.

### **10.2 Overview and Basic Features of the System**

The basic features of the system include: control of the system by the Accounts department; maintenance of a fixed asset register with details of additions, disposals, write-offs, and depreciation; annual preparation of capital expenditure budgets; allocation of a fleet number for each motor vehicle and a register number for each allocated fixed asset.

The key internal controls with regard to the fixed assets system are as follows:

- a. Proper authorization procedures for the purchase and disposal of assets.

Authority should be established at levels commensurate with status in the organisation.

- b. Physical control of assets to prevent abuse and theft.
- c. Adequate insurance cover.
- d. Maintenance of an asset register and the physical comparison thereof to the assets from time to time to ensure that all assets are accounted for.
- e. Established depreciation and maintenance policies.
- f. Regular review of vehicle costs.
- g. Authorization and establishment of policies governing vehicle usage.

### **10.3 Fixed Assets Accounting Procedures**

#### **10.3.1 Capital Budgeting**

Prior to the commencement of each financial year, the management of MRFC prepares a capital budget. This details all of the asset requirements of the business for the coming financial year and the estimated costs of acquiring these.

The Department Heads are responsible for the preparation of the departmental requirements. This information is then consolidated into a capital budget for MRFC as a whole.

The funds available for capital expenditure are determined with reference to operating budgets and to projected cash flow forecasts. Capital rationing is necessary where the funds available for capital expenditure are less than the figure required in terms of the capital budget.

The capital budget ensures that capital expenditure is established and controlled. The capital budget is approved by the MRFC Board. Additional authority is obtained where budgeted expenditure is exceeded or where assets are required which are not budgeted for.

### **10.3.2 Fixed Asset Register**

The Accounts Department is responsible for the maintenance of the fixed asset register. This is an historical record of all fixed asset transactions and is important for the physical control of assets.

The fixed asset register details each of the following particulars for each asset:

- Date of purchase.
- Useful life.
- Location.
- Supplier.
- Depreciation method.
- Original cost.
- Net book value.
- Asset control number (see below).

### 10.3.3 Physical Control

All assets are assigned asset numbers. These are physically imprinted on the assets. Every two years a complete physical inventory is performed. This entails agreeing details in the asset register to the asset and noting the condition thereof. Assets not in working order are scrapped, following proper approval.

An insurance register is maintained by the Director of Personnel and General Administration. This record details the assets insured, policy numbers, due dates/renewal dates and insured values.

Assets are kept in a secure location to prevent theft and damage. Vehicle costs are monitored in order to identify abuse and to determine whether it may be more cost effective to dispose of vehicles rather than maintain them.

### 10.3.4 Purchase of Assets

Assets are only purchased if authorised by the Board either through the Capital Budget or where additional authority has been obtained.

Prior to the purchase of any asset a Capital Expenditure Form (CEF) is completed. In addition to this form, which notifies the Accounts Department of the impending purchase, the standard LPO will also be completed as per any normal purchase of goods.

The CEF is completed in duplicate and after authorization distributed as follows:

- Copy 1 - Operations Manager to be filed with all previous forms.
- Copy 2 - the Accountant.

The authorization procedures are as follows:

- a. CEF authorised by Department Head and passed on to the General Manager.
- b. If the expenditure is within the limits approved by the Board in the Capital Budget, the General Manager may authorize the expenditure.

- c. If the expenditure is in excess of that approved by the Board, additional Board approval is required.
- d. The CEF is passed on to the Operations Manager who is responsible for sourcing the asset and preparing the LPO.
- e. The CEF is used by the Accounts Department to update the Fixed Asset Register. These are filed in a capital expenditure file.

#### 10.3.5 Disposal of Assets

Assets are only disposed of after the appropriate authority has been obtained. For each asset disposal an Asset Disposal Form (ADF) is completed. The ADF provides a record of the asset disposed to enable the Accounts Department to update the nominal ledger and the asset register. These forms are filed by the Accounts Department.

Asset disposals are authorised by the MRFC Board or the General Manager depending on the value of the asset and/or the contribution it makes to the organisation operations. All assets disposed of are sold on a tender basis. The highest offer secures the purchase of the asset.

### **10.3.6 Depreciation of Fixed Assets**

Standard depreciation charges are posted monthly to the nominal ledger.

These charges are based on the budgeted figures for the year.

At each financial year end, the year's depreciation charge is computed for each category of assets. This is entered onto the Asset Register and the new net book amount is obtained by subtracting the year's charge from the net book amount brought forward.

A journal is prepared which amends the standard monthly amounts charged in the general ledger for the year to the amounts computed above.

### **10.3.7 Monitoring of Vehicle and Motor Cycle Costs**

A vehicle and motor cycle cost monitoring system is important to ensure vehicles are not abused by users and to determine whether it is cost effective to maintain a vehicle or to dispose of it.

Vehicle expenses are accounted for as per normal expenses. Expenses are entered into a spreadsheet which has been set up for monitoring and control

purposes. Each expense is allocated to a particular vehicle. This is done by recording the vehicle number on the expense voucher. Expenses should be classified into the following categories: fuel, oil/lubricants, repairs/maintenance - parts and labour, other costs.

All vehicles are assigned asset numbers. These are physically imprinted on to the vehicles for identification purposes. Expense vouchers are marked with these numbers to allow for the accumulation of costs per vehicle.

Vehicle log books shall be maintained by the user of each vehicle. Mileage travelled, reasons for travel and the destination are recorded in these books. At month end a Vehicle Log Sheet (VLS) is prepared by the user and sent to the Department Head for checking and approval.

The Department Head checks the use of vehicles and mileage travelled from the VLS. Excess usage requires an explanation. The VLS are signed as evidence of this check having been performed.

Using mileage travelled from the VLS, costs per kilometer travelled are calculated by entering these figures into the spreadsheet. These reports are

reviewed by the heads of department. Figures are compared against past performance and budget.

Major fluctuations are followed up with users and written explanations obtained with management taking appropriate corrective action.

### **10.3.8 Disclosure in the Financial Statements**

Disclosure in the financial statements shall include the following: depreciation charge for the period is shown in the Income and Expenditure Account; net book value of fixed assets is shown in the Balance Sheet; MRFC policy in respect of depreciation as stated in the Notes to the Financial Statements. (A summary of fixed assets and depreciation, showing all movements during the financial period is included in the Notes to the Accounts).

## **11.0 CENTRAL FINANCE**

### **11.1 Objectives of Central Finance**

The overall objectives of the system are to ensure that all loans to MRFC borrowers and all deposits are accurately and completely recorded in the accounting records;

timely reports to management are generated to assist in the decision making process; interest is correctly and accurately raised and charged on loans; and where loans are outstanding, information is generated at an early stage to identify these and enable timely follow-up and collection procedures.

### **11.2 Overview and Basic Features of Central Finance System**

The Central Finance Department, located in Lilongwe, is responsible for the system. A loans subsystem shall be maintained (and eventually computerised).

Reconciliations between the nominal ledger balances and the loans system balances are performed monthly. Copies of source documents (ie. receipts and loan payments) are sent to the Central Finance Department for processing through the loans subsystem.

The key internal controls of the system include authorization procedures for all Central Finance transactions, maintenance of accurate, complete and up-to-date records, and monthly reconciliation of the Central Finance subsystem to the nominal ledger.

### **11.3 Central Finance Accounting Procedures**

#### **11.3.1 Budget preparation - annual lending program**

The Annual Lending Program is the source of information for preparing Credit Fund Estimates. The preparation of the Annual Lending Program begins and ends at the Agency level. It shows Farm Input requirements and is sent to the Branch.

At the Agency level the details from the Annual Lending Program and operating costs from the Annual Work Plan are used to produce consolidated estimates which are forwarded on to the Branch.

The Branch Manager and Branch Accountant incorporate the branch operating costs into the estimates. Prior to producing consolidated estimates for the whole Branch, the Branch Accountant and Branch Manager meet in order to review the figures. Following this meeting the Branch Accountant prepares a consolidated budget estimate and draft a Cash Flow statement.

The Branch Accountant then prepares a budget in the form of a Profit and Loss statement and Balance Sheet supported by the Annual Lending Program

which is sent to MRFC Headquarters Planning/Budget Officer by April 30.

The Headquarters will provide the Branch an indication of the prices of inputs to be used in the budgets.

The Planning/Budget Officer and the Branch review the estimates, and if found satisfactory, prepare a consolidated budget which is sent to the General Manager for discussion with the Management Committee and the Board of Directors in June.

When Board approval is obtained the approved Budgets are then sent to the Branch Managers. The Branches then allocate funds to the Agencies as required in the approved Budget.

### **11.3.2 Time table for the annual budget**

Agency - The preparation begins in January. The input requirements are consolidated in February.

Branch - The requirements are consolidated in March, and estimates prepared and sent to the Headquarters by April 30.

MRFC Headquarters - The estimates are sent to the MRFC by May and discussed in June.

### 11.3.3 Management and control of the accounts

In compliance with the requirements of the MRFC Board Policy, the following books of accounts are maintained at the Branch.

Purchases Day Book - Record all purchases of farm inputs. The information for this is obtained from the upper part of the forms record from the Agency.

Sales Day Book - Record all sales or loans issued. The information for this is obtained from the lower part of the (A) Forms received from the Agency.

Journal - Used for opening and closing of accounts, correcting and adjusting entries, and transferring from one account to another.

Ledger Accounts - The following ledger accounts are maintained:

- Purchases
- Creditors (Suppliers)
- Sales (Loans issued)
- Debtors (Borrowers)
- Sundry Debtors
- Sundry Creditors
- Provision for doubtful Debts
- Bad debts
- Depreciation
- Capital
- Fixed Assets
- Interest receivable

- Cash/Bank (all levels)
- Profit and Loss
- Expenses (e.g. Salaries, Wages, Stationery, etc.)
- Stock
- Surcharges

Posting of the accounting transactions follow the principles of double entry book keeping (i.e. for every debit entry there has to be a corresponding credit entry).

#### **11.4 Balancing and closing of accounts**

At the end of every month, the ledger accounts are balanced and a Trial Balance prepared. The total of debit balances must be equal to the total of credit balances to ensure the arithmetical accuracy and correctness of the ledger accounts.

#### **11.5 Balance Sheet Notes**

Only the net values will be shown. Depreciation and any additions to the Assets will appear on the Fixed Assets Schedule. Medium Term Loans not due are shown separately under Loans. A description of the some of the balance sheet notes follows:

- a. Depreciation - The note will show how the net value of the assets were arrived at.

- b. Doubtful debts provision - The note will show how the figure of doubtful debts provision was arrived at.
- c. Inter-company transactions are shown by the Branch but MRFC will eliminate them when consolidating the Balance Sheet.
- d. All fixed Assets should be shown on the schedule.
- e. Purchase of capital items are shown in a below the line account. It will be included in the budget as a separate line item.
- f. Make up of Medium Term Loans not yet due should be provided.
- g. Prepare a list of Stock. Seasonal and Medium Term Loans should be separated.
- h. The Branch should keep a list of all debtors by Agency level while the MRFC shows the debtors list by Branch and Agency.
- i. Bank Account figures should be detailed (i.e. Reserve Bank, National Bank of Malawi, and Post Office Savings Bank).

- j. Bank overdrawn liability is shown as such in the Balance Sheet.
- k. Capital is shown by source of funds (i.e. World Bank, African Development Fund, GTZ, USAID, Malawi Government, etc.)
- l. Fixed Assets - Small items (less than MK100) which may be consumed within a year should not be capitalized. If a capital item is being bought, the item is included in the Schedule of Assets and the Balance Sheet.

#### **11.7 Control on disbursement of farm inputs and credit recoveries.**

The accountable documents used in obtaining inputs is an authorization form or Purchase/Sale order form (PSO) from the supplier. This is used when issuing farm inputs to borrowers. The upper part of the PSO is a purchase while the lower part is a sale. The Branch will obtain these forms from the MRFC.

Upon receipt of accountable books the Branch will open the Accountable Documents Register in which books will be entered in numerical order. Each type of document has its own section. The Cash Accountable Documents have their own section in the Register.

Upon receipt of Accountable documents from the Branch a similar register is maintained at the Agency. The Loan Officer issues the PSO forms at the agencies.

### **11.8 Transfer of accountable documents**

There must be no transfer of Accountable Documents from one to another. Transfer within the Branch requires proper documentation and approval from branch management. Transfers between branches must be approved by MRFC headquarters.

### **11.9 Obtaining inputs**

The PSO form is raised at the point-of-sale (e.g., ADMARC Market). This is because the PSO form is issued for inputs actually supplied to borrowers. The authorization will be made by the Agency Loan Officer as authorizing officer. The borrower or all Club officers then sign for receipt of input.

The Purchase Delivery Order (PDO) is prepared in five copies and distributed as follows:

- Copy 1** - Sent to Branch together with the delivery note (S1) and promissory note attached to the PSO form dispatch note.
- Copy 2** - Club chairman or farmer.

Copy 3&4 - the ADMARC representative.

Copy 5 - remains in the book for audit purposes.

### **11.10 Bulk purchases**

These purchases are discouraged but should the need arise bulk purchases will be authorized by the Branch. The PSO Forms raised for issues to borrowers out of the bulk purchase will be cross referenced to bulk purchase PSO Form. The Bulk Purchase form PSO should be endorsed as such.

The S1 is an invoice and is prepared by ADMARC, if used as the supplier. The S1 (or similar form) is to be signed by the borrower acknowledging delivery of inputs.

### **11.11 Opening of books and posting issues in debtors account**

The Agency Accounts Assistant will open a Loan Ledger as soon as the approved Borrowers list is received. Upon receipt of PSO forms, S1s and Promissory Notes, the Agency will open a Sales Day Book in which will be entered details of issues which will be the basis of opening Debtors accounts in the loan ledger.

The Loan Officer will maintain a daily Issues Register in which he will record all purchases as per PSO forms. The totals will be transferred to the debtors account in the loan ledger.

At the Branch, upon receipt, the PSO Forms, S1s and Promissory Notes are checked and Purchases/Sales Day Books are opened. The details of issues which will be the basis of opening the Debtors, Sales, Purchases and Creditors accounts.

#### **11.12 Reconciliation of issues**

The purpose of reconciliation is to ensure that records kept at the Branch and Agency agree. After the distribution of farm inputs is completed in March a reconciliation by Branch is carried out against the field records. This exercise must be done prior to the preparation of interim accounts which the Branch submits in June to the MRFC.

### 11.13 Credit recoveries

#### 11.13.1 The accountable documents

The accountable documents used in Credit Recoveries should be kept under lock and key and consist of the Club Receipt Book, MRFC Receipt Book, and the Post Office Savings Bank Pass Book.

Club Receipt Book: The club receipt book will be used by the Club Treasurer to receipt credit recoveries from individual members. The Club Treasurer will ensure that these receipts are issued in numerical order. These books will be obtained from MRFC at the Agency.

MRFC Receipt Book: The MRFC receipt book will be used for collecting Credit recoveries from borrowers by the Loan Officer. These books will be obtained from MRFC at the Branch.

POSB Pass Books: POSB Pass Books will be kept by the LOs and used for depositing credit recoveries to the Post Office. Pass Books are obtained from the Post Office. Completed pass books should be transferred to the Branch

Accountant via the Agency for safe keeping and audit. The Branch Accountant will arrange for fresh issues.

### **11.13.2 Register of accountable documents**

Upon receipt of accountable documents from the MRFC by the Branch, an Accountable Documents Register is opened and the Branch Accountant enters these in numerical order. Each type of document has its own section in the Register. Similar registers are maintained by the Agency office.

### **11.13.3 Issue of accountable documents**

The issue of accountable documents is limited to one book for each Loan Officer. However, the MRFC Receipt Book is issued to the Agency only.

## **11.14 Accounting for repayments**

### **11.14.1 Farmers clubs**

The Treasurer of the club issues receipts to individual members of the club for loan repayments. The receipts issued are summarized in the members Cash Book by the Club Treasurer.

### **11.14.2 Deposit of credit repayments with LO**

When accounting for recoveries to the Loan Officer (LO), the Treasurer will have a Members Receipt Book and a Members Cash Book. These will be checked by the LO before the issue of a MRFC receipt. The LO will initial, stamp and endorse the number of the MRFC receipt at the back of the last receipt issued by the Treasurer of the club.

### **11.14.3 Accountability of credit recoveries**

Daily Repayment Sheet (DRS). At the end of each working day the LO will enter all MRFC receipts issued on the DRS in numerical order. The LO totals all MRFC receipts issued and balances them against actual cash received.

Thereafter the DRS will be ruled off. At the bottom of the DRS the LO writes a summary of recoveries in order of their years and type of Loan. The canceled receipts must remain intact in the book.

Distribution of the MRFC receipt, written in triplicate, are as follows:

- Copy 1 - the Branch with DRS.
- Copy 2 - the borrower.
- Copy 3 - remain in book for audit purposes.

### **11.15 Banking of loan repayments**

After ruling off the DRS the LO must deposit the money as soon as possible in the following manner:

#### **11.15.1 Banking with Commercial Banks**

The LO will prepare six copies of the bank deposit slips which will be stamped with the MRFC Account number. The distribution of the bank's slips will be as follows:

- Copy 1-3 - retained by bank cashier,
- Copy 4 - to Branch with the MRFC receipt and DRS.

- Copy 5 - to MRFC who will issue a General Receipt.
- Copy 6 - remains with LO as audit copy.

### **11.15.2 Banking with Post Office Savings Bank**

The LO will prepare four (4) copies of POSB SB7 deposit slips and deposit the money with the Post Office. The SB7 copies are distributed as follows:

- Copy 1 - retained with POSB Cashier
- Copy 2 - Branch together with the original MRFC receipts and DRS to support the deposit.
- Copy 3 - MRFC to enable MRFC maintain a record on a special Memorandum Cash Book for funds deposited with POSB.
- Copy 4 - retained by LO as audit copy.

### **11.16 Banking by Agency Manager**

Where banking facilities are not available the Agency Manager will collect loan repayments from the Loan Officers and issue an MRFC receipt. The LO will then prepare bank deposit slips for each collection made in line with the MRFC receipt

issued. One copy of the deposit slip must be sent to the LO where the money was collected.

### **11.17 Credit collectors chart**

Accounting for deposits should be made on a weekly basis, to ensure that this procedure is adhered to, the Agency Manager will maintain a Credit Collectors Chart. The Agency Manager should ensure that he checks the DRS, the MRFC receipt and the bank deposit slips brought in by the LO. The chart will enable the Agency and Branch to monitor the frequency of deposits made by LO to the banks.

Copies of the DRS, MRFC receipt and the cash book copy will form part of this batch. Bank deposit slips will be batched on a weekly basis and submitted to the Branch with a cover letter.

### **11.18 Reimbursement of loan repayments deposited with POSB**

At the Branch, an account in the name of MRFC will be opened for each Agency to which will be debited the amounts deposited as per deposit slips SB7 received from Agencies. Quarterly, the Branch will call for POSB pass books from the field for reconciliation with the POSB account. A claim will then be made to POSB. Upon

receipt of a cheque from POSB, the POSB account is credited. The cheque is then deposited with a commercial Bank in favor of MRFC's Bank Account Number. A copy of the Bank Deposit Slip is sent to MRFC upon which the General Receipt will be issued.

#### **11.19 Bad debts, losses and write-off procedures (classification of debts):**

The following are terms used in the classification system:

Current - These are good and recoverable, usually one year old. No provision for bad debts is necessary.

Performing - These are doubtful because they have been outstanding for one to three years but interest is still being charged. A provision of 50 percent will be made.

Non Performing - These are classified as bad debts. They have been outstanding for more than three years and charging of interest has ceased. A provision of 100 percent should be made on such debts. (NOTE - The declaration of a debt being bad does not include debts that have been given some consideration by way of a rescheduling).

After careful review, on a quarterly basis, the accounting staff at the Branch should give management a list of debtors that is recommended for write-off. It should be noted that even when debts have been recommended for write-off the field staff should continue their efforts to recover these debts. The recommendation for write-off should be made to MRFC for approval.

### **11.20 Legal action against defaulters**

It is not the MRFC's intention to take defaulters to court. Legal action is regarded only as the last resort when all attempts to recover outstanding debts by other means have failed. When the Agency or the Branch deem it necessary to take farmers, clubs or individual borrowers to court, the LO or Agency Manager must check the Loan Ledger thoroughly in order to confirm that the loan balances for each debtor are correct.

When court action is contemplated, Agency Managers and LOs will only select defaulters who have not been able to repay after their loans were due. These debtors will then be listed on the List of Debtors and be recommended for court action. The list will be presented to the court and copies distributed as follows:

- Copy 1 - to traditional court for registration of the case(s);
- Copy 2 - to the Agency for filing in the court matters file;

Copy 3 - to be retained by the LO or Agency Manager as applicable.

Once Civil Cause numbers have been allocated by the Court, the Agency Manager or LO will quote the Civil Cause Number. Details of repayments through the Court will be transferred to the Ledger.

### **11.21 Farmers club repayment**

After collecting the debt from the defaulter the court will instruct the Agency to take control of the money. The Agency Manager or LO will collect the money from the court on behalf of the Agency. The procedure to be adopted is outlined below:

(1) The Loan Officer will collect Agency repayments from the court by signing the Court Deposit Receipt;

(2) The LO then issues Credit Repayment Receipts for the amount received indicating the season to which the repayment relates. The LO should ensure that the Court Deposit Receipt (CDR) number is quoted on top of the Credit Repayment Receipt. The Loan Ledger should then be updated accordingly.

(3) Finally, the LO should attach the club's copy of the Credit Repayment Receipt to the Court Deposit Receipt (DRS) and file both documents in the Court Matters file.

If after Court action, there is a genuine need for debtors to pay money at the Agency or another designated center due to long distances or for other reasons, the following procedure should be followed:

(1) On receipt of the money the LO should write the Civil Cause Number and the season to which payment relates on the Credit Repayment Receipt form;

(2) The LO should present such receipts to the Court Clerk for proper recording and updating;

(3) The LO must ensure that no copy of the Court Deposit Receipt is given to the Farmers' Clubs or individuals because the debtor will have already been given a Credit Repayment Receipt. The LO should thereafter file the Court Deposit Receipt in the Court Matters File.

### **11.22 Procedures for recommending write-offs**

Each year the Branch should submit to the MRFC a list of its debts that are delinquent. This list should provide details of the age of the debt, the sum of the original loan provided and the outstanding balance. In addition, club membership details including the names of the individual farmers who make up the debt should be shown for each season. Any outstanding seasonal loan and/or medium term loan should be shown separately.

The medium term list of outstanding loans should include information on what steps have been taken to recover the debts. Whether any efforts have been made to repossess the items concerned and if not, why not. Verification of the following information backing the recommended bad debts to be written-off is important. Debtors (both clubs or individuals) should have location addresses listed including name of Village, Traditional Authority and District.

### **11.23 Accounting procedures for writing off bad debts**

After authority to write-off has been obtained, the following transactions should be effected in the books of accounts.

Debit the provision for bad debts account and credit the individual debtors account with the amount recommended for write-off. The effect will be that of reducing our debtors and also reducing the provision for bad debts that nets off MRFC's Balance Sheet Debtors in the Debtors schedule.

A copy of the authority letter to write off is to be sent to the Agency. It should be noted that information on write offs is confidential and should not be released to the borrowers.

#### 11.24 Losses

There are three types of losses - loss of cash, loss of farm inputs, and loss of accountable documents.

Once a loss of cash or inputs has occurred, a write-off has been applied for, and the MRFC is still awaiting Board of Directors authority for the write-off, a debtors account in the name of person involved should be opened. Also, a provision for bad debts account will be opened. A 100 percent provision for the bad debt will entered in the accounts.

When authority to write-off has been obtained, the treatment in the books of accounts is similar to that of bad debts. In a situation where the loss has been written off but later some money is recovered from the individual, an entry should be made to the profit and loss account as recovery income from bad debts. Any such recoveries should be communicated to all parties affected, by sending copy of the official receipt issued.

All loss reports on credit matters should be submitted to the MRFC. The MRFC will open a loss register so that monthly returns are properly accounted for.

According to the MRFC Board of Directors policy, "accountable documents" are disposed of as shown hereunder and without the necessity of a further authority:

(NOTE - This area needs to be confirmed by the Board and with legal consultation)

### **GENERAL RECORDS**

#### **TYPE OF RECORD**

#### **DESTRUCTION SCHEDULE**

Audit Queries:

3 years after settlement

Bank Statements:

5 years after audit

Cash Books (originals):

Transfer to MRFC archives office after 1 year subject to their having been audited

<u>TYPE OF RECORD</u>	<u>DESTRUCTION SCHEDULE</u>
Cash Book (Duplicates):	1 year after audit
Daily posting:	End of the fiscal year
Debtors records:	5 years after account is closed
Personal Advance Record:	2 years after account is closed
Salary Charge Sheet:	1 year after fiscal year to which they relate.
Salary Record Cards:	Transfer to MRFC Archives, one year after the officer has left the company.
Vouchers:	(To be determined)
Original:	Transfer to MRFC Archives, one year after the financial year
Voucher duplicates:	1 year after financial year to which they relate.

Approved by the General Manager on \_\_\_\_\_.

Approved by the Board of Directors on \_\_\_\_\_.

ANNEXES

**BALANCE SHEET:**

**MALAWI RURAL FINANCE COMPANY  
BALANCE SHEET  
AS OF DECEMBER 31, 19XX  
(MK '000)**

**ASSETS**

Current Assets:

Cash and Deposits in Banks  
Seasonal and Working Capital Loan  
Accrued Interest Receivable  
Allowance for Loan Losses

\_\_\_\_\_

Total Current Assets:

Long-Term Assets:

Long Term Loans (Med-Term to SME's)  
Fixed Assets  
    Vehicles  
    Equipment  
    Furniture and Fixtures  
Depreciation

\_\_\_\_\_

Total Long-Term Assets:

Total Assets:

\_\_\_\_\_

**LIABILITIES and CAPITAL**

Current Liabilities:

Savings Deposits  
Taxes Payable  
Farmers Club Reserve Fund

\_\_\_\_\_

Total Current Liabilities:

Long-Term Liabilities:

Borrowings (Transferred from SACA)

Long Term Debt (GOM-IDA)

Total Long Term Liabilities: \_\_\_\_\_

Total Liabilities: \_\_\_\_\_

Capital:

Paid in Capital (Auth. MK25'000'000)

Preferred Stock

Common Stock (Borrowers Capital Base)

Retained Earnings \_\_\_\_\_

Total Capital: \_\_\_\_\_

Total Liabilities and Capital: \_\_\_\_\_

**INCOME STATEMENT**

**MALAWI RURAL FINANCE COMPANY  
INCOME STATEMENT  
FOR THE YEAR ENDED DECEMBER 31, 19XX  
(MK 000'S)**

**Income:**

Interest Income

Other Income

\_\_\_\_\_

Total Income:

**Expenses:**

Head Office/Branch Expenses

Personnel (Salaries)

Benefits, Admin. & Occupancy

Training

Consultancy

Vehicles

Travel

Operations & Maintenance

Depreciation

Interest Expense on Deposits

Interest Expense on Borrowed Funds

Provision for Losses

Misc. Operating Expense (Postage, Telephone, Fax, etc.) \_\_\_\_\_

Total Expenses:

Profit/(Loss) before Income Tax

Income Tax @ \_\_\_ %

\_\_\_\_\_

Profit/(Loss) After Income Tax

\_\_\_\_\_

Other financial ratios

Dividend Rate

Dividend on preferred Shares

Current Year Profit/Loss

Accumulated Retained Earnings

Return On Assets (ROA)

Return On Equity (ROE)

**SOURCE AND USE OF FUNDS**

**Malawi Rural Finance Company  
Sources and Uses of Funds  
For the Year Ended December 31, 19XX  
(MK 000's)**

**Sources of Funds:**

Deposits	
Short Term Debts	
Borrowed Funds WB/GOM (L-T Debt)	
Net Profit or Loss after Tax	
Provision	
Less Loan Written off	
Increase (Decrease) in Funds from Operations	
Increase (Decrease) in Equity	_____
<b>Total Sources of Funds</b>	<b>_____</b>

**Uses of Funds:**

Cash	
Deposits	
Increase in Accrued Interest	
Fixed Assets	
Increase (Decrease) in L/T Loan Portfolio	_____
<b>Total Uses of Funds</b>	<b>_____</b>

**TRIAL BALANCE**

When the closing entries have been recorded and posted, the accounts can be balanced - that is, the debits and credits added and an account balance determined - and a Trial Balance can be prepared. This Trial Balance shows the account balances for all real accounts. The nominal accounts are not shown since they have been closed. This step is designed to provide some assurance that the previous steps in the cycle have been performed properly.

-----

**Malawi Rural Finance Company  
Trial Balance  
As of the Month Ended (Month)(Year)**

		<u>DEBIT</u>	<u>CREDIT</u>
Cash and Deposits in the Banks	x		
Seasonal and Working Capital Loan		x	
Accrued Interest Receivable	x		
Allowance for Loan Losses	x		
Long Term Loans (Med-Term SME's)		x	
Vehicles			x
Equipment			x
Furniture and Fixtures		x	
Depreciation		x	
Savings Deposits			x
Taxes Payable			x
Farmers Club Reserve Fund			x
Borrowings (Transferred from SACA)			x
Long Term Debt (GOM-IDA)			x
Paid in Capital (Auth. K25'000'000)			x
Preferred Stock			x
Common Stock (Borrowers Capital Base)			x
Retained Earnings			x
Totals		<u>    x    </u>	<u>    x    </u>

**Malawi Rural Finance Company (MRFC)**

**Policy and Procedures Manual**

**VOLUME III: Personnel**

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## **PERSONNEL POLICIES AND PROCEDURES**

### **1.0 Purpose and structure of the manual**

This Manual is an official document of the Malawi Rural Finance Company (MRFC) which sets forth the basic personnel policies and guidelines for the conduct of business and the management of human resources. The purpose of this Manual is to provide detailed information on MRFC personnel policy and should guide employees and supervisors of MRFC in the application of various policies, rules and regulations. This Manual constitutes current personnel policies and standards that have been developed by MRFC as currently practiced.

The Director, Personnel and General Administration has the primary responsibility for maintaining these policies. S/he shall report proposed changes to and obtain the concurrence of the General Manager and of the MRFC Board of Directors for all such changes. S/he or his/her designate shall review the Manual at least annually to decide what changes or revisions, if any, should be made to the Manual.

Each employee is encouraged to provide their suggestions relating to this Manual to the Director, Personnel and General Administration. The organization chart and any subsequent changes to it, including all positions for MRFC will be approved by the Board of Directors.

## **2.0 Recruitment and selection for employment**

2.1 Any vacancies occurring in positions authorized by the Board of Directors may be filled by management by promotion from within provided that all staff are advised of the opening and given an opportunity to indicate their interest.

When not filled from within, positions shall be advertised in at least two issues of the newspapers so that interested applicants have a chance to apply.

2.2 Applications for employment shall be submitted on a standard application for employment forms supplied by the Personnel Department.

2.3 All applications for employment shall be forwarded to the Personnel Department. The Director, Personnel and General Administration or designate will assist the manager of the branch, agency, department, or division to "short list" candidates for the vacancy, considering the educational requirements and any other standards set in the job specifications for the position.

2.4 A selection panel shall be formed consisting of the supervisor of the position to be filled, the Director, Personnel and General Administration or his designate, and the appropriate Branch Manager.

2.5 The best qualified applicant shall be selected with due consideration to the ability of the candidate to advance to greater responsibilities with the growth of MRFC. Candidates with experience in MRFC shall be given preference, provided their qualifications are equal to or better than other top candidates.

2.6 Applicants may be required to complete written and oral tests as prescribed by the Personnel Department. A medical examination may be required, at MRFC expense to ascertain insurability under the MRFC Medical Plan [to be developed].

### **3.0 Probationary period**

All employees of MRFC are initially appointed on a probationary basis. The probationary period is a time for mutual evaluation by both the employer and the employee. Every new employee or an employee promoted to a new position shall be subject to a probationary period.

For clerical level employees, the period is a minimum of three and a maximum of six months. For supervisory and management staff, the standard is six months which may be shortened or extended for up to another three months, depending on the evaluation of performance by the supervisor. An extension beyond six months must be approved by the manager of the department to whom the supervisor reports.

During the probationary period of a new employee, employment may be terminated immediately if a performance appraisal determines the person is unable or unwilling to perform the functions assigned to the position.

During the probationary period, an employee promoted or transferred to a new position may be returned to their last or a comparable position if (1) a performance appraisal indicates that the employee is unsuitable for the new position and (2) a post is available.

An employee will only be confirmed in a position after a performance evaluation has been completed to assure that required standards for the post are being met or the supervisor is confident that standards will be met. The confirmation shall be in writing and signed by the immediate supervisor and the General Manager or his designate.

#### **4.0 Conditions of employment**

All employees of MRFC are obligated to abide by certain conditions of employment:

- a. As a member of the MRFC staff, employees will have access to confidential information concerning borrowers and fellow employees. Such information is to be kept in strict confidence. Every employee is required to sign an Oath of

Secrecy on entering employment and such secrecy must be maintained even after termination of employment for whatever reason.

- b. All employees must be bondable through the MRFC Fidelity Bonding Program [to be determined]. The standard employment application forms contain the information essential to determining bondability.
- c. Every employee must disclose any personal interests, direct or indirect, in contracts, agreements, transactions or loans being considered by MRFC and must refrain from any participation in the approval or action of any kind on same.
- d. Employees are prohibited from engaging in any outside employment, business or profession that impinges or might impinge on his/her ability to perform effectively and consistently and without conflict to the best interests of MRFC.
- e. Any questions arising concerning the Conditions of Employment requiring interpretation should be addressed to the Management of MRFC.

## **5.0 Working conditions and Standards**

MRFC's regular office hours are 7:30 to 12:00 and 13:30 to 17:00 Monday to Friday. Except for specific employees with prescribed work schedules, all employees are expected to be at their work stations during this time. Exceptions are made for staff that are required to travel in the course of their work.

Staff that are required to travel in the course of their work are not required to observe the scheduled office hours, providing that they file a work schedule with their supervisor in advance to indicate where they will be and have advised the receptionist in the office where they will be during the time they are not in the office.

## **6.0 Salary grades and Positions**

Salary grades have been established for all positions within MRFC. The various positions and corresponding levels are subject to the approval of the Board of Directors and is to be reviewed from time to time by the Director, Personnel and General Administration.

The General Manager is responsible for recommending to the Board of Directors the salary grade for any new position developed.

The salary grade and positions are as follows:

<u>GRADE</u>	<u>POSITION</u>
1	Driver Messenger Watchman
2	Clerk (General Duties) Typist
3	Loan Officer Data Entry Clerks Accounts Assistant Secretary (Shorthand typist)
4	Loan Officer Senior Accounts Assistant Secretary (Stenographer)
5	Assistant Auditor Senior Loan Officer Assistant Branch Accountant Assistant Branch Manager, Data Processing
6	Assistant Branch Manager, Credit Branch Accountant Agency Manager Associate Auditor Administrative Officer Accountant
7	Branch Manager Internal Auditor Senior Accountant Assistant Manager, Data Processing

<u>GRADE</u>	<u>POSITION</u>
8	Assistant Manager, Personnel Assistant Manager, Training Assistant Manager, Administration Assistant Manager, Data Processing Chief Accountant Assistant Manager, Planning & Budgeting Senior Internal Auditor
9	Assistant Manager, Seasonal Loan Operations Assistant Manager, Other Lending Operations Assistant Manager, Finance
10	Deputy General Manager, Lending Deputy General Manager, Finance Director, Personnel/General Administration Chief Internal Auditor
11	General Manager

The Board of Directors shall select the General Manager, determine the salary and benefit package extended.

### **7.0 Compensation**

The Director, Personnel and General Administration is responsible for developing and monitoring a schedule of salary ranges in accordance with the salary grades detailed in the previous section. The schedule shall be recommended to the General Manager and approved by the Board of Directors. No exceptions to the salary ranges may be made without the specific approval of the Board of Directors.

Compensatory time. Personnel in salary levels 4-10 are expected to be on duty during MRFC's regular office hours, except when travelling. The salary paid recognizes that personnel in these positions may be required to work well beyond normal office hours in the regular performance of their duties. Time off may be authorized for the extra time required on the following basis:

- One hour for every three hours of extra time put in. This may be accumulated to the equivalent of at least one day but should be taken within a month from the time it is earned.
  
- Management staff will not earn or be given compensatory time.

Overtime. Personnel in salary levels 1-3 may be authorized overtime compensation on an hourly basis on the following conditions:

- a. It must be approved by the supervisor and must be for work that could not have been done during regular office hours.
  
- b. The minimum overtime is one hour. No overtime payment will be allowed for less than one hour.

- c. For extra work performed during the week, the overtime rate shall be one and a half times the regular hourly salary based on a 40 hour work week.
  
- d. For work on Sundays and public holidays, the rate shall be two times the regular hourly salary based on the 40 hour work week.
  
- e. Authorized overtime must be reported on the proper form, signed by the employee, verified by the Supervisor and sent to accounting for processing. Approved overtime payments will be made at the time of the regular salary payments for the month.

Under unusual circumstances, an emergency salary advance may be granted to a permanent employee in amounts and on terms and conditions approved by the General Manager. Repayment of the advance will be by payroll deduction.

## **8.0 Attendance Records**

MRFC maintains time of arrival and attendance records for all staff. Supervisors must ensure that their staff is aware of their responsibilities and when they are to be on duty. People who are habitually late create a bad image of the organization, have a negative effect on morale, and place an extra burden of work on their fellow employees. Employees who are late more than

twice in a month without a reasonable excuse are tardy in their duties and will be issued a written warning as provided in the Misconduct Section of these policies and procedures. Three such warnings are grounds for immediate termination.

Employees absent from work for any unplanned reason must complete a Report of Absence Form immediately upon their return to work and submit it to their supervisor. This applies to all absences whether for leave, illness or any other reason. The supervisor will sign the report verifying its accuracy and forward the form to the Personnel Department.

Employees must request approval, in advance, for time to be taken off as annual leave. See the section on Annual Leave.

## **9.0 Housekeeping and General Conduct**

It is the duty of every employee of MRFC to keep his/her work area neat and tidy and to help maintain a professional and business-like atmosphere in MRFC offices. Employees should also aid in keeping general work areas, washrooms, etc. clean and orderly.

General conduct. Employees must be professional in conduct and as knowledgeable as possible about rural finance and the operations of MRFC in order to carry out the

requirements of their positions and serve the best interests of the company and its customers.

Lateness. MRFC practices the concept of hiring mature adults who will act responsibly to whatever position they hold. Lateness may be unavoidable on rare occasions. However, habitual lateness will not be accepted and may be grounds for disciplinary action as set out in this manual.

Absence. Any employee required to be absent from work due to illness or other unforeseen reasons must inform his/her supervisor by the normal starting time for work, in at all possible. If the employee is to be away for more than one day, another request must be made, unless satisfactory arrangements were made in advance with the employee's supervisor.

Use of telephones. MRFC telephones and other office equipment are for business purposes. Since the number of telephone lines is limited, the telephone must be available for customers and official business. Employees are not allowed to conduct personal business or socialize during normal business hours. Abuse of this policy may be grounds for disciplinary action.

Grooming. Employees are expected to be neat, presentable and to maintain a standard of dress, grooming and general decorum that will help present MRFC as a top quality business and financial organization in Malawi.

## **10.0 Performance Evaluations**

Every employee on probation shall have a performance evaluation completed by his/her supervisor at the end of the probationary period. Every confirmed employee shall have an annual performance evaluation.

For the employee on probation, the evaluation may result in a recommendation to be confirmed in the position, an agreed upon extension of the probationary period, a return to the previous post or termination. Only one extension of probation is permitted. The performance review must be documented on the proper form and submitted to the appropriate manager with a recommendation for action.

Confirmed employees shall have an annual evaluation of performance conducted by their immediate supervisor individually and in private. The discussions shall be documented on the required form, signed by both parties and submitted to the appropriate manager along with recommendations for salary or other action.

When all performance reviews have been completed each year, the information will be summarized and sent to the General Manager. He will use the performance evaluation information to finalize any salary adjustments within the salary range schedule approved by the Board of Directors.

The Chairman of the Board shall complete a performance review of the General Manager after the staff evaluations have been completed. This review shall also be documented, signed by both parties and discussed in a confidential session of the Board. The Board is responsible for setting the salary of the General Manager.

Supervisors are expected to deal with problem situations as they arise and not save them up for the annual performance review. Similarly, employees have the right to request an informal evaluation of their performance at any time.

One copy of the performance review form is retained by the employee, one copy should be retained by the supervisor conducting the review, and one copy is to be forwarded to the Personnel Department through the next level of management. The signed copy of the performance review form is to be kept in the confidential personnel file of each employee.

## **11.0 Grievances**

In the spirit of good employee relations, MRFC encourages two-way communications between management and staff as this helps to foster a team spirit within the organization. Employees are encouraged to submit new ideas to improve operations, satisfy customers and provide appropriate services.

Employees are encouraged to resolve issues at the lowest possible level in the organization. Employees should feel free to approach their supervisor on an informal basis on any concerns and attempt to arrive at a satisfactory solution. If necessary, issues and problems may be passed up through the levels of management to the General Manager, who will make the final decision to resolve the issue with or without granting an audience to the employee.

## **12.0 Discipline**

### **12.1 Acts of misconduct**

As a financial institution, MRFC must demand high standards of conduct and discipline from all staff. Acts of misconduct, defined later in this section, shall be brought to the attention of the employee by their supervisor in private. If the offense is repeated, a

written warning must be given the employee with a copy of the signed statement placed in the employee's personnel file.

A person with three written warnings shall be terminated immediately without salary in lieu of notice but with the approval by the next level of management for the position.

**12.2 Acts of misconduct to be reported to the General Manager in writing immediately:**

- a. Being absent from work without permission.
- b. Willfully failing to perform the duties assigned, disobeying instructions (insubordination), carelessness, negligence or continuous inefficiency in the performance of duties.
- c. Working counter to established policies or in direct conflict with supervisory directives or subverting recognized channels of communications to appeal to senior management or board members.
- d. Behaving in a manner that is disgraceful, immoral, improper, or unbecoming or being insulting or discourteous while on duty.

- e. Using her/his position in MRFC to further personal interest or to gain personal privileges from customers or fellow employees.
- f. Committing an illegal offense.
- g. Making false claims or acting in a fraudulent manner.
- h. Failure to disclose any previous arrests or convictions.
- i. Failure to properly account for all MRFC funds in his/her possession.
- j. Contravention of conditions of employment with MRFC.

**12.3 Acts of misconduct that may result in immediate suspension without pay:**

- a. Reporting for duty under the influence of intoxicating liquor or habit-forming drugs.
- b. Disclosing confidential information without permission.

- c. Receiving payment from any person or institution for services provided while working for MRFC.
- d. Engaging in a secondary occupation or undertaking which conflicts with purposes of MRFC or interferes with job duties.
- e. Failure to take reasonable care of MRFC property under his/her control. This especially applies to all motor vehicles, motor bikes, and computer hardware.

Suspension of an employee requires approval of the General Manager who will decide the duration of the suspension, not to exceed one month. All cases of suspension must be documented and a copy placed in the employee's personnel file. A second occurrence that results in a suspension is grounds for immediate termination without notice and without salary in lieu of notice.

**12.4 Acts of misconduct that may result in immediate termination:**

- a. Misappropriation of funds or conversion of MRFC loans for personal benefit in any form or manner.
- b. Destroying, altering or concealing MRFC records.

- c. Committing, taking part in or assisting in any way, directly or indirectly, any action considered to be a criminal offense according to the laws of Malawi. In any of the above cases, the employee will be suspended immediately without pay until an investigation is completed. If found innocent, the employee will be reinstated with full restitution of salary and benefits. If found guilty, the employee will be terminated as of the date of the suspension.
  
- d. Willfully supplying false, misleading or incomplete information to secure employment with MRFC.
  
- e. Willfully committing other acts which are disloyal to, or may damage the reputation of MRFC, its customers or employees.

Recommendations for termination for cause must be fully documented and approved by the General Manager before being implemented. The General Manager is required to report all cases of termination for cause to the Board of Directors.

It is important to carefully file all the documents related to a termination for cause in the employee's personnel file.

### **13.0 Annual Leave**

13.1 All permanent, full time staff earn vacation credits for the purpose of taking annual leave or leave with pay. Annual leave is accumulated and used based on MRFC's fiscal year. Vacation credits are earned by each employee in relation to his/her time of service with MRFC and level of responsibility in the organization as detailed in this section of the personnel manual.

13.2 Personnel on probation are not eligible to take annual leave until they are confirmed. However, they may earn vacation credits from the date of their employment.

13.3 Leave with pay will be granted to all permanent staff, based on the credits earned in the year following confirmation.

13.3 Annual leave must be taken within the year after it is earned. Exceptions may be granted only on special written request documenting the reasons. Such request must be submitted in advance by the employee to his/her supervisor. The supervisor will then make a recommendation to the Director, Personnel and General Administration. The maximum vacation credits that may be accumulated is 60 working days.

13.4 Leave is accumulated on the following basis:

Salary levels 1 to 4: 20 working days

Salary levels 5 to 8: 25 working days

Salary levels 9 and 10: 30 working days

Salary level 11: 36 working days

13.5 The Personnel Department shall maintain a current record of all leave entitlement for permanent staff.

13.6 At the beginning of each fiscal year, each employee shall be advised of the total leave entitlement to be taken during the year and will be asked to indicate his/her first and second choice of leave time.

Each Branch Manager and Division Head will prepare a recommended "Leave Schedule" for the year and provide a copy for action to the Director, Personnel and General Administration. The Director, Personnel and General Administration will develop a coordinated schedule and give final approval to submitted plans. A copy of the approved schedule will be provided to all employees.

Certain positions within MRFC cannot be on leave at the same time. In so far as possible, the employee's wishes will be recognized with due regard for the work to be accomplished. When two employees who cannot be away at the same time are requesting

the same leave time, the final decision will be made by the Branch Manager on the basis of rank and seniority before sending the schedule on to the Director, Personnel and General Administration.

13.7 When a scheduled payday occurs during the employees approved vacation time, the employee may arrange alternate means for collecting his/her pay.

#### **14.0 Paid Sick Leave**

In case of illness, the employee or a family member must advise his/her immediate supervisor of the circumstances and when he or she expects to be able to return to work. If the illness extends beyond one day, a medical certificate from a recognized medical practitioner attesting to the illness is required in order to have the time lost charged against sick leave.

Employees earn one day of sick leave credits for each month employed by MRFC to a maximum of 60 working days. Sick leave credits may only be used for illness, accident, dental or medical examinations for the employee.

The Personnel Department is responsible for maintaining a current record of all sick leave accumulated and taken by each employee.

Abuse of the sick leave benefit is a serious act of misconduct that can result in loss of pay or other actions.

### **15.0 Extended Paid Sick Leave**

Normal sick leave is not intended for employees who may have extended illnesses. Extended sick leave for such purposes may be authorized by the General Manager in the following special circumstances:

- An injury as a result of an accident while on duty.
  
- An employee with 5 or more years of service suddenly becoming ill and requiring more sick leave than he/she has accumulated.

Employees have the right to convert unused vacation credits to continue salary during a period of extended illness.

If an employee who has been granted extended sick leave becomes ill again before accumulating sufficient sick leave, salary will not be paid for the period of absence unless special circumstance warrant such and approval by the General Manager is obtained.

If the employee is unable to return to work for an extended period of time after using up all accumulated paid sick leave benefits and any extensions as provided in this policy, unpaid sick leave may be advanced to the employee by the General Manager.

### **16.0 Maternity Leave**

A female employee who has served continuously for one year or more may be granted 30 days of maternity leave with full salary and benefits and an additional 30 days at half pay. Unpaid extensions may only be granted by the General Manager if a registered medical practitioner so recommends.

### **17.0 Special leave of absence with pay**

Emergency leave. In cases of an emergency, the General Manager may grant an employee up to 5 days of emergency leave. Such emergency only includes serious accident, illness or death in the employee's immediate family.

### **18.0 Special leave of absence without pay**

An employee may apply for leave without pay. Such an application must be in writing and filed well in advance of the planned absence. The application shall indicate the time and purpose of

the planned absence. Each application will be considered on its own merit by the employee's immediate supervisor. The supervisor's recommendation is to be forwarded to the General Manager for action.

### **19.0 Educational Leave**

MRFC employees will be given opportunities for additional training in areas identified as needing to be developed in his/her performance review. Employees may be provided partial or full salary during participation in such educational programs, depending on the length of training involved. Before embarking on such training, the employee is required to sign the bond applicable for service required after returning from the training program.

Employees with one or more years of service may obtain permission to take leave of absence without pay to complete professional qualifications. Such employees will be assured employment at least equal to the job they left when they return to MRFC.

### **20.0 Holidays**

The following are recognized as paid public holidays during which all offices of MRFC are to be closed:

- New Year's Day
- Good Friday
- Christmas Day
- Republic Day
- The President's Official Birthday
- Any other days specifically declared as public holidays by the Government, subject to approval by the General Manager.
- Martyr's Day
- Easter Monday
- Boxing Day
- Tree Planting Day

If a holiday occurs during the time an employee is on annual leave, he or she may add one day to the leave time.

## **21.0 Benefits**

Immediately upon employment, employees will receive:

- a. Housing allowance as detailed in the Housing Allowance Policy.
- b. Personnel for salary levels 5 to 10 are provided a relocation allowance for the employee, one wife and all dependent children under the age of 18 years and transport of household goods and baggage from their current home to work location by the most economical means. Personnel in levels below 5 are expected to be recruited from the local area so no relocation allowance is provided.

After satisfactory completion of the probation, employees will receive, in addition:

- a. Medical benefits as set out in the Medical Plan, to be developed by the Management of MRFC.

- b. Accumulation of vacation and sick leave credits from the first day of employment.
  
- c. Participation in the Insurance Benefit Program as set out in the Insurance Plan [to be developed].

Upon completion of one year's continuous service, employee will also receive enrollment in MRFC's Pension Plan as set out in the Plan document [to be developed].

## **22.0 Housing Allowance**

22.1 The General Manager will be provided appropriate housing at the expense of MRFC.

22.2 Subject to the availability to housing, MRFC will provide housing to employees in salary level 5 to 10. The housing will be leased by the Company and assigned to individual employees.

22.3 Where housing is provided to an employee, they shall pay 5% of their basic salary as a contribution towards housing cost. They shall pay 7.5% if the house is fully furnished.

22.4 An employee who does not desire MRFC to provide housing shall be paid 20% of their basic pay as a housing allowance.

22.5 Employees supplied housing by MRFC shall pay all the usual service charges such as supply deposits, electricity, water and telephone charges.

22.6 No alteration to any house provided by MRFC shall be made without the prior approval of the Director, Personnel and General Administration and the landlord.

22.7 The employee in housing provided by MRFC shall ensure that the house and surroundings are kept in a reasonable condition. In the case of neglect, a surcharge will be imposed to accommodate the repairs or maintenance. Normal wear and tear shall not be considered.

22.8 Employees living in houses provided by MRFC shall be responsible for all damages and breakages other than those caused by normal wear and tear.

22.9 An employee living in housing leased by MRFC who, for personal gain, lets for rent any part of the house shall be evicted from the house and lose all rights in the housing policy.

### **23.0 Transport**

MRFC will provide appropriate transport for the General Manager to use as he deems necessary.

Adequate and appropriate vehicles shall be provided for staff to perform their functions in an efficient and effective manner. Vehicles, motor bikes, etc. assigned to staff members are for official business use only. MRFC will provide appropriate accident insurance for the assigned vehicles/bikes.

MRFC encourages field staff to purchase the motor bike assigned them by the Company. This purchase may be according to terms and arrangements agreeable to the employee and MRFC but repayment must be made within 60 months. Payments made by payroll deduction or direct payment. When the cost is fully recovered, the motor bike becomes the property of the individual and is available for personal use.

Employees may use their own motor vehicles/motor bikes for duty traveling authorized by their supervisor. Mileage allowance will be paid at the rate established by the Management of MRFC. Payment of mileage claims will be paid upon submission of an approved claim form.

## **24.0 Training and Educational Opportunities**

It is the policy of MRFC that each employee be encouraged to develop his or her job skills to the fullest extent possible. This will help improve the efficiency of the organization as well as increase the pride of accomplishment and job satisfaction of the employee.

To supplement on-the-job training, employees are encouraged to improve their professional standings through approved regular course attendance, short courses and correspondence courses or extended training in Malawi or abroad.

- a. Courses taken on MRFC time must be approved first by the employee's supervisor to be sure it does not interfere with the work flow and secondly, by the Director, Personnel and General Administration to be sure the training is relevant to the needs of MRFC.
- b. Courses taken by correspondence or on weekends or evenings need not be cleared unless the employee wishes to receive reimbursement for some or all the costs.
- c. An employee wishing to undertake a course of study may submit an application for an educational advance to cover tuition, books and other related costs. This

request must go to his/her immediate supervisor who shall direct the request to the Personnel Department for a decision.

Educational advances are not an automatic right. They will only be approved when the requested training is related to the employee's current or a possible future job within MRFC. The employee must sign an agreement to repay the advance if he/she leaves MRFC within 24 months of the date of the completing the training.

MRFC will provide full reimbursement to the employee who does not request an advance for all the same costs upon satisfactory completion of the course and fulfilling conditions set out in the bonding agreement.

MRFC will cover the full costs of tuition, books, meals, accommodations and travel for employees scheduled to attend MRFC sponsored courses, seminars, or workshops.

## **25.0 Termination and Resignation**

Voluntary termination. An employee confirmed in his post may terminate his service by giving the company official notice at least one month in advance of the prospective termination date. The employee will be entitled to full pay and benefits plus payment of unused annual leave, if notice is one month before termination date. If notice is less

than one month, MRFC will deduct from any compensation due the employee the difference between the notice actually given and the amount required.

Involuntary termination for economic reasons. If for reasons of economy, MRFC must reduce staff, those involuntarily terminated will be given 30 days notice and paid their accrued annual leave.

Involuntary termination for medical reasons. If an employee exhausts all regular sick leave and extended sick leave and is still unable to work, the General Manager shall request a report from a registered medical practitioner and determine whether or not to terminate the employee. In cases of termination on medical grounds, all benefits due will be paid plus any gratuity that may be authorized by the Board of Directors in relation to the employees years of service.

Termination for cause. The section on DISCIPLINE outlines all the reasons, with and without warnings, for termination for cause.

- a. The employee terminated for cause may be paid for unused annual leave and salary to date of release, less any outstanding claims for advances, loans, travel imprest or other indebtedness to MRFC. Settlement shall be made after the employee has turned over all keys and properties in his/her possession belonging

to MRFC. The employee is also entitled to withdraw his/her contributions to the pension plan plus earnings to date as well as the vested portion of the employer's contribution on behalf of that employee.

- b. The employee is required to sign an acceptance of the final settlement as agreed.

## 26.0 Severance Pay

If an employee is terminated, except for cause, a severance allowance will be paid. The rate of pay shall be as follows:

### Salary levels 1 to 4:

- a. 1-3 years of service; one month's salary
- b. Thereafter, one week salary for each additional year of service to a maximum of five years.
- c. For service over 5 years, the General Manager may provide additional amounts at his discretion.

### Salary levels 5 to 10:

- a. Up to 2 years of service, one month's salary.
- b. Thereafter, two weeks salary for each year of service to a maximum of five years.
- c. For service over 5 years, the General Manager, in consultation with the Board of Directors, may provide additional amounts.

Severance pay does not apply to employees who retire from MRFC.

**27.0 Retirement**

Normal retirement for all employees shall be the month in which they reach 60 years of age. Terms and conditions of early retirement are set out in the Pension Plan to be developed. The employment of a person past the age of 60 may occur, upon the approval of the General Manager.

Where an employee has served the agricultural credit system in Malawi either as a volunteer or an employee for more than 10 years at the time of retirement, a lump sum gratuity may be authorized by the General Manager.

**28.0 Exit Interview**

All employees leaving the service of MRFC for any reason is entitled and encouraged to conduct an exit interview with a member of the management team. The interview will be documented, reviewed by the General Manager and placed in the employee's permanent personnel file.

Approved by the General Manager on \_\_\_\_\_.

Approved by the Board of Directors on \_\_\_\_\_.

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**Malawi Rural Finance Company (MRFC)**

**Policy and Procedures Manual**

**VOLUME IV: Internal Audit**

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## **ABBREVIATIONS**

<b>ADMARC</b>	- Agricultural Development and Marketing Corporation
<b>BA</b>	- Branch Accountant
<b>BCS</b>	- Batch Control Sheet
<b>BM</b>	- Branch Manager
<b>CDR</b>	- Court Deposit Receipt
<b>CFC</b>	- Chief Financial Controller
<b>DCR</b>	- Daily Cash Reconciliation
<b>LO</b>	- Loan Officer
<b>PCS</b>	- Petty Cash Summary
<b>PDO</b>	- Purchase/Delivery Order
<b>POSB</b>	- Post Office Savings Bank
<b>PSO</b>	- Purchase/Sale Order
<b>SLO</b>	- Senior Loan Officer

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## INTERNAL AUDIT POLICIES AND PROCEDURES

### 1.0 Purpose and Structure of the manual

This Manual is the official document of the Malawi Rural Finance Company (MRFC) which details the basic policies and guidelines for the internal audit of MRFC activities.

The Chief Internal Auditor has the primary responsibility for maintaining these policies and procedures. He shall report proposed changes to and obtain the concurrence of the MRFC Audit Committee and the Board of Directors for all such changes. He or his designate shall review the Manual at least annually to decide what changes or revisions, if any, should be made to the Manual.

Each employee is encouraged to provide his/her suggestions relating to this Manual to the Chief Internal Auditor.

### 2.0 Internal control and external audit

The MRFC assets and accounts will be subjected to both external and internal audits with formal reports and findings submitted.

### **3.0 General overview and basic features of the system**

The "model" policy which follows establishes the authority for the Internal Audit Department to perform a series of audits throughout the operations of the MRFC.

#### **3.1 Policy**

It shall be the duty of the Internal Audit Department to audit the quality of the operations of the MRFC, including the internal controls and operations of all departments. Special attention will be paid to the quality of the loan portfolio, loan-related assets, and the quality of credit administration in each level of operations. The Chief Internal Auditor shall adopt policies defining audit criteria and provide for the issuance of reports to the Audit Committee of the MRFC Board of Directors.

These policies shall ensure all that evaluating and reporting will be conducted under the supervision the Chief Internal Auditor. In addition, an audit program shall be prepared annually to designate the schedule to be followed and scope of audit to be made in each area of operations.

3.1.1 A written report shall be prepared on each Branch and Agency within 30 days of the end of the audit field work. This report shall detail the quality of the

credit portfolio, the quality of credit administration, an evaluation of MRFC staff and management, and compliance with current law, regulations, and policies.

3.1.2 Statistical reporting shall comply with minimum standard requirements prescribed by the MRFC Board of Directors.

3.1.3 The policy shall establish the responsibilities of the MRFC internal audit staff and their expected accountability in performing their duties (i.e. written policies, requirements and procedures to guide audit staff).

3.1.4 A comprehensive audit scope will be conducted each year covering all areas of MRFC operations. The audit scope shall include credit, accounting, data processing, human resources, business development, and all other functional areas. Auditors shall certify compliance with current laws, regulations, policies and procedures and determine whether any conflicts of interest exist. Special attention shall be given to management performance, demonstrated accountability, and the relationship between the MRFC and its branches and agencies.

3.1.5 Audit work should be performed on the basis that operations that have more problems will require more follow-up audits and those with fewer problems

are audited less - in conformity with criteria established by the Audit Committee and the Chief Internal Auditor.

3.1.6 Audits will be made in each agency every six months. However, audits of greater frequency should be made of high-concern agencies or branches, in conformity with established criteria.

3.1.7 Audit department "working papers" will describe and support the scope of work performed, audit findings, auditors' conclusions, and the purpose and content of the final report. Auditors will collect, analyze, interpret, and document information necessary to support the audit work performed and their findings. These "working papers" will be maintained to enable someone to readily evaluate the scope and quality of the auditors' work.

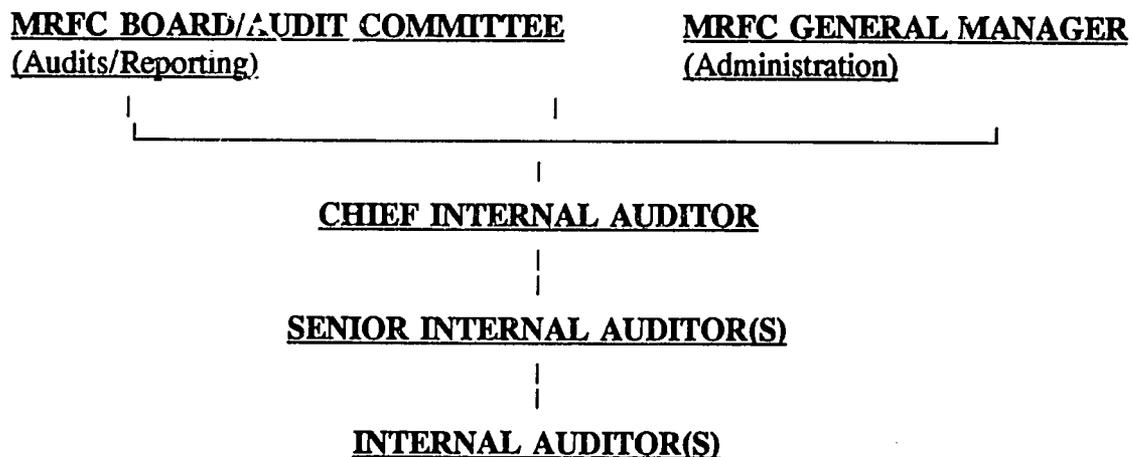
3.1.8 Audit findings and conclusions will be reported to the appropriate MRFC responsible for supervision of the specific branch and/or agency operations. The supervisory staff will be responsible for recommending and implementing the corrective action to be taken on deficient or unsatisfactory conditions reported by the auditors. The primary purpose of these supervisory reports will be to enable branch and agency management to be more effective in carrying out their

responsibilities. Auditors will conduct follow-up audits to ensure that appropriate action has been taken on matters previously reported.

3.1.9 MRFC management, with the aid and support of the external auditors, will establish and maintain a quality control program to evaluate the operations and effectiveness of the audit function.

#### 4.0 Organizational Structure

##### 4.1 Organization Chart Internal Audit/MRFC



##### 4.2 Staffing

To assure organizational independence, the audit staff and its function shall be separated from the other operating units (credit, accounting, etc.). The Audit Department will be

supervised administratively by the General Manager and be directly accountable to the MRFC Audit Committee.

There shall be sufficient qualified staff assigned to the internal audit unit to carry out the required audit program and schedule. Staff assigned to audit work shall have the appropriate educational background, technical proficiency, and experience for the conducting audits of credit, accounting, human resources, data processing, management and other functions. They must be qualified in applying audit standards, procedures, and techniques as well as understand management principles in order to recognize departure from sound business practices and to evaluate its significance.

Audit staff job descriptions are included in the Annex.

## **5.0 Credit Extension and Credit Administration**

A comprehensive internal audit program shall be developed and include the classification and audit of loans above a certain "cut off" amount, with a limited audit of loans below this limit. A thorough audit of credit extension and credit administration methods and techniques will also be made to ensure compliance with policies, procedures and standards of the MRFC. Audits shall be conducted on a regularly scheduled basis according to agreed upon and approved policy and specific standards.

The emphasis of the program will be to identify what is being done properly and should continue, what is wrong and needs to be corrected or discontinued, and to interpret and implement audit findings and recommendations. This program shall also include a method of identifying and establishing a proper loss reserve.

### **5.1 Scope of Audit.**

A comprehensive scope of audit shall include the following: classification and audit of loans, an evaluation of credit administration procedures, and identification of the number and amount of losses estimated in the loan portfolio. If any of these three areas are to be excluded from the audit, a statement explaining the reason for its exclusion must be included in the audit report.

### **5.2 Loan Classifications**

Credit classifications are ways of expressing the degree of risk for non-payment. All loans have risk, but the risk varies among individual credit assets. A credit classification is assigned to a loan on the basis of the inherent risk. An evaluation of the five credit factors used for making the credit decision is also the basis for assigning the credit classification. In addition, the credit administration of an individual loan will also be

considered when assigning a classification. Loans shall be classified in accordance with the following MRFC loan classification standards:

Acceptable Loans: These are non-criticized loans of the highest quality. This classification includes a wide range of loan quality. Borrower equity in relation to the amount of credit extended must be adequate to protect the MRFC from more than normal risk. Management ability and the total income must be adequate over a reasonable period of time to assure repayment within the loan terms, in order to maintain or improve the loan quality. Past performance is satisfactory and the future ability to repay the loan, under normal conditions, is good. These loans will require only normal supervision.

Special Mention Loans: These loans are currently protected from loss, but are potentially weak. They constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of "substandard". Special Mention loans have potential weaknesses that may further weaken the loan at some future date, if not corrected.

Loans included in this category are those with departures from prudent lending practices or adverse market or economic conditions. An adverse trend in the borrower's operation or an imbalance in the balance sheet may be reflected by this classification when the deterioration has not reached a point where full repayment is questionable.

**Substandard Loans:** Loans within this classification have a well-defined weakness(es) that may jeopardize full repayment. The loan may not repay in full if the deficiency is not corrected.

Some of the significant factors in these loans could include: equity position creating more than normal risk, substandard operating performance, unwise use of credit, general adverse economic trends, failure to comply with loan terms and conditions, or weak financial management by the borrower. All of these could result in serious credit weaknesses. Such loans are believed to be fully collectible but require more than normal supervision, either to improve performance to acceptable standards or to achieve planned re-scheduling of the loan terms.

**Doubtful Loans:** A loan classified doubtful has the characteristics of a substandard, however collection is highly questionable or improbable. The possibility of loss is high, but because of reasonable pending factors that may strengthen the possibility of repayment. Its classification as a loss is deferred until the repayment status is determined.

**Loss Loans:** Loans classified loss are considered uncollectible. This classification does not mean that the loan may not have some repayment in the future. Losses should be recorded when they are known to be uncollectible. The actual amount of the loss is

defined as the difference between the borrower's total debt (principal and accrued interest) and the amount of known repayment from the liquidation of the borrower's assets pledged as collateral.

These loans represent cases where it appears that all or a portion of the borrower's total loan will not be collected in full. The auditor will identify a specific amount or range that will not be collected. This amount will be a specific allocation of the loan loss reserve. In addition to physical collateral actually taken, consideration will be given to other assets pledged as collateral for collection purposes if there is reasonable expectation that it can be obtained. Determining the availability of "other collateral" may ultimately dictate whether a loan will be classified "loss".

A loan can have a shortage in total collateral at a given point but still have the ability to pay out. A "loss" classification implies that the viability of the borrower is seriously impaired and repayment must be taken from the liquidation of collateral. This conclusion should be supported by the present financial condition of the borrower, debt load, economic conditions, cash flow, and outlook.

### 5.3 Classification Standards

Credit assets (loans and loan-related assets) represent the majority of the MRFC assets. Assessing the quality of these assets is an important phase not only in the overall evaluation of credit operations, but also in determining the financial position and ultimately the financial condition of the MRFC. The internal audit department will use prescribed classification standards to rate the risk exposure in each Branch and Agency portfolio. A necessary part of the classification process is the specific identification of potential or actual loan losses.

Because of the wide range of factors affecting an individual loan and the importance given to each factor, considerable judgement must be applied in the classification process. The definitions that follow are intended to provide the internal auditor some basic guidelines to be used in classifying a loan.

Weakness Codes: Weakness codes are used to designate the primary credit or credit related weaknesses identified in each loan. Credit weaknesses may occur in any loan. In classifying loans, only those weaknesses which are considered major or minor are identified. The degree is evaluated by consideration of the impact the weakness has on the total credit position of the loan. The weaknesses identified on an individual loan may contain both minor and major weaknesses.

**Minor Weaknesses** - a credit weakness which will have a negative impact on the ability of the borrower to repay the loan if allowed to continue uncontrolled or uncorrected.

**Major Weaknesses** - a credit weakness which has or will have a major impact on the ability of the borrower to repay the loan or the MRFC to provide continued credit services to the borrower.

**Negative Trend**: A negative financial trend lasts for two or more years and is evidenced by a weakening of the borrower's financial position. The degree of this weakness is measured by the impact that the losses have on the repayment capacity of the borrower or the ability to make a profit in the future.

**Debt/Equity**: This is the ratio of debt to net worth which reflects the debt leveraging, risk bearing ability, and structure of assets and liabilities. In comparing the level of debt to the level and market value of owner's equity, the auditor can assess the ability of the borrower to repay the debt.

**Financial Management**: This consists of the effective use and control of all financial resources including cash assets, non-cash assets, and the use of financial and operating records. The degree of this weakness is measured by the impact of the borrower's ability

to effectively maintain a credit consistent with repayment ability, and to provide adequate financial and operating records.

**Repayment Capacity:** The ability to produce sufficient income to repay debts including operating costs, living costs, and bank loans. The degree of this weakness is measured by the impact of the borrower's ability to generate sufficient cash income to repay loans and other commitments within the agreed terms.

**Accountability:** The demonstrated accountability of the borrower in all business relationships. These include the borrower's level of cooperation and integrity in providing reliable information, meeting commitments made through loan or legal agreements, and application of funds against the loan from the sale of secured or pledged assets. The degree of this weakness is measured by the level of confidence the MRFC has in the borrower complying with all loan agreements, written or oral.

**Over-extended:** The level of the loan debt being carried by the borrower in relation to the ability to repay the debt over an acceptable period of time. The degree of this weakness is measured by the identification of the time and level of income required to repay the debt, based on assumptions of future debt requirements and the continuity of management during this period.

#### 5.4 Factors Considered in Classifying a Loan

The five credit factors of a sound loan are the basis for consideration in extending credit as well as loan classification. In addition, considerable weight is given to borrower performance on previous or existing loans and, in the case of new loans, to a borrower's record with other creditors.

To expedite the handling of a large number of loans, an auditor needs to develop skills in classifying loan files efficiently. This is best achieved by concentrating on the dividing line between "acceptable" and "substandard" loans. A majority of the "acceptable" loans can be recognized quickly by developing a systematic method of checking financial position, loan size, loan purpose, collateral, earnings and performance. An auditor shall learn to recognize these factors quickly and where a loan meets the "acceptable" standard, classify it as such and move on. Loss of time during an audit occurs most frequently in needless review of details on "acceptable" loans.

Loans other than "acceptable" will require the auditor's careful analysis in order to determine if there is a weakness or a potential weaknesses, the specific weaknesses involved, the loss exposure, if any, and the recommendations to be made. Loans misclassified (substandard, doubtful loss) usually comprise the core of credit problems and therefore require the auditor's precise evaluation.

#### 5.4.1 Other Considerations in Loan Classification

Other considerations in loan classification include the production conditions and price outlook at the time of audit. In projecting repayment prospects, due weight will be given to prevailing crop and pasture conditions and prices of the products from which repayment is expected. The effects of current developments upon the borrower's credit situation at the maturity of his loan need to be considered in classifying the loan. Weaknesses are to be recognized, whether they arise through neglect or other fault of the borrower, or are due to natural disasters beyond control (drought, fire, etc.)

Loans shall also not to be up- or down-graded on the basis of the quality of MRFC management or other credit personnel. Nor will loans be up- or down-graded for supervisory purposes. Recognition of good performance, or criticism for shortcomings of Managers and Loan Officers will be reflected in the auditor's overall comments and recommendations. Strength or weakness in management may also be given recognition in the auditor's comments and recommendations concerning individual loans.

#### **5.4.2 Adequacy of Recorded Information on Loans**

Adequate credit information will vary depending on the circumstances surrounding an individual loan. A Loan Officer is expected to assemble and maintain loan files containing all pertinent information needed to determine the soundness of the loan applied for, information developed through inspections and other field visits, and other contacts with the borrower. This file information will provide the basis upon which the auditor will classify the loan.

Some loans require special information such as periodic profit and loss statements, balance sheets, etc. The degree to which such information is obtained, the dependability of such data, and the analysis made by the Loan Officer are areas requiring the auditor's special attention.

When information needed to classify a loan is lacking, the auditor will ask the Manager or Loan Officer for any additional current information they may have. If the information is provided orally, the auditor will determine in each case the weight to be given to the oral statements.

In some instances it may be necessary for the Loan Officer to obtain a current field report to provide the information needed by the auditor. If the Agency

Manager does not take steps to provide the needed information, the auditor may decide to review the loan in the field himself.

### **5.4.3 Classifying two or more loans to one borrower**

Except in very unusual cases, the auditor will give the same classification to all the loans of one borrower who has two or more loans. An example of multiple loans is the borrower who has a crop production loan and term loan. The same credit factors are in all loans to the same borrower, except for possible collateral differences, and their relationship to his total line of credit should be the basis for loan classification. Any exception will only involve loans where some portion of the total line of credit is uncollectible.

## **5.5 Classified Loan Reporting**

### **5.5.1 Comments of Acceptable Loans**

Loans in this classification group will usually be identified on the "listing sheet" without adding any comment. Large or complicated loans may warrant comment if the auditor sees areas in which the credit administration is not adequate. Care must be exercised to limit comments to those beneficial in future handling of the

loan. Any comment that serves only to justify the classification should be omitted.

Acceptable loans will usually be the largest portion of a loan portfolio. It includes loans of top quality and those having minor credit weaknesses. No attempt will be made to isolate weaknesses on individual loans, however, the group as a whole requires a broad analysis.

#### **5.5.2 Comments of Special Mention Loans**

Loans in this group will be identified on the "listing sheet" without adding any comment. The auditor needs to be alert as the audit progresses to note trends of credit administration weakness or credit risk. These trends will be summarized in the narrative section of the report. Where a certain weakness or risk is found in many loans, reference to examples which show this factor may be included in the comments. Care should be taken to avoid developing this into a long report which might defeat its purpose.

The auditor's analysis of the credit quality for "Special Mention" loans needs to be tailored to conditions in the Branch or Agency being audited. Where preceding audits and past history show sound management and satisfactory credit

quality, a minimum of analysis and only a brief comment is necessary. Where unsatisfactory trends were observed, or weaknesses are known to exist, a substantial analysis and a detailed report may be necessary. The auditor shall be alert in all areas but the following shall especially be noted: significant negative trends, extent to which large loans predominate portfolio, and financing of specialized operations which increases risk.

### **5.5.3 Comments of Substandard Loans**

A major purpose of credit audits is to identify all "Substandard" loans which the auditor believes have major credit weaknesses requiring more than normal supervision. The auditor will need to comment on each loan in this group in order to define what the major weaknesses are and when to either make recommendations to improve the loan or to work out of the loan completely.

Comments will be written on a memorandum in sufficient copies for the Loan Officer to place a copy in the loan file to aid in future loan handling. Comments shall also be concise, relate to important credit weaknesses without reciting needless history, and include constructive recommendations for servicing. When loans reach the stage where there has been sufficient deterioration in financial position and collateral status, the auditor's analysis of these factors is important.

Comments will reconcile the changes which have occurred since the loan was made. Recommendations will be made to improve servicing, aid in avoiding loss, and to identify other major credit weaknesses.

#### **5.5.4 Comments of Doubtful and Loss Loans**

Careful evaluation will be made of any deterioration occurring in the repayment capacity and collateral values of "Doubtful and Loss" loans. It will be necessary for the auditor to discuss these loans with a Credit Supervisor or Senior Loan Officer to be certain the most current facts have been recognized. The auditor's comments will be written on a memorandum form, with a copy for the loan file.

#### **5.6 Methods Of Computing Estimated Losses**

In estimating loan losses and recommended charge-offs, the auditor will first determine the borrower's total indebtedness. This consists of the unpaid principal, the accrued interest and any account receivable or other loan fees. Estimates will then be made of the repayment amount from current production (if any), collateral values when sold by MRFC, other resources of the borrower which can be attached, and from the assets of any endorser or guarantors. The difference will constitute the auditor's estimate of the total loss.

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In making the above evaluation, a very careful analysis will be made of the liquidating value of assets under lien, and the degree to which other claimed assets of the borrower and those of endorser and guarantors can be attached for collection. Consideration will also be given to the probable date of sale, necessary collection, maintenance or handling costs, additional production costs, legal fees, loss of inventory and depreciation. While recognition can be given to a Loan Officers ability to negotiate advantageous liquidation, an auditor must make these estimates of loss on the basis of the current situation and cannot give weight to speculative values or the possibility of support from relatives or individuals, such as other club members, who are not legally obligated.

#### **5.6.1 Partial Charge-off**

As long as a possible source of repayment remains, the auditor will recommend a partial charge-off of principal in an amount which will reduce the total liability to an amount believed to be collectible.

When a loss is determined, the auditor should recommend transferring the loan out of the active loan ledger to eliminate the further accrual of interest which would be uncollectible.

### **5.6.2 Full Charge-Off**

When further repayment of a loan is not expected, a full charge-off will be recommended. The Agency Office is expected to continue its efforts to collect on any charged-off items until all likelihood of recovery is exhausted.

Where a partial charge-off exists, the amount of charge-off to be recommended under this section will be the balance necessary to liquidate the remaining principal, accrued interest and accounts receivable.

### **5.7 Summary For Report Purpose**

When loan classification work is completed, "listing sheets" will be compiled to obtain information needed to complete the summary. In addition, a written summary will be developed for the narrative or comments section of the report.

### **5.8 Loan Classification Program**

The loan classification program will involve the following:

- a. An annual schedule of audits covering each Branch and Agency Office every six months shall be developed.
- b. A "cut-off" date will be chosen for the audit, usually at the end of a month to ensure a clear "tie-in" with the accounting records.
- c. A "listing sheet" showing the loans to be reviewed shall be prepared. This "listing sheet" will be prepared by the Lead Auditor with assistance from the Senior Accountant. It will show borrower balances as of the "cut off" date selected for the audit.
- d. The loan files shall be reviewed and classified according to the instructions in this manual. The auditors decisions shall be documented on the "listing sheet" in every case.
- e. The results of the audit will be shown in the Credit Audit Report.

## **5.9 Credit Audit Report**

Following the completion of each credit audit, a "Credit Audit Report" must be written. This report will provide a brief summary of the credit quality plus a comprehensive

summary of the credit administration of the office involved. A copy of the report shall be given to the MRFC General Manager, Deputy General Manager, Lending as well as the Manager of the office audited.

**5.9.1 Report Format - The audit report shall follow the following format:**

**Scope.** This section describes in narrative form the purpose and scope of the audit. It briefly states what the audit team set out to achieve and what the audit covered. It serves as a road map and helps the reader understand what to expect from the rest of the report. The nature and extent of the audit will be summarized in this section of the report. Any limitations of the audit are also identified here, as well as areas which were not audited. Comments regarding credit operations will be consolidated.

**Introduction.** The introduction identifies the type of audit conducted, organization of audit, references the findings or recommendations in prior reports with their current status, and provides brief background information on the office being audited.

**Summary.** This area provides a management or executive summary of the audit results. It summarizes overall conclusions, results, and findings of the audit.

General comments will be used to summarize the audit, including the priorities of concerns in credit operations. This will help to direct managerial attention to matters needing improvement on a priority basis. For further information, the reader will be directed by references to additional details located elsewhere in the report.

Findings and Conclusion. This section details major findings, conclusions, comments and recommendations. A major finding is a factual statement which has a significant impact on the credit operations. Findings are necessary to support conclusions and recommendations included in the report. Findings are the results of inquiries and investigations and are facts produced by the auditor's efforts and field work. Findings may be favorable or unfavorable and explain satisfactory conditions that warrant explanation in the report, or unsatisfactory conditions that need correcting.

Audit findings are based on the following common attributes:

- a. Condition: What actually exists? What was found?
- b. Criteria: What should exist based on laws, policies, standards, measures, or expectations?

- c. Cause: What are the reasons for the difference between the expected and actual conditions? Why does the difference exist?
  
- d. Effect: What is the impact of the difference or deviation? What is the cost, risk, or exposure to MRFC because the condition is not the same as the criteria?
  
- e. Recommendation: What is to be done? What actions should be taken to correct existing conditions or improve operations?
  
- f. Management Response: Does management recognize the condition? Do they agree with the cause? How will the difference or deviation be corrected? Do they concur with the recommendation?

The first paragraph of the "Findings" section will list those audited areas where there are no significant findings to report. Findings will be listed in order of importance determined by the auditor. The sequence of findings should correspond to the sequence used in the "Summary" section.

**5.9.2 Sample Format**

**CREDIT REVIEW REPORT**

(Name of Office)

**CREDIT AUDIT REPORT**

As of \_\_\_\_\_

(cut-off date)

**Summary of Credit Quality:**

<u>Classification</u>	<u>Number of</u>		<u>Amount of</u>	
	<u>Loans</u>	<u>%</u>	<u>Loans</u>	<u>%</u>
Acceptable	_____	_____	_____	_____
Special Mention	_____	_____	_____	_____
Substandard	_____	_____	_____	_____
Doubtful	_____	_____	_____	_____
Loss	_____	_____	_____	_____
Totals	=====	=====	=====	=====

**Scope:** (as explained above)

**Introduction:** (as explained above)

**Summary:** Comments will be based on observations contained in the credit administration and loan classification audit. The comments will reflect conclusions related to: performance in loan administration, adherence to MRFC policies and procedures, consistency and adequacy of credit procedures, performance in credit operations (role of Management), and collection practices.

### **5.9.3 Credit Administration**

Credit Administration is the management of the extension of credit and is composed of five major areas: (1) Information gathering; (2) Verification and reconciliation of loan information; (3) Analysis of loan information; (4) Loan decision, consistent with items listed above; and (5) Supervision and control of loans by Loan Officer.

These areas are basic to the day-to-day decision making or problem solving process. The negative classification of loans is the effect of either weak credit administration or uncontrollable factors such as economic or climatic conditions. Since credit administration is a controllable element of determination in credit quality, the emphasis of the credit audit is placed on the analysis and reporting of the credit administration. Good credit administration is necessary if sound and constructive credit is to be extended.

Although the credit administration is audited through a sample group of loans, an evaluation of credit administration is based on all the loans audited.

To facilitate the structure and simplify the terminology used in the credit audit report, all topic areas related to "credit administration" and "credit operations"

will fall under the general heading "credit administration". In communicating the observations, the positive as well as negative aspects of credit administration are reported. Areas which are found to be deficient will include a brief explanation regarding the effect of the deficiency.

**5.9.4 Steps in Extending Credit:** The steps in extending credit are as follows:

Information gathering. This refers to the level of information needed for analysis. The documentation of detailed data will provide sufficient information for the verification and analysis of credit factors required to make a sound constructive credit decision.

Verification and reconciliation. This investigation process provides assurance that the pertinent information used in the decision and control steps is valid.

Any steps taken to verify file data or reconcile information or inventories shall be documented in the loan file through comments or on specific forms. In reporting on performance in the area of verification, an overview of the office procedures is presented. Weaknesses noted in procedures will be commented on if they have a significant affect on administration. When weaknesses in verification are identified, examples will be cited to illustrate these areas.

Analysis. These activities involve the separation and evaluation of the credit elements in their component parts, and ultimately lead to the basis for a decision. The level and depth of analysis of the credit elements essential to the credit decisions will be commensurate with the size, quality, and complexity of the operation.

Loan Decision. The proper credit analysis of pertinent information will provide the foundation for a final loan decision. An appraisal of the basis for approval involves evaluating whether the loan decisions are consistent with the analysis and if the credit terms correspond to the size, quality, and complexity of the loans. The evaluation also includes the level of documentation in the credit file and communication of loan terms to the borrower.

The identifiable basis of approval will be consistent with the analysis. Credit decisions that are frequently inconsistent with credit conditions should be commented on.

Supervision and Control These activities provide for the monitoring of loans to insure compliance with the loan agreement and the timely initiation of appropriate action to correct significant deviations. The purpose in evaluating the supervision

and control of loans is to ensure the Loan Officer has supervised loans as required by the size, complexity and quality of individual loans.

Credit Management. This is the management and supervision of the lending operation. An overall evaluation of credit management is included as part of the credit audit report.

### **5.10 Adversely Classified Loan Reports**

During the process of classifying loans a certain number may be adversely classified (i.e., classified substandard or lower). Each time a loan is adversely classified an individual loan report must be prepared. Copies of the "problem loan report" and "loss loan report" forms follow. Both forms are self-explanatory.

**Problem Loan Report:**

<u>Substandard Loan</u>		_____
		(cutoff date)
_____	_____	_____
(Name of Borrower)	(Branch)	(Agency)
_____	_____	_____
(Borrower Number)	(Balance)	(Maturity)

Comments:

(point out major weaknesses, inept loan administration, other important issues as appropriate)

Recommendations:

(recommendations for correction or improvement and future handling of loan)

\_\_\_\_\_  
Name of Credit Auditor

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**Doubtful and Loss Loans Report:**

_____	_____
(Branch)	(Agency)
Borrower(s) Name:	_____
Loan No.	_____
Principal Balance Outstanding:	_____
Accrued Interest:	_____
Other Charges (Describe):	_____
Total:	_____
Less Repayments:	_____
Other repayment sources:	_____
	_____
	_____
	_____
Debt after repayment:	_____
Existing Partial Charge-off:	_____
Additional Charge-offs:	_____

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FINANCIAL POSITION

Date: \_\_\_\_\_

Assets: \_\_\_\_\_

Debts: \_\_\_\_\_

Net Worth: \_\_\_\_\_

\* Comment on loan soundness and analyze extent could legally attach to collect loan.

COLLATERAL:

(List all collateral by unit type, value per unit, and value of each type. Prepare and attach separate list of equipment and livestock; value each piece, and list make, year, age, condition, etc.)

Total: \_\_\_\_\_

\* Comment below on date of appraisal or inspection and audit reliability of values.

COMMENTS

(Brief history leading up to the deterioration of the loan.)

(Point out weaknesses.)

(Analysis of loan administration.)

(Recommendations for getting maximum results.)

(Describe procedures used to estimate amount of loss.)

\_\_\_\_\_  
Date/Name of Credit Auditor

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Name of Director of Audit

\_\_\_\_\_  
Signature

## **6.0 Accounting and Finance Audits**

The MRFC Internal Audit Department will also audit the Accounting and Finance functions. This is in addition to the audit performed by independent external auditors. The primary purpose is to insure compliance with MRFC Accounting and Financial policies and procedures. This will provide the Board and Management assurance of the internal control system.

### **6.1 Scope of Audit**

The scope of audit will include all accounts and systems of the MRFC. Reports and work papers will be in accordance with the Internal Audit Policy within this Manual. The headquarters systems and activities, including investments, will be audited at least annually six months after the external audit.

Audits of Branch and Agency offices will be semi-annual. They may be performed with the credit audit or be scheduled separately at the option of the Chief Internal Auditor. The audits will focus on the cash collection system, remote bank accounts, controlled documents and compliance with accounting procedures and systems. Source documents will be tested for accuracy of the data entry function. A sample of loan ledgers will be confirmed with the borrower.

The audit procedures for the Loan Accounting system is within the MIS manual. This audit program will verify loan balances, interest accrual, and the borrower's loan ledger.

## **6.2 Assets**

### **6.2.1 Cash**

Cash is the most liquid asset of the MRFC and as such requires the most compressive audit program. The cash collection and transfer systems at the Agency and Branch offices will be within the scope of each Internal Audit. The audit program may be expanded, but will include the following:

- a. Count and reconcile the petty cash fund. Insure that expenditure receipts are valid and accounted for. Insure expenditures have been under MK100 and under MK200 with special authorization. Review for the weekly surprise cash count by some one other than the custodian.
- b. Review and test in-coming mail procedures. Review the mail register and insure payments are properly endorsed and receipted. Mail should be opened in the presence of at least two MRFC personnel.

- c. Reconcile all bank accounts and agree with the cash book and the general ledger balances. Follow up on the in-transit deposits and any checks outstanding for a longer than normal period. Review any unusual reconciling items. Review the daily cash reconciliation. Insure that bank statements are forwarded to MRFC by verifying the address on the bank statement. Periodically the monthly reconciliation should be performed by someone other than the assigned person.
  
- d. Review bank books for timely remote deposits. Match daily receipts to recorded deposits and the daily cash summary. Review the cash transfers from remote POSB to the Headquarters account. Explain any unusual delays.
  
- e. Account for all receipt books, insuring books are issued in accordance with established procedures. Review and account for receipt audit copies. Insure that all cash is correctly receipted. Trace receipts to bank deposit slips, bank statements, the office daily receipt summary and the general ledger. Test receipt book issue procedures. Loan Officers should not have more than two books at any time. Note date of receipts and date of deposit and reconcile differences.

- f. Review a sample of cash disbursements. Insure that payments were authorized, a payment voucher completed and within policy. The majority of payments should be from the operating bank account. Payments above MK200 should be with a cheque and below MK200 from the petty cash fund.

### 6.2.2 Investments

Excess MRFC funds should be invested in interest bearing assets within the board policy. Investments will be acquired with funds from the central finance bank account. Audit steps include:

- a. Review the investment register, insure that they are within the board policy. Note maturities and rates of return. Insure maturing investments are timely reinvested at maturity. Explain any unusual areas.
- b. Reconcile the investment register to the general ledger. Review past monthly reconciliation, noting any unusual reconciling items.
- c. Review the income account for timely recording of investment income. Review for the best rate of return and explain any differences for

accepting a low return. Test to see if rates of return are negotiated, if possible.

### **6.2.3 Loans**

Loans are the primary asset of MRFC. Internal audit procedures for loans are to insure disbursements and repayments are recorded in a timely manner, from source documents. In addition, legal documents showing the member liability, guarantor statements and collateral documents are properly safe guarded. Internal audit procedures include:

- a. Reconcile the loan ledger to the general ledger and explain any differences.
- b. Insure that loan disbursement and repayments are recorded on a timely basis. Disbursements should be recorded the date inputs or loan proceeds are received by the borrower. Repayments should be recorded the date of the bank deposit. Explain any unusual delays.
- c. Review a sample of legal documents for proper acknowledgement by the borrower. Insure that legal documents are properly safe guarded in a fire

proof vault. The custodian should maintain a legal document register, listing all documents within the safe. Review collateral documents for term loans, insure that they have been recorded with the Register General.

- d. Confirm a sample of loan balances with the borrower. Contact the Club Treasurer or individual borrower to verify the loan balance. Explain any differences and follow up on any negative replies.

#### **6.2.4 Accounts Receivable**

Accounts receivable due from others should not include amounts due from borrowers. These amounts should be recorded in the loan ledger. Internal audit procedures include:

- a. Reconcile the accounts receivable subsidiary ledger to the general ledger and explain any differences. review the past several months for any unusual reconciling items.
- b. Complete an accounts receivable aging. Explain amounts due more than 60 days.

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- c. From a detailed listing, review for amounts due from borrowers and explain any balances. Review for delinquent amounts due from employees and insure that the amount is within MRFC policy.
- d. The Lead Auditor may consider confirming accounts receivable over a stipulated amount or any unusual balance.

#### **6.2.5 Fixed Assets**

Fixed assets consist of buildings, leasehold improvements, fixtures, vehicles, etc., that are depreciated over time. They should be identifiable and inventoried at least annually. Depreciation should be periodically recorded within the authorized schedule. Internal audit procedures include:

- a. Reconcile fixed asset subsidiary ledger(s) to the general ledger.
- b. Review purchases for proper approvals, noting any unauthorized expenditures. Insure that the subsidiary ledger reflects the correct value. Review expense accounts for fixed assets that may not be properly recorded.

- c. Review the most recent physical inventory(ies). Note any differences and the Managers action. Insure that fixed assets are marked to identify them as MRFC property and to trace to subsidiary ledgers.
  
- d. Review the depreciation schedules. Insure that the depreciation rate is within the authorized schedule. Review periodic accounting entries for timely recording of the depreciation expense. Some low value items may be expense, but are recorded on the fixed asset register for control purposes.

### **6.3 Liabilities**

The primary liabilities of the MRFC are interest bearing term liabilities, trade payables, and the payroll. Liabilities should be recorded when recognized and paid when due. Scheduled payments may be coordinated with the Financial Manager to properly forecast the cash position.

#### **6.3.1 Notes Payable**

Notes payable is the largest liability of the MRFC. Interest is accrued monthly and paid when due. Internal audit procedures include:

- a. Reconcile the note payable register to the general ledger and explain any differences.
- b. Verify the interest accrual and expense calculation for the past three months. Insure that the expense was properly recorded and that timely payments were made when authorized.
- c. Periodically the balance(s) should be confirmed by the Chief Internal Auditor.

### **6.3.2 Trade Payables**

Trade payables occur within the normal course of business. Generally, they are non-interest bearing and some vendors may have a discount for early payment. Internal audit procedures include:

- a. Reconcile the trade payable subsidiary records to the general ledger, noting any unusual reconciling items.

- b. Perform an aging of trade payables. Explain any amounts not paid over 30 days. Review past payments for proper authorization and compliance with MRFC policy.
  
- c. Identify if vendors offered a discount for early payment, but was not taken and explain the reason.

### 6.3.3 Payroll

The payroll may have a separate bank account. The payroll will include only MRFC employees and will be used to record the periodic salary payments. Internal audit procedures include:

- (1) Reconcile the payroll register to the general ledger. Insure that the salary expense is properly recorded. Payroll deductions, if any, will be recorded as a liability until paid.
  
- (2) Identify the employees listed on the payroll register.
  
- (3) Verify the sairy of employees is the amount approved by Management. Note any unusual or additional payments to employees.

- (4) Verify the calculation and payment of any employee payroll deductions.  
Insure that the deductions were authorized in writing by the employee.

#### **6.4 Capital Accounts**

Capital accounts consist of retained earnings and the general ledger accounts uses to record the issuance of MRFC equities. Internal Audit procedures will verify the balances are fairly stated. Internal audit procedures include:

- a. Reconcile the MRFC equity (stock) subsidiary ledger(s) to the general ledger. Insure that issued stock is within the Board policy. Review the ownership record to insure all shares reflect the proper owner.
  
- b. Review the activity in the retained earnings general ledger account. Insure that recorded amounts agree with the statement of income. Identify and explain any unusual adjustments.

#### **6.5 Investigation of losses**

Once there is a suspicion of a loss, the Chief Internal Auditor should be called in and send an audit team to investigate the matter. If there is the need for further investigation

the Chief Internal Auditor should send the members of Internal Audit team to confirm the loss and all circumstances surrounding the loss. After this investigation, a loss report must be produced and sent to MRFC for presentation to the Audit Committee of the Board of Directors, the General Manager, and the Chief Financial Controller.

If theft is suspected the police must be informed. In cases where a loss has been reported to police, it is the police who will hand the case over to the court. Court proceedings will be forwarded to the Branch where it can then be recommended for write-off, depending on circumstances.

**ANNEX:****AUDIT DEPARTMENT JOB DESCRIPTIONS**

The following job descriptions allow for different levels of ability and experience in a proposed MRFC credit audit department. It should be noted that many of the duties in each job description will apply at the MRFC/HQ level only from the viewpoint of an overview supervisory standpoint. For example, the MRFC staff auditors will not be expected to perform complete Branch level audits, although they should know how to do the job. They will be expected to be able to develop policies, programs, methods and procedures. And to be able to test those systems in the field. They will also be responsible for the follow-up and supervision of MRFC Branch credit audit programs.

If all of the jobs are not going to be used then some duties will have to be combined to ensure all necessary jobs are performed. All are full-time positions!

The normal structure is as follows:

Chief Internal Auditor

Senior Internal Auditor

Internal Auditor

Associate Auditor

Assistant Auditor

## **A. CHIEF INTERNAL AUDITOR**

The Chief Internal Auditor's position is a key position. As such it is vital that it be staffed by a full-time Manager. He is responsible for auditing all aspects of MRFC credit operations and reporting the findings to Senior Management.

### **1. Purposes:**

The purposes of this position is to administer the credit audit activities in all the Branch Offices; to develop a comprehensive practical program of credit audit coverage; to accomplish the credit audit program in accordance with acceptable standards and schedules; and to maintain effective working relations with executive and operating management.

### **2. Authority and Responsibility:**

- (1) Prepare a comprehensive, long range program of audit coverage.
- (2) Identify those activities subject to audit coverage, evaluate their significance and assess the degree of risk in each activity in terms of cost, efficiency and effectiveness.

- (3) Establish the audit department structure.
- (4) Obtain and maintain an audit staff capable of accomplishing the audit function.
- (5) Assign audit areas, staff and budget to assistants.
- (6) Develop a system of cost and schedule control over audit projects.
- (7) Establish standards of performance for the audit department and by review, determine that performance meets standards.
- (8) Provide senior management with reports on audit coverage and the results of audit activity, and interpret these results to improve the audit program and coverage.
- (9) Establish and monitor accomplishment of objectives directed toward increasing the audit department's ability to serve management.

**3. Reports to: MRFC General Manager**

## **B. SENIOR INTERNAL AUDITOR**

### **1. Purposes:**

To develop a comprehensive, practical program of credit audit coverage for assigned areas of credit audit in the branches; to supervise the activities of auditors assigned to the audit of various organizational and functional activities; to ensure conformance with acceptable audit standards, plans, budgets and schedules; and to maintain effective working relations with operating management.

### **2. Authority and Responsibility:**

- (1) Under the general guidance of the Chief Internal Auditor.
- (2) Supervises the work of auditors engaged in the credit audits of organizational and functional activities in the assigned Branch Office.
- (3) Provides a comprehensive, practical program of annual audit coverage within general areas assigned by the Chief Internal Auditor.

- (4) Determines areas of risk and appraises their significance in relation to operational factors of cost, schedule, and quality. Classifies loans as to degree of risk and significance and as to frequency of coverage.
- (5) Provides for flexibility in audit programs so as to be responsive to management's special needs.
- (6) Schedules projects and staff assignments so as to comply with management's needs, within the scope of the department's overall program.
- (7) Audits and approves the purpose, scope, and approach of each audit project for assigned areas of audit coverage.
- (8) Directs audit projects to see that professional standards are maintained in the planning and execution and in the accumulation of data.
- (9) Counsels and guides credit auditors to see that the approved audit objectives are met and that adequate, practical coverage is achieved.
- (10) Reviews and edits reports and, in company with the auditor-in-charge for the assigned project, discusses the reports with appropriate management.

- (11) Presents oral briefings to branch and headquarters staff.
- (12) Provides for and performs research on audit techniques.
- (13) Provides formal plans for the recruiting, selecting, training, evaluating, and supervising of staff personnel. Develops manuals and other training aids.
- (14) Accumulates data, maintains records, and prepares reports on the administration of audit projects and other assigned activities.
- (15) Identifies factors causing deficient conditions and recommends courses of action to improve the conditions, including special surveys and audits.
- (16) Provides for a flow of communication from operating management to the staff of the audit department. Assists in evaluating overall results of the audits.

**3. Reports to: Chief Internal Auditor**

## C. INTERNAL AUDITOR

### 1. Purpose:

To conduct credit audits of assigned organizational activities; to evaluate the adequacy and effectiveness of the management controls over those activities; to determine whether organizational units in the Branches are performing their credit activities in compliance with the credit management instructions, applicable statements of policy and procedures, and in a manner consistent with both MRFC objectives and high standards of administrative practice; to plan and execute audits in accordance with accepted standards; to report findings and to make recommendations for correcting unsatisfactory conditions, improving operations, and reducing cost; to perform special credit audits at the request of management; and to direct the activities of assistants.

### 2. Authority and Responsibility:

- (1) Surveys functions and activities in assigned areas to determine the nature of operations and the adequacy of the system of control to achieve established objectives.
- (2) Determines the direction and thrust of the proposed audit effort.

- (3) Plans the theory and scope of the audit, and prepares an audit program.
- (4) Determines the procedures to be used, including statistical sampling and the use of electronic data processing equipment.
- (5) Identifies the key control points of the system.
- (6) Evaluates a system's effectiveness through the application of a knowledge of business, including credit and other operations, and his understanding of audit techniques.
- (7) Recommends necessary staff required to complete the audit.
- (8) Performs the audit in a professional manner and in accordance with the approved audit program.
- (9) Obtains, analyzes, and appraises data as a basis for an informed, objective opinion on the adequacy and effectiveness of the system and the efficiency of performance of the activities being audited.

- (10) Directs, counsels and instructs staff assistants assigned to the audit, and reviews their work for sufficiency of scope and for accuracy.
  
- (11) Makes oral or written presentations to management during and at the conclusion of the audit discussing deficiencies and recommending corrective action to improve and reduce cost.
  
- (12) Prepares formal written reports, expressing opinions on the adequacy and effectiveness of the system and the efficiency with which activities are carried out.
  
- (13) Appraises the adequacy of the corrective action taken.

3. Reports to: Senior Internal Auditor

**D. ASSOCIATE AUDITOR****1. Purpose:**

To conduct or assist in conducting audits of assigned organizational and functional activities; to evaluate the adequacy and effectiveness of the management controls over those activities; to determine whether organizational units are performing their credit activities in compliance with management instructions, applicable statements of policy and procedures, and in a manner consistent with both objectives and high standards of administrative practice; to plan and execute complete audits of limited assignments, or conduct audits of portions of extensive assignments, in accordance with accepted professional standards; to report findings and to make recommendations for the correction of unsatisfactory conditions, improvements in operations, and reductions in cost; to perform or to assist in the performance of special audits at the request of management; to direct, when applicable, the activities of assistants.

**2. Authority and Responsibility:**

- (1) Surveys functions and activities in assigned areas to determine the nature of operations and the adequacy of the system of control to achieve established objectives. Identifies the key control points of the system.

- (2) Determines or assists in determining the direction and thrust of the proposed audit effort. Determines or assists in determining the audit procedures to be used.
- (3) Plans or assists in planning the theory and scope of the audit, and prepares or assists in preparing audit programs.
- (4) Performs the audit in a professional manner and in accordance with the approved audit program.
- (5) Obtains, analyzes, and appraises data as a basis for an informed, objective opinion on the adequacy and effectiveness of the system and the efficiency or performance of the activities being audited.
- (6) Makes, or assists in making, oral or written presentations to management during and at the conclusion of the audit discussing deficiencies, recommending corrective action, and suggesting improvements in operations and reductions in cost.
- (7) Prepares formal written reports, as requested, expressing opinions on the adequacy and effectiveness of the system and the efficiency with which activities are carried out.

- (8) Appraises, or assists in appraising, the adequacy of the corrective action taken to improve deficient conditions.

**3. Reports to: Internal Auditor**

**E. ASSISTANT AUDITOR****1. Purpose:**

To verify and analyze transactions and representations while conducting audits of assigned organizational and functional activities; to evaluate the adequacy and effectiveness of the management controls over those activities; to assist in determining whether organizational units are performing their credit activities in compliance with management instructions, applicable statements of policy and procedures, and in a manner consistent with both objectives and high standards of administrative practice; to prepare working papers showing the results of the audit.

Also, to report findings on the results of the audit and to make recommendations for the correction and unsatisfactory conditions, improvements in operations, and reductions in cost; and to assist in the performance of special audit at the request of management.

**2. Authority and Responsibility**

- (1) Assists in determining records or activities to analyze the extent of tests to apply, and the working papers to prepare.

- (2) Assists in performing the audit in accordance with the approved program in a professional manner.
- (3) Recommends the means of obtaining, analyzing, and evaluating data as a basis for an informed, objective opinion on the adequacy and effectiveness of the system of control and on the efficiency of performance of the activities being audited.
- (4) Reviews transactions, documents, records, reports, and methods for accuracy and effectiveness.
- (5) Prepares acceptable working papers which record and summarize data on the assigned audit segment.
- (6) Holds preliminary discussions of apparent deficiencies with operating personnel to verify facts and to obtain explanations of and reasons for such apparent deficiencies.

### 3. Reports to: Associate Auditor