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RATING SYSTEM

FOR

MICROFINANCE INSTITUTIONS

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To U S Agency for International Development
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The USAID-PRESTO Project is implemented under contract by
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CENTER FOR MICROENTERPRISE FINANCE (CMF)

Rating System for Ugandan MFIs
Version 1.0 March 1999

I. Overview

1. Purpose and Scope

The purpose of the rating system is to provide USAID Uganda with an objective measure of the quality of the microfinance institutions (MFIs) that have been provided with financing under the Financial Services Grant Program (FSGP) Although the Center for Microenterprise Finance (CMF) is currently providing training and technical assistance to many Ugandan MFIs, only MFIs that have passed USAID's due diligence ('Pre-Award Survey') are included in the rating This is because the rating, if it is to be meaningful, must be based on accurate financial statements and portfolio performance information Many MFIs obtaining services from the CMF are improving their accounting and loan tracking systems, but have not yet achieved a standard that will enable them to submit accurate and timely financial performance information in the FSGP quarterly reporting format (see Annex 1)

The scope of the assessment is limited to an analysis of quantitative performance indicators An alternative system, such as the ACCION CAMEL, uses a combination of quantitative and qualitative indicators to assess institutional performance Although qualitative assessment undoubtedly increases the depth of the analysis, it also substantially increases the human resources – both at the rating agency and the MFI – required to collect and interpret the data The CMF's intention is to establish a rating system that can be used to monitor performance across MFIs on a quarterly basis, and will facilitate the build up of an information base that will enable performance trends to be established Therefore, a system that involves extensive site visits four times a year is not appropriate for our purposes It should be noted that all MFIs that have received financial support from USAID Uganda have undergone a thorough appraisal by the CMF, and receive monitoring visits annually

2. Method

The CMF makes adjustments to the unaudited[1] quarterly financial statements and portfolio performance information submitted by the MFIs, and then performs ratio analysis on these revised statements Adjustments are made so that all MFIs can be compared according to the same standards The adjustments strip the MFI's financial statements of all subsidies, including interest rate subsidies, monetize and capitalize all donations and grants (rather than showing them as income on the Profit and Loss), and account for the effects of inflation on

[1] The statements are unaudited as they contain very recent information, but all grantees are required under FSGP to have their financial statements audited annually by a reputable firm MFIs submitting applications to FSGP must submit audited financial statements for the past three years

the capital base See Annex 2 Adjustments to MFI Financial Statements and Portfolio Information for a complete description of the adjustments made

The ratios used for rating the MFIs were identified through a review of recent literature on microfinance ratio analysis, and an assessment of CMF requirements The CMF is particularly indebted to ACCION International, whose revised CAMEL instrument provided us with valuable guidance Although ACCION's experience is based on the Latin American context which may not be directly applicable to Uganda, we used their scoring system when a better alternative based on the experience of MFIs in Uganda was not available To the best of our knowledge, there has not yet been an attempt to develop a rating system for African MFIs Several years of experience will be needed to fine-tune the CMF's system, and ratios and scoring will be adjusted periodically to reflect our increasing level of knowledge

3. Peer Groups

Even with adjustments to the financial statements and portfolio performance information, it is not appropriate to compare different types of microfinance institutions This is because of fundamental differences in methodology and institutional structure For this review, we have identified two peer groups banks and non-bank financial institutions (NBFIs) Banks differ substantially from NBFIs in their financing, because they can mobilize and intermediate deposits from the public, their real cost of capital in Uganda currently ranges between 2% and 6% NBFIs, on the other hand, cannot legally mobilize or intermediate savings, consequently, their lending capital must come from retained earnings, donations, and loans The adjustments to the financial statements value all loans at the market price, which is defined as the commercial lending rate Currently, this averages 20% in Uganda Therefore, banks have a decided advantage over NBFIs in terms of the profitability indicators

Even within the banking group, it can be argued that comparing Uganda's two banks engaged in microfinance is misleading Centenary Rural Development Bank is a bank that specializes in lending to the small and microenterprise sector, whereas Co-operative Bank is a commercial bank with six specialized microfinance agencies These agencies receive substantial support from the 'mother' bank in many areas, including personnel, finance and internal audit Therefore, a cost must be assigned for these services but the true value of this cost is difficult to determine In addition, the two banks use different methodologies Centenary provides loans to individuals, whereas Co-operative Bank provides loans through two different group mechanisms and is now beginning to introduce individual lending as a third product line Despite these differences, we have kept both banks within the same peer group, as a peer group with only one institution can only be compared to itself!

Three NBFIs have been included in the second peer group FINCA, FOCCAS and UWFT These MFIs have many similarities they are all specialized microfinance institutions registered as Companies Limited by Guarantee and they all offer financial services using a 'village banking' methodology However, FOCCAS's provision of health education to its groups would be expected to increase its costs compared to both FINCA and the Uganda Women's Finance Trust (UWFT), which only offer financial services FOCCAS also targets a rural clientele, which would be expected to be more costly to service than the urban and peri-urban clientele of FINCA and UWFT

As a result of these differences between the two peer groups, and the differences within the peer groups, the findings from this rating and ranking exercise should be viewed as provisional As the Center for Microfinance begins to build up a profile of each institution over the next two years, it will be possible to identify trends for each MFI This trend analysis for an individual institution may ultimately be more useful for decision makers than a comparison of ratios among institutions

4. Rating and Scoring System

Indicator	Maximum No of Points
Capital Adequacy	
Risk Assets / Equity	7
Loan Exposure	8
Adequacy of Loan Loss Reserves	5
Total points in category	**20**
Asset Quality	
Portfolio at Risk	10
Loan Write-off Ratio	10
Total points in category	**20**
Management	
Caseload No Clients per loan officer	5
Yield Gap	5
Operating Efficiency	7
Total points in category	**17**
Earnings	
Financial Self-Sufficiency	10
Adjusted Return on Equity	3
Adjusted Return on Assets	5
Total points in category	**18**
Liquidity	
Quick Ratio (for banks)	5
Expenses Indicator (for NBFIs)	5
Total points in category	**5**
Scale and Scope	
Number of Active Borrowers	4
Number of Savers	4
Average Loan Size	4
% Women	4
Dropout Rate	4
Total points in category	**20**
GRAND TOTAL	**100**

SECTION II. RATIOS AND INDICATORS

1. CAPITAL ADEQUACY

1.1 Risk Assets to Equity

This ratio compares the assets that the MFI has at risk with its capital base Banks are typically required to operate with a ratio of 12 5 or less this means that they can leverage up to 12 5 times their capital in deposits or other liabilities that are then put at risk in the market There is a growing convergence of views among microfinance experts that MFIs should operate within more conservative limits because of the potential volatility of a large number of short-term uncollaterized loans, the high operating costs associated with administering these loans and MFIs' limited ability to raise additional funds should a crisis erupt

The classification of risk assets which makes up the numerator of this ratio is shown in Table 1

Table 1 Asset Risk-Weighting	
Cash on hand and in banks	0%
Investments in short-term govt paper < 1 yr	0%
Reserves in central bank	0%
Other short-term market instruments < 1 yr	10%
Loan portfolio	100%
Other receivables	100%
Net fixed assets	50%
Long-term assets	100%

Source ACCION CAMEL (1998, Saltzman and Salinger)

The scores for the rating of risk-weighted assets to equity is shown in Table 2

Table 2 Rating - Risk Assets to Equity	
Scale	Range
7	Less than or equal to 6 0
6	6 1 – 7 0
5	7 1 – 8 0
4	8 1 – 9 0
3	9 1 – 10 0
2	10 1 – 11 0
1	11 1 – 12 0
0	Over 12 0

Source Modified from ACCION CAMEL (1998, Saltzman and Salinger)

1 2 Loan Exposure

This ratio assesses the extent to which loans which are at exceptional risk of default are covered by the MFI's capital Loans at exceptional risk are defined as those having payments overdue by 90 days or more The value of these loans are divided by the MFI's capital The scoring is shown in Table 3

Table 3 Rating - Loan Exposure	
Scale	Range
8	0% – 10%
7	11% - 20%
6	21% - 30%
5	31% - 40%
4	41% - 50%
3	51% - 60%
2	61% - 70%
1	71% - 80%
0	Over 80%

Source CMF

1 3 Adequacy of Loan Loss Reserves

This ratio compares the adjusted loan loss reserve after write-offs to the actual loan loss reserve shown on the MFI's books It shows the extent to which the MFI has been provisioning adequately for its potential loan losses

Table 4 Rating - Adequacy of Loan Loss Reserves	
Scale	Range
5	Over 80%
4	60% - 79%
3	40% - 59%
2	20% - 39%
1	1% - 19%
0	0%

Source of Rating ACCION CAMEL (1998, Saltzman and Salinger)

2 ASSET QUALITY

2 1 Portfolio at Risk (30 days)

Portfolio at Risk (30 days) shows the extent to which the loan portfolio is adversely affected by clients with overdue loans If a client has one or more payments that are 30 days or more late, then the entire loan is classified as 'at risk' Thus, it is a much more conservative ratio than the arrears rate which shows only the impact of late payments on the portion of the portfolio that is due or past due

Table 5 Rating - Portfolio at Risk (30 days)	
Scale	Range
10	1% or less
9	1 1 – 2%
8	2 1 – 3%
7	3 1% - 4%
6	4 1% - 5%
5	5 1% - 6%
4	6 1% - 7%
3	7 1% - 8%
2	8 1% - 9%
1	9 1% - 10%
0	Over 10%

Source of Rating CMF

2 2 Loan Write-Off Ratio

The loan write-off ratio shows the portion of the portfolio that has been written off, or should have been written off, in the past year The CMF makes an adjustment on the MFI's financial statements to provision for doubtful loans The provisioning guidelines used are shown on Table 6

Table 6 Provisioning Table		
Aging Status	% Provision Regular Portfolio	% Provision Rescheduled Portfolio
Current Loans	0%	
Rescheduled Loans		10%
Loans Past Due 1-30 Days	10%	50%
Loans Past Due 31-90 Days	30%	75%
Loans Past Due 91-180 Days	60%	100%
Loans Past Due > 180 Days	100%	100%
Loans in Legal Recovery < 180 Days	100%	100%

Source ACCION CAMEL

Loans past due more than one year must be written off This is a stricter standard than that commonly used by banks (two years past due) It is considered appropriate for MFIs because of the shorter loan term of the average micro-loan (typically four to six months) The scoring for the loan write-off ratio is shown in Table 7

Table 7 Rating - Loan Write-Off Ratio

Scale	Range
10	1% or less
9	1 1% - 1 5%
8	1 6% – 2 0%
7	2 1% – 2 5%
6	2 6% – 3 0%
5	3 1% – 3 5%
4	3 6% – 4 0%
3	4 1% - 4 5%
2	4 6% - 5 0%
1	5 1% - 5 5%
0	Greater than 5 5%

Source of Rating CMF

3 MANAGEMENT

3.1 Caseload. No. of clients per loan officer

Caseload measures management's capacity to develop an efficient methodology The number of clients that a loan officer services has a large impact on both the cost structure and income of an MFI

a) MFIs using the group lending methodology

MFIs in Uganda typically provide services to groups of clients, this is a cost-effective mechanism that allows MFIs to reach large numbers of clients at one time and to substitute group guarantees for individual collateral It is easier for MFIs working with clients in urban areas to reach large numbers of clients with a single loan officer than MFIs working in rural areas This is because of higher population densities and less time needed for travel to the group's meeting place However, MFIs working in rural areas do need to develop clusters of large groups so that interest rates can be kept at reasonable levels In order not to establish a bias against rural-oriented MFIs, the maximum rating in this category has been set to a level that rural-based MFIs with efficient operations should be able to attain

Table 8 Rating - Caseload for MFIs using group lending methodology

Scale	Range
5	300 or more
4	250 – 299
3	200 – 249
2	150 – 199
1	100 – 149
0	Less than 100

Source of Rating CMF

b) **MFIs using the individual lending methodology**

The caseload for the individual lending methodology can be expected to be lower than for the group methodology, because the loan officer visits individual clients rather than groups of clients MFIs using this methodology usually provide larger loans to a more affluent clientele than MFIs using the group methodology

Table 9 Rating - Caseload for MFIs Using individual lending methodology	
Scale	Range
5	150 or more
4	125 – 149
3	100 – 124
2	75 – 99
1	50 – 74
0	Less than 50

Source of Rating CMF

3 2 Yield Gap

The yield gap compares the MFI's actual earnings from interest and fees to its theoretical earnings It shows how effective management has been at maximizing returns, given the existing interest rate and fee structure

Table 10 Rating – Yield Gap	
Scale	Range
5	Less than 5%
4	6% - 10%
3	11% - 15%
2	16% - 20%
1	21% -25%
0	More than 25%

Source of Rating CMF

3 3 Operating Efficiency

The operating efficiency ratio answers the question "what does it cost the MFI to support the capacity required for managing the portfolio?" It compares operating costs with the average net outstanding loan portfolio for the same period Operating costs in this ratio include personnel, administrative, depreciation and overhead costs but exclude financial costs and loan loss provisions

If the ratio is high, it shows that the cost of operating is expensive for the value of the loan portfolio The management of the MFI could consider ways of reducing the costs of managing the same size of portfolio or ways of increasing the size and quality of the portfolio without increasing costs If neither of these options are possible, the MFI should ask itself whether it is cost-effective to remain in operation Management should wish to observe a decreasing trend of the operating efficiency ratio A decreasing trend means that the MFI is learning to manage the portfolio more efficiently The trend will be set back when new branches are opened because of the time lag between setting up the branch and attaining an optimum portfolio

This rating, like several others in the system, has been based on the experience of ACCION However, it is quite likely that the costs of operating are substantially higher in Uganda than they are in Latin America. Therefore, the CMF will track actual values for this indicator and adjust the rating periodically to reflect the realities of the local context A major factor contributing to high costs in Uganda is the tightness of the labor market for professional staff, and consequent wage inflation

Table 11 Rating - Operating Efficiency	
Scale	Range
7	Less than 20%
6	20% - 25%
5	26% - 30%
4	31% - 35%
3	36% - 40%
2	41% - 45%
1	46% - 50%
0	Above 50%

Source of Rating ACCION CAMEL (1998, Saltzman and Salinger)

4 EARNINGS

4 1 Financial Self-Sufficiency

Financial self-sufficiency indicates the MFI's ability to cover <u>all</u> its costs with income earned from interest and fees Costs are defined to include adjustments for inflation, in-kind or cash donations and interest-rate subsidies

Table 12 Rating - Financial Self-Sufficiency	
Scale	Range
10	100% or greater
9	93% - 99%
8	87% - 93%
7	80% - 86%
6	73% – 79%
5	66% – 72%
4	59% - 65%
3	52% - 58%
2	45% – 51 %
1	38% – 44 %
0	Less than 37%

Source of Rating CMF

4.2 Adjusted Return on Equity

The ultimate goal of commercial business is to ensure an acceptable return to equity owners The Return on Equity shows the MFI's ability to generate such a return for its investors Although Companies Limited by Guarantee do not have individual investors, they should also be seeking to generate a competitive return that can be ploughed back into the MFI for its future growth and sustainability The Return on Equity can be compared to alternative uses of investors' funds, such as investments in risk-free Treasury Bills The Adjusted Return on Equity used in this rating system accounts for donations and subsidies, as explained in 4 1 above but excludes inflation This enables the return to be compared to the inflation rate If the return is greater than the inflation rate, then the MFI is generating enough profit/surplus to maintain the real value of its capital The rating is based on this limited use of the ratio

Table 13 Rating - Adjusted Return on Equity

Scale	Range
3	Greater than or equal to the inflation rate
2	1% less than the inflation rate
1	2% less than the inflation rate
0	More than 2% below the inflation rate

Source CMF

MFIs set up as Companies Limited by Guarantee typically have different capital structures than Companies Limited by Shares because equity is usually donated rather than invested For this reason, the Return on Equity indicator is not a fair comparison of profitability across MFIs or for comparisons of MFIs with other organizations The table shown below illustrates several different debt and equity structures Given a particular level of profitability, the return on equity of a commercial bank (C) that is largely funded by deposits would be significantly higher than MFIs A and B that are not licensed to take deposits because the equity base is much smaller

Table 14 Examples of MFI Liability and Equity Structures

Type of Institution	A MFI	B MFI	C Commercial Bank
Equity	80%	60%	15%
Liabilities	20% (commercial loan)	40% (mostly soft loans)	85% (mostly deposits)

Source CMF

4 3 Adjusted Return on Assets

The Adjusted Return on Assets is a more appropriate indicator than the Adjusted Return on Equity for comparing the profitability of MFIs It measures the adjusted return in relation to the asset base of the organization rather than the portion that is funded by equity Therefore, it emphasizes the efficiency of asset use rather than capital structure

Table 15 Rating - Adjusted Return on Assets	
Scale	Range
5	Above 2 2%
4	1 6% - 2 1%
3	1 0% - 1 5%
2	5% - 9%
1	0% - 4%
0	Less than 0%

Source of Rating ACCION CAMEL (1998, Saltzman and Salinger)

5 Liquidity

Liquidity refers to a state of having sufficient liquid resources to pay expenses and meet debts as they fall due Liquid resources are those assets that are readily convertible into cash for meeting obligations They consist primarily of current assets Some current assets are easier to convert into cash than others Cash held in the MFI or at the bank is the most liquid asset followed by short term deposits The least liquid current asset is the loan portfolio

Liquidity indicators are especially relevant for institutions that mobilize and on-lend deposits It is essential for the credibility of the institution that these deposits are available to be returned to clients as and when agreed MFIs that only take 'compulsory' savings as a collateral substitute, and that block access to these savings until the end of the loan period (or even until the client leaves the program) have reduced needs for liquidity Therefore, two ratings need to be established one for MFIs that mobilize demand deposits, and another for MFIs that collect compulsory blocked savings only

5.1 Liquidity Ratio for MFIs mobilizing demand deposits

Common liquidity ratios are the current ratio and the quick ratio The Current Ratio is a rough measure of whether there are adequate current assets to cover current liabilities The current ratio does not indicate the urgency with which cash may be required For those with savings services, a more appropriate ratio is the quick ratio The Quick Ratio measures the ability to turn assets into cash quickly in order to meet short-term liabilities (mainly deposits)

Generally, the more liquid the current asset, the lower its return to the institution Cash held at the MFI earns nothing Cash held in a current or savings account at the bank earns relatively little as compared to term deposits which also earn less than loans to clients Thus excess liquidity reduces profitability On the other hand, inadequate liquidity is a threat to the operations of the institution Liquidity ratios will move up and down with daily transactions Management's concern should be that they do not fall below a certain level that is appropriate for an MFI's operations In a regulated environment particularly, frequent failure to maintain the minimum required liquidity could lead to the closure of a financial institution

Table 16 Rating - Quick Ratio For institutions that take demand deposits	
Scale	Range
5	200% or more
4	176% - 199%
3	151% - 175%
2	126% - 150%
1	100% - 125%
0	Less than 100%

Source CMF

5 2 Liquidity Ratio for MFIs mobilizing compulsory savings or no savings

MFIs without demand deposits need liquidity to pay expenses and the excess of loan disbursements over loan repayments The CMF's liquidity indicator for this type of institution compares quick assets with the sum of two months operating expenses and 10% of the loan portfolio

Table 17 Rating – Expenses Indicator For institutions that do not take demand deposits	
Scale	Range
5	100% or more
4	90% - 99%
3	80% - 89%
2	70% - 79%
1	60% - 69%
0	Less than 60%

Source CMF

6. Scale and Scope

6.1 Number of Active Borrowers

There are presently hundreds of thousands of micro and small-scale business people in Uganda who do not have access to financial services Consequently, the ability of an MFI to reach a significant number of these people is important In addition, MFIs that have a very small client base will have difficulty reaching sustainability because of insufficient revenues from interest and fees However, in order not to tilt the rankings in favor of very large MFIs, and recognizing the value that small to medium-sized MFIs may have, particularly in providing services to under-served areas, the maximum rating is given to any MFI with 5,000 or more clients

Note This rating scale is not appropriate for a village-based financial institution such as a credit union

Table 18 Rating - Number of Active Borrowers	
Scale	Range
4	5000 or more
3	3500 - 4999
2	2000 - 3499
1	500 -1999
0	Less than 500

Source CMF

6 2 Number of Savers

In most cases, the number of savers should be as great, or greater, than the number of borrowers We include as 'savers' those clients with compulsory savings as well as those with voluntary savings

Note This rating scale is not appropriate for a village-based financial institution such as a credit union

Table 19 Rating - Number of Savers	
Scale	Range
4	5000 and greater
3	3500 - 4999
2	2000 - 3499
1	500-1999
0	Less than 500

Source CMF

6.3 Average Outstanding Loan Size

Microfinance in the context of the PRESTO Project is defined to include those micro-entrepreneurs whose average outstanding loan size is less than U S $1,000 Poverty lending programs typically target those whose needs are well below that ceiling The highest rating has been given to those MFIs that target relatively poor, economically active individuals Loan size is a useful if inexact proxy for the poverty level of borrowers It is also a proxy for the length of time in the program, as loan size tends to increase with each loan cycle

Table 20 Rating - Average Outstanding Loan Size	
Scale	Range
4	Less than $500
3	$ 500 - $749
2	$ 750 - $999
1	$ 1,000 - $1,249
0	$1,250 or more

Source CMF

6 4 Percent Women

Women are considered to be less advantaged members of society than men, not only in Uganda but also around the world They also tend to be better clients than men, using their loans for the intended purpose and repaying according to schedule Impact studies have shown that women spend most of their earnings from their micro-businesses on the health and welfare of their children However, the rating system recognizes that MFIs should also try to identify creditworthy men and include them in their programs, therefore, the maximum rating for this indicator has been set at 70%

Table 21 Rating - Percent Women	
Scale	Range
4	70% or greater
3	55 – 69%
2	40 – 54%
1	25 - 39%
0	Less than 25%

Source CMF

6 5 Dropout Rate

The dropout rate provides an indication of the MFI's ability to serve the needs of its clients Clients that drop out often are dissatisfied by the facilities offered by the MFI

Table 22 Rating - Dropout Rate (per annum)	
Scale	Range
4	Less than 5% per annum
3	5 – 10% per annum
2	11 – 15% per annum
1	16 – 20% per annum
0	More than 20% per annum

Source CMF

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PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

ITEM	ACCOUNT	BALANCE THIS QUARTER UGSHs	DESCRIPTION
1a	Cash and bank		All sight deposits current accounts petty cash accounts and cash on hand
1b	Investments in short term market instruments		All interest bearing deposits and investment in financial instruments mostly for the purposes of liquidity management due within 90 days
1c	Reserves in central bank		Relevant only for licensed financial intermediaries
1d	**TOTAL QUICK ASSETS**		Sum of lines 1a 1b and 1c
1e	Current loan portfolio		Total of the loans outstanding to clients that are due within one year including past-due accounts
1f	(Loan loss provision)		A contra asset account reflecting the reserves set aside for possible loan losses
1g	Accrued interest		Appropriate only for institutions that use accrual based accounting for income
1h	Other short term assets		Variety of accounts including loans to employees prepayments and accounts receivable This includes investments in market instruments maturing in a period greater than 90 days and less than one year
1i	**TOTAL CURRENT ASSETS**		Sum of lines 1a through 1h
1j	Long term portion of loan portfolio		Loans or portions of loans that are due in more than one year
1k	Long term investments		Shares in other entreprises and other long term illiquid assets that earn returns This includes investments in market instruments maturing after one year
1l	Land buildings and leasehold improvements		The value of land buildings and leasehold improvements net of accumulated depreciation on buildings and leasehold improvements
1m	Vehicles and equipment		Vehicles and equipment net of accumulated depreciation
1n	**TOTAL LONG TERM ASSETS**		Sum of lines 1j through 1m
1o	**TOTAL ASSETS**		Line 1i plus line 1n
2a	Voluntary savings		Savings with no withdrawal restrictions They should only be included if they are available to the program to be on lent or invested They should be excluded if they are accumulated and/or deposited in commercial bank accounts that are not in the name of the institution
2b	Compulsory savings		Appropriate only for those programs that require clients to save a pre-determined amount in order to qualify for a loan These savings should only be included if they are available to the program to be on lent or invested They should be excluded if they are deposited in commercial bank accounts that are not in the name of the institution
2c	Demand deposits		Current accounts (chequing accounts)
2d	Time deposits		Certificates of deposit and other non-demand deposits repayable within one year
2e	Loans from central bank		Rediscounted funds from the Central Bank repayable within one year
2f	Loans from head office		Loans or portions of loans made to a specialized microfinance division of a larger banking institution from its head office repayable within one year
2g	Loans at market interest rates		Loans or portions of loans from other types of support institutions at market rates which are repayable within one year
2h	Loans at subsidized interest rates		Loans or portions of loans from other types of support institutions bearing no interest or rates which are below market rates which are repayable within one year
2i	Interest accrued on liabilities		Appropriate only for institutions that use accrual based accounting
2j	Other short-term liabilities		All other amounts owed by the institution and repayable within one year
2k	**TOTAL SHORT-TERM LIABILITIES**		The sum of lines 2a to 2j
2l	Term savings		Any savings deposited with the institution which are not due for repayment within one year They should only be included if they are available to the program to be on lent or invested
2m	Long term loan from Head office		Loans or portions of loans made to a specialized microfinance division of a larger banking institution from its head office that are not repayable within one year
2n	Long term debt at market interest rates		Borrowings at market rates not due for repayment within one year
2o	Long term debt at subsidized interest rates		Borrowings bearing no interest or rates which are below market rates which are not due for repayment vithin one year
2p	Other long term liabilities		All other amounts owed by the institution which are not repayable within one year

PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

2q	**TOTAL LONG-TERM LIABILITIES**		Sum of lines 2l through to 2p
2r	**TOTAL LIABILITIES**		Sum of line 2k and line 2q
3a	Shareholders equity		Capital contribution of the owners of the institution on which dividends could be paid if a for profit entity
3b	Donated capital		Accumulated value of grants and donations from sources that do not receive dividends
3c	Retained surplus/(deficit) prior years plus prior quarters of current year		Accumulated earnings (losses) from prior periods including prior quarters of the current year
3d	Reserves		Any reserves used by the program including revaluation reserves exchange rate depreciation reserves etc
3e	Other capital accounts		Any special reserves or other capital accounts
3f	Retained surplus / (deficit) this quarter		Bring over from line 17 of the income statement
3g	**TOTAL CAPITAL**		Sum of lines 3a through line 3f
4	**TOTAL LIABILITIES & CAPITAL**		Line 2r plus line 3g

PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

ITEM	ACCOUNT	TOTAL THIS QUARTER	DESCRIPTION
		UGSHs	
5a	Interest on loans		
5b	Fees on loans/savings		Fees and commissions to clients with loans Programs that charge fees on savings accounts should also include this income here
5c	Loan/savings income		Sum of line 5a and 5b
5d	Investment income		Income from the non loan investment portfolio
5e	Other operating income		Any other operating income – e g gains on foreign exhange transactions
5e	**TOTAL OPERATING INCOME**		Sum of lines 5c through 5e
6a	Interest on market debt		Interest and fee expenses and all charges for market debt
6b	Interest on subsidized debt		Interest and fee expenses and all charges for all subsidized debt
6c	Interest on savings		Interest and fee expenses and all charges for all customer deposits
6d	Exchange rate depreciation expense		Provision for exchange rate depreciation on foreign currency denominated liabilities
6e	Total financial expenses		Sum of lines 6a through 6d
7	**GROSS FINANCIAL MARGIN**		Line 5e net of line 6e (Difference between total operating income and total financial expenses)
8	Loan Loss provision expense		Cost of creating & maintaining the loan loss provision This corresponds to that part of the loan loss provision expensed during the quarter
9	**NET FINANCIAL MARGIN**		Line 7 net of line 8
10a	Personnel expense		All staff and consultant cost including fringe benefits (preferably on an accrual basis especially in the case of major future benefits such as severance pay obligations)
10b	Rent and utilities		Office rent equipment maintenance electricity etc
10c	Transportation		Transportation of staff to attend to clients and to manage operations
10d	Office supplies		Printed matter supplies photocopies books etc
10e	Depreciation		Allowance for deterioration and eventual replacement of equipment
10f	Other operating and administrative expenses		
10g	**TOTAL OPERATING EXPENSE**		Sum of lines 10a through 10f
11	**PROFIT (LOSS) ON FINANCIAL SERVICES**		Net financial margin less total operating expenses Line 9 net of line 10g
12	EXTRAORDINARY INCOME (EXPENSE)		Extraordinary income or expenses that derive from events or transactions that are distinct from the ordinary activities of the MFI and are therefore not expected to recur frequently or regularly e g income from consulting fees and profit from sale of properties and expenses from remodeling and amortization of start up costs
13a	Grants and donations to subsidize financial services		Grants and donations received for the operation of financial services e g operating costs loan funds and fixed assets
13b	Income from non financial services		Any income typically donations received from the operation of NON financial services services - typically these services are not closely related to the financial services offered
13c	Expenses from non financial services		Any expenses generated by NON financial services typically these services are not closely related to the financial services offered
14	**SURPLUS/DEFICIT**		Sum of lines 11 12 13a and 13b net of line 13c
15	Taxes paid(on taxable Income)		Corporation tax payable on taxable income
16	Dividends		Dividends paid or payable to shareholders
17	**RETAINED SURPLUS/DEFICIT**		Line 14 less lines 15 and 16

PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

NOTE MFIS WITH MORE THAN 3 BRANCHES SHOULD SUBMIT ADDITIONAL SHEETS SHOWING ALL BRANCHES

SUMMARY OF PAST DUE LOANS

Please provide data as of the last day of the period to be analyzed

Name of Branch	Total Principal Outstanding	Total Principal Past Due	Principal in Arrears 1 30 days	Principal in Arrears 31 60 days	Principal in Arrears 61-90 days	Principal in Arrears 91-180 days	Principal in Arrears181 365 days	Principal in Arrears 365+days
Totals								
Provision Rates								
Computed Provisions								

PLEASE EXPLAIN ANY DIFFERENCES IN THE LOAN LOSS PROVISIONS AS CALCULATED IN THE SUMMARY OF PAST DUE LOANS TABLE SHOWN ABOVE AND THOSE SHOWN IN THE FINANCIAL STATEMENTS

PORTFOLIO AT RISK (PAR)

Please provide data as of the last day of the period to be analyzed Please note that PAR refers to the entire portfolio affected by overdue payments NOT just the payments that are past due

Name of branch	Total Principal Outstanding	Portfolio at Risk 1 day		Portfolio at Risk 30 days		Portfolio at Risk 90 days	
		Total amount	Overall % rate	Total amount	Overall % rate	Total amount	Overall % rate
TOTAL							

VALUE OF LOANS WRITTEN OFF THIS QUARTER	VALUE OF LOANS WRITTEN OFF PRIOR QUARTERS OF CURRENT FISCAL YEAR	VALUE OF LOANS WRITTEN OFF LAST FISCAL YEAR

PLEASE DESCRIBE YOUR POLICY FOR WRITING OFF DELINQUENT LOANS

PLEASE DESCRIBE ANY DIFFERENCES BETWEEN YOUR STATED LOAN WRITE OFF POLICY AND THE WAY THAT LOANS HAVE BEEN WRITTEN OFF EITHER THIS YEAR OR LAST YEAR

PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

Outreach Loans			
	Product A	Product B	Product C
Number of borrowers with loans outstanding at the beginning of the quarter*			
Number of borrowers with loans outstanding at the end of the quarter*			
Value of loans outstanding at the beginning of the quarter			
Value of loans outstanding at the end of the quarter			
Number of loans disbursed during the quarter			
Value of loans disbursed during the quarter			
Number of loan clients exiting the program during the quarter**			
Percent women			

*** This number should be the number of people served by the program, NOT the number of groups**

****Do not include clients who are in between loan cycles, or who have temporarily declined loan facilities**

Outreach Savings			
	Product A	Product B	Product C
Number of savers at the beginning of the quarter***			
Number of savers at the end of the quarter***			
Value of savings at the beginning of the quarter			
Value of savings at the end of the quarter			
Percent women			

***** This number should be the number of people served by the program NOT the number of groups**

PRESTO CENTER FOR MICROFINANCE QUARTERLY Financial Performance Information	
MICROFINANCE INSTITUTION	REPORT PERIOD

STRUCTURE OF LIABILITIES ANALYSIS

Description, Each of Program's Liabilities Include savings and/or deposits only if these funds are available to be on-lent or invested				
Source (complete on separate sheet if necessary)	Item No and Account on Balance Sheet	Is liability in local or foreign currency?	If foreign give value of liability in that currency	Amount of the liability on Balance Sheet (in UGSHs)
A				
B				
C				
D				

Costs of Funds Data, Each of Program's Liabilities				
Source	Average amount of this liability during the quarter	Nominal interest rate (annualized)	Terms and conditions (original value of liability repayment period frequency of payment declining balance or flat)	Interest expense incurred for this liability for the quarter
A				
B				
C				
D				

STATE PARTICULARS OF ANY LIABILITIES SHOWN ON BALANCE SHEET THAT ARE NOT INCLUDED IN ABOVE ANALYSIS

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PRESTO CENTER FOR MICROFINANCE

QUARTERLY Financial Performance Information

MICROFINANCE INSTITUTION	REPORT PERIOD

OPERATIONAL ANALYSIS

Operational Subsidy Analysis	
1 Grant Income	
DID YOUR PROGRAM RECEIVE GRANTS TO SUPPORT ITS OPERATIONAL COSTS IN THE QUARTER TO BE ANALYZED?	Yes No
WHAT WAS THE AMOUNT OF THESE GRANTS DURING THE QUARTER TO BE ANALYZED? (ENTER ON LINE 13a OF OPERATING PROFIT AND LOSS STATEMENT)	
2 In Kind Subsidies	
WERE ANY MANAGERIAL OR OPERATIONAL PERSONNEL PAID BY DONOR FUNDS THAT ARE NOT INCLUDED IN YOUR INCOME STATEMENT? INCLUDE ANY EXPATRIATE STAFF OR CONSULTANTS WHO PROVIDED DIRECT OPERATIONAL SUPPORT BUT EXCLUDE ANY SHORT TERM TECHNICAL ASSISTANCE EXPLAIN BELOW ANY PERSONNEL THAT HAVE BEEN EXCLUDED	Yes No
WHAT WAS THE AMOUNT OF THE SUBSIDIZED SALARIES AND BENEFTIS DURING THE QUARTER?	
DID THE PROGRAM USE ANY PROPERTY OR EQUIPMENT WHICH BELONGS TO ANOTHER PARTY AND IS NOT ACCOUNTED FOR ON YOUR FINANCIAL STATEMENTS? (i e OFFICES COMPUTER EQUIPMENT VEHICLES ETC)	Yes No
IF YES PLEASE EXPLAIN TO US WHAT KIND OF EQUIPMENT/PROPERTY AND HOW IT WAS USED IN YOUR OPERATIONS	
WHAT WOULD YOU HAVE HAD TO SPEND TO SUBSTITUTE FOR THIS EQUIPMENT OR PROPERTY DURING THE YEAR TO BE ANALYZED? EXPLAIN YOUR CALCULATION IN THE SPACE BELOW	

Information on Staffing and Personnel
NUMBER OF STAFF BEGINNING OF QUARTER
NUMBER OF STAFF HIRED DURING QUARTER
NUMBER OF STAFF WHO HAVE LEFT DURING QUARTER
NUMBER OF LOAN OFFICERS END OF QUARTER

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ANNEX I

PRESTO CENTER FOR MICROFINANCE
ANNUAL FINANCIAL INFORMATION

MICROFINANCE INSTITUTION	REPORT PERIOD

PHYSICAL LOCATION OF FINANCIAL SERVICES	KAMPALA % current clients	DISTRICT TOWNS % current clients	VILLAGES % current clients

Client Characteristics

GENDER	TYPE OF ECONOMIC ACTIVITY (%)
MALE % FEMALE %	COMMERCE. SERVICE MANUFACTURING AGRICULTURE. OTHER

Financial Products and Delivery Methodologies

DESCRIPTION OF PRODUCT OR SERVICE		TERMS AND CONDITIONS FOR EACH PRODUCT OR SERVICE
LOANS	Product A	INTEREST RATE (Nominal Annual Rate) CALCULATION METHOD (Declining or flat) FEES/COMMISSION PAYMENT FREQUENCY LOAN TERM GRACE PERIOD TIME BETWEEN LOANS GROUPS OR INDIVIDUALS AVERAGE DISBURSED LOAN SIZE
	Product B	INTEREST RATE (Nominal Annual Rate) CALCULATION METHOD (Declining or flat) FEES/COMMISSION PAYMENT FREQUENCY LOAN TERM GRACE PERIOD TIME BETWEEN LOANS GROUPS OR INDIVIDUALS AVERAGE DISBURSED LOAN SIZE
	Product C	INTEREST RATE (Nominal Annual Rate) CALCULATION METHOD (Declining or flat) FEES/COMMISSION PAYMENT FREQUENCY LOAN TERM GRACE PERIOD TIME BETWEEN LOANS GROUPS OR INDIVIDUALS AVERAGE DISBURSED LOAN SIZE

PRESTO CENTER FOR MICROFINANCE
ANNUAL FINANCIAL INFORMATION

MICROFINANCE INSTITUTION	REPORT PERIOD

	DESCRIPTION OF PRODUCT OR SERVICE	TERMS AND CONDITIONS FOR EACH PRODUCT OR SERVICE
SAVINGS	Product A If MFI has compulsory savings list it here as Product A	TYPE OF SAVINGS IF COMPULSORY % OR AMOUNT OF AVERAGE DISBURSED LOAN THAT MUST BE SAVED PRIOR TO DISBURSEMENT OF THE LOAN * CUSTODY OF SAVINGS (Group bank account individual bank account MFI bank account) WHO HAS EFFECTIVE CONTROL OVER THE ACCOUNT? (clients MFI) WITHDRAWAL RESTRICTIONS INTEREST (annual rate) FREQUENCY OF INTEREST PAYMENT
	Product B	TYPE OF SAVINGS CUSTODY OF SAVINGS (Group bank account individual bank account MFI bank account) WHO HAS EFFECTIVE CONTROL OVER THE ACCOUNT? (clients MFI) WITHDRAWAL RESTRICTIONS INTEREST (annual rate) FREQUENCY OF INTEREST PAYMENT
	Product C	TYPE OF SAVINGS CUSTODY OF SAVINGS (Group bank account individual bank account MFI bank account) WHO HAS EFFECTIVE CONTROL OVER THE ACCOUNT? (clients MFI) WITHDRAWAL RESTRICTONS INTEREST (annual rate) FREQUENCY OF INTEREST PAYMENT
OTHER	Product A	
	Product B	

Note If percentage (or amount) that must be saved varies according to the loan cycle, please use the percentage or the amount that corresponds to the 'average disbursed loan size' shown for each loan product in the 'Financial Products and Delivery Methodologies' table

PRESTO CENTER FOR MICROFINANCE
ANNUAL FINANCIAL INFORMATION

MICROFINANCE INSTITUTION	REPORT PERIOD

Accounting Policies

a) Basis Of Accounting (Valuation method Historical Cost Basis Adjusted Historical Cost Current Cost Accounting) If any of the four fundamental accounting assumptions (i e going concern consistency accrual and prudence) are not followed please indicate

b) Depreciation Method (also mention how often depreciation is calculated and posted)

c) Revenue recognition method for interest commission and fee income **(accrual or cash)**

d) Translation/conversion of foreign currencies (including the disposition of exchange gains and losses)

e) Any other policy (e g method of allocation of common costs in a multi purpose program)

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CENTER FOR MICROENTERPRISE FINANCE (CMF)

Rating System for Ugandan MFIs
Version 1 0 March 1999

Annex 2· Adjustments to MFI Financial Statements and Portfolio Information

Introduction

Financial viability must always be a core element of an MFI's business strategy For the CMF to be able to monitor the progress of this strategy and compare MFIs with their peers, the financial statements, portfolio information and related data must be analyzed In order to do this, there must be common agreement as to which expenses, revenue and balance sheet items to include in the analysis This calls for adjustments to the financial statements presented by the MFI the Balance Sheet and the Profit and Loss statements (pages 1 to 3 of the FSGP Quarterly Financial Performance Information Report)

The ACCION CAMEL Technical Note gives two basic reasons for the adjustments

a) to bring the financial position, financial performance and financial adaptability of the reporting MFI to the realities of a 'commercial environment'

b) to create a level playing ground for peers for purposes of making meaningful comparisons, scoring and therefore ranking the peers

The overall effect of the adjustments is to isolate the performance of the microfinance activity, to accurately measure the quality of the loan portfolio and the value of other balance sheet items, and to correctly account for all revenue and expenses of the microfinance activity The MFI is not obliged to adopt these adjustments in its records The adjustments are made on the CMF work papers for the reasons explained above

CMF will make adjustments in the following areas

1 Scope of the Microfinance Activity
2 Loan Loss Provision
3 Loan Write-off
4 Explicit and Implicit Subsidies
5 Inflation
6 Accrued Income
7 Foreign Exchange Transactions
8 Accrued Expenses and Prepayments

Each of these adjustments is described in this document

1 Scope of the Microfinance Activity

Objective

Some MFIs are stand-alone microfinance programs while others like the Co-operative Bank are lodged in larger institutions Those that are lodged in larger institutions must isolate the microfinance activity in order for a meaningful analysis to be made The process of isolation will ensure that the common costs (indirect costs) and common revenue are charged/recognized to the microfinance activity on a fair basis

Procedure:

a) Determine whether the institution is multipurpose or is lodged in a larger organization with which it may share common costs or investment revenue e g from shared fixed deposit accounts, fixed costs and liabilities If it is a stand alone MFI or if the credit program is strictly self accounting, then there is no need for any adjustment in this area Otherwise, proceed as follows

b) Study the comment, if any (page 3 of the annual report) regarding accounting policies for the allocation of common costs to the credit program If there is no comment in the report, then it is necessary to call up the reporting organization to get the required information the overall cost structure, type and amount of the common costs, shared fixed assets and shared revenue If there is a policy, it is still necessary to study it, and to establish its reasonableness i e , is there a fair allocation? It will then be necessary to determine the cost drivers of these common costs to come up with a fair allocation of these costs

c) In case the common expenses, liabilities, revenue, and/or fixed assets of the credit program have been understated/overstated as per the report, then it is necessary to make an adjustment The adjusting entry will depend on how the original transaction was recorded in the first place and whether inter-company/department accounts are used

   In case of an understated expense

   Dr the understated expense by the understated amount

   Cr an appropriate capital/liability account

   If, for example, the fair rental expense for the microfinance program has been understated, it will be necessary to re-state the rental expense by the amount understated and if, for example, a full amount of cash was paid to the landlord by the 'head-office', an inter-company-head-office account will need to be credited This account will be created in the adjustments column of the CMF worksheets If the full rent expense was accrued in the first place, then it will be necessary to share the accrual on an equitable basis

d) In case the expenses to the credit program have been overstated, the entry in c) above will be reversed

e) Similar entries will be made for revenues, assets, liabilities and equity where applicable

2. Loan Loss Provision

Objective

The adjustment ensures that the loan loss provision expense and the resulting accumulated loan loss reserve bears an appropriate relationship to the quality of the loan portfolio

Procedure

a) Study page 4 of the quarterly report and apply CMF provisioning rates to the aging categories shown on the 'Summary of Past Due Loans Schedule' Add up the resulting amounts This will be the appropriate level of the loan loss reserve

Provisioning Table		
Aging Status	% Provision Regular Portfolio	% Provision Rescheduled Portfolio
Current Loans	0%	
Rescheduled Loans		10%
Loans Past Due 1-30 Days	10%	50%
Loans Past Due 31-90 Days	30%	75%
Loans Past Due 91-180 Days	60%	100%
Loans Past Due > 180 Days	100%	100%
Loans in Legal Recovery < 180 Days	100%	100%

Source ACCION CAMEL

b) Compare this amount with the actual reserve accounted for on the MFI's Balance Sheet (page 1, line 1f of the quarterly report) In case of a deficiency, the following adjusting entry needs to be made

Dr Loan Loss Provision expense

Cr Loan Loss Reserve

c) In case of an over provision the above entry is reversed

NB The result of the calculation in a) above is cumulative and if it is quite material, it may be necessary to spread the adjustment This is done by taking the provisioning for the prior years and debiting prior period retained earnings

3 Loan Write-off

Objectives

By not writing off uncollectible loans within an appropriate time frame, the MFI is inflating its loan portfolio and skewing its performance ratios Proper write-offs will ensure that adequate provisioning has been done

Procedure.

a) From page 4 of the quarterly report, establish the amount of loans written off and establish the amount which should have been written off according to the tables given on page 4 All loan balances beyond 360 days are written off in the adjustments made by the CMF

b) Add the amount purported to be written off back to the loan loss provision in the Balance Sheet of the quarter in question Compare this new figure with the corresponding figure in the last quarter Balance Sheet The difference should be explained by the loan loss provision in the current quarter Profit and Loss statement

c) In case the difference is bigger than the loan loss provision in the current Profit and Loss statement, the write-off was not adequately done In that case, take the difference and make the following adjusting entry

Dr Loan Loss Reserve

Cr Loan Portfolio

4 Explicit and Implicit Subsidies

Objective.

The objective is to obtain a true picture of the MFI's potential for commercial viability Will the operations of the MFI be viable if they are expanded beyond the limits of donor support? There are three sub-adjustments to be made in this area

- Cash donations
- Subsidized debt
- In-Kind Subsidy

4 1 Cash Donations

Objective

To remove cash donations from the Profit and Loss statement and reclassify them as capital on the Balance Sheet

Procedures

a) Compare item 3b on page 2 of the current quarter with that of the previous quarter and reconcile this with the information given on page 7 of the same report as well as item 13a on page three The objective is to establish the actual amount of donations/grants received in the quarter in question and how they were treated If the donation/grant was credited to income, then it needs to be removed from there

Dr Grant/donations(13a of page 3)
Cr Donated capital(3b of page 2)

4 2 Subsidized Debt

Objective:

To reflect the commercial cost of borrowing in the financial statements so as to show the extent of the MFI's ability to meet these costs This adjustment calculates the cost of an MFI's liabilities as if it were raising funds on local commercial markets

Procedure.

a) Given the CMF commercial rate (determined quarterly by averaging the rate that commercial banks charge their good customers, for the period ending 12/98, this is 23%) and the data on page 6 of the quarterly report, determine whether any MFI liability is subsidized, if so, it needs to be adjusted

b) Divide the rates by 4 Subtract the subsidized rate from the commercial rate and then multiply the result by the average amount of liability for the quarter for each liability source on page 6 of the quarterly report Alternatively, calculate the adjustment by multiplying the 'commercial rate' with the average subsidized liabilities and then subtracting line 6b of page 3 of the quarterly report

c) Make the following adjustment using the resulting figure from (b) above

Dr Interest on subsidized debt (line 6b on page 3, quarterly report)

Cr Interest subsidy adjustment account
(This is an adjusting capital account in the Balance Sheet)

4 3 In-Kind Subsidies

Objective:

To estimate the expenses the institution would incur if it did not receive subsidies that have a significant impact on the operating capacity of the MFI, and to include, at fair market value, goods and services which the MFI does not pay for but which are important to the conduct of its business Examples include a rent–free or subsidized facility, free fixed assets and donated salaries for staff

Procedures·

a) Study page 7 of the quarterly report and establish the amount of subsidy received by the MFI in the quarter that is not included in the report You may also want to call up the MFI to get more clarification about the subsidies – their nature and whether in fact there is need to include these in the accounts Materiality, reason for subsidy and impact of the subsidy on the revenue earning capacity of the MFI should be considered in determining whether a subsidy should be included or not

b) Once it is established that an in-kind subsidy should be included, establish the market cost of that subsidy and pass the following adjustment

Dr Relevant expense/asset account

Cr Donated capital
(line 3b of the Balance Sheet on page 2 of the quarterly report)

c) If it is a fixed asset, check out the accounting policy on depreciation on page 3 of the MFI annual report That information should enable you to calculate the depreciation expense for the quarter

Dr Depreciation expense

Cr Accumulated depreciation

5 Inflation

Objectives

The historical cost based accounts do not to show the extent to which the real value of equity of the organization is being eroded by the effects of inflation Thus the objective of the adjustment is to bring the MFI's financial statements to the realities of inflation

Procedures

a) Check out the accounting basis policy on page 3 of the reporting MFI's annual report and establish whether or not the MFI accounts for inflation If it does, it will may be necessary to call up the MFI and get more information about, for example, the inflation rate used In case the rate is appropriate and the accounting is done correctly, then no adjustment is necessary

b) In case the reporting indicates that the MFI's accounting basis is not inflation accounting (for example, common-historical cost basis) then there is need for two inflation adjustments one to revalue the non-monetary assets and a second to account for the eroded value of the MFI's equity

c) Revaluation of non-monetary assets Divide the government's annual given inflation rate by 4 to get the quarterly inflation rate and multiply it with the average non-monetary assets These are the fixed assets shown on lines 1l+1m of page 1 of the quarterly report The average may be obtained by adding the previous quarter s balance and the balance as per the Balance Sheet of the reported quarter and then dividing by two

d) With the figure obtained from (c) above make the following entry

Dr The respective fixed asset accounts

Cr The inflation adjusted capital account or revaluation reserve

Please note that the increment to the non-monetary assets (fixed assets) because of the adjusting entry in (d) above need to be depreciated in line with the MFI's depreciation policy.

Dr Depreciation expense

Cr Accumulated depreciation

e) Take the inflation rate from (c) above and multiply it by the MFI's average total capital and using the resulting figure make the following entry

Dr Inflation adjustment expense

Cr Inflation adjusted capital account

6. Accrued Interest Income

Objective

To eliminate interest income which is accrued so that all income is on a cash basis

Procedure

a) Study the MFI's accounting policies regarding revenue recognition on page three of the MFI's annual report If the MFI does not accrue income at all, then no adjustment is necessary However, if the MFI accrues interest, it will be necessary to remove that accrued interest from the interest income account and from the Balance Sheet accrued interest account by making the following entries

Dr Interest income

Cr Accrued interest
(line 1g on the Balance Sheet of the quarterly report)

The amount used in this entry is the amount accrued in the quarter in question Thus, while the accrued interest for the period in the Profit and Loss statement will be cleared by this entry, the accrued interest account in the Balance Sheet may not necessarily be cleared To clear, it is necessary to pass the following prior period adjusting entry

Dr Retained surplus/(deficit) (line 3c of page 2 of the quarterly report)

Cr Accrued interest (line 1g of page 1 of the quarterly report)

7 **Exchange gains/losses for the MFI's liabilities denominated in foreign currencies.**

Objectives

To ensure that an MFI with foreign exchange transactions deals with them in accordance with acceptable standard practice – IAS 21 and SSAP 20 An MFI may transact business in a foreign currency, e g by buying fixed assets or borrowing money for loanable funds The liabilities denominated in foreign currency outstanding as of the Balance Sheet date should reflect the current obligation (Balance Sheet date) of the MFI in the local reporting currency and the gains or losses arising from fluctuations in the foreign exchange rates should be correctly reported

Procedure.

a) Study the MFI's information regarding liabilities on page 6 of the quarterly report and ascertain whether the MFI has any foreign liabilities – loans which are denominated in a foreign currency In case the MFI has such liabilities, then study the accounting policies – part (d) on page three of the annual report and establish how foreign transactions are handled in the MFI's records It may also be necessary to call up the MFI for clarification regarding the liabilities and/or the policy

   As a first scenario it is be possible that the MFI does not have any foreign liabilities and in that case there will be no need for any adjustment

   The second scenario is that the MFI has foreign liabilities and that their treatment in their books of account are in accordance with IAS21/SSAP20 Again in this case there is no need for adjustment

   The third scenario is that the MFI has foreign liabilities but the MFI is recording the liabilities on a historical cost basis and therefore does not recognize the gains and losses emanating from foreign exchange fluctuations In this case proceed as follows

   Find out from an authoritative source the exchange rate as at the Balance Sheet date for the currency in question Multiply this rate with the value of the foreign liability as stated on page 6 of the quarterly report The result is subtracted from the liability as reported in the Balance Sheet If the result is positive then there is an exchange gain which must be recorded

Dr the liability (Balance Sheet account)

Cr the exchange gain account (line 5e on the Profit and Loss account)

If the result is negative

Dr exchange loss (line 6d on the Profit and Loss account)

Cr the liability

8 Accrued Expenses and Prepayments

Objective

To ensure that the MFI has recorded all the expenses and only the expenses has incurred in the quarter

Procedure

a) Review items 10a, 10b, 10d and 10f of page three of the quarterly report and compare with the previous quarter if applicable Note any significant/ material changes in these accounts and find out from the MFI whether these have been accounted either by improperly recorded prepayments or unrecorded accruals Depending on the case the adjustments are as follows

Improperly recorded prepayment (prepayment recorded as an expense)

Dr Prepayments account

Cr Expense account

Unrecorded accrual

Dr Expense account

Cr Accruals account

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