Commercial Bank Assessment Tool

PRISMS
Promoting Improved Sustainable MSME Financial Services

August 2005
This document was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.

PRISMS

Promoting Improved Sustainable MSME Financial Services

Contract No. 620-C-00-04-00037-00

Last modified on August 31, 2005

Module 1
Introduction to Nigerian Community Banks and the Operating Context

Goal

Participants will be familiar with the current trends in and status of community bank operations in Nigeria, as well as the economic and political context within which these banks operate. By the end of this module, participants will have constructed a basic matrix outlining both the opportunities and challenges of commercial bank lending to community banks, and articulate how their respective institutions can benefit from lending to community banks.

Objectives

By the end of Module 1, participants will have discussed the following:

1. What is the community bank's *effective demand* for commercial bank financial services?

2. What are the *impediments* to commercial banks providing these services?

3. What *opportunities* exist for commercial banks to provide such services?

4. What are the *challenges* to commercial banks' providing financial services to Nigerian community banks?

Duration

6 hours

Module 1 Summary: Introduction to Nigerian Community Banks and the Operating Context

Time and Technique	Session	Materials
Lecture and discussion 15 minutes	**Step 1: Introduction** Facilitator provides an overview of the course goals and objectives, and the goals and objectives of Module 1.	PowePoint Slide x
Lecture and Guided Discussion 45 minutes	**Step 2: Interactive Discussion on the Need and Rationale for Commercial Bank Lending to Community Banks in Nigeria** • Why do you think it might be useful to include wholesale lending to community banks in commercial bank operations?	Flipchart Markers

Lecture and Guided Discussion 1.5 hours	**Step 3: General Perceptions of the Role and Characteristics of Nigerian Community Banks** • How do you define "community banks" in Nigeria? How do they compare to standard commercial banks or MFIs? What are your overall perceptions of community banks? • How do Nigerian community banks operate? • Who are the primary clientele of community banks: • What are the major products and services provided by and through community banks? • Why might commercial banks want to lend to community banks? Why might they *not* want to do so?	PowerPoint Slides x-y

Lecture 1.5 hours	**Step 4: The Current Status of Nigerian Community Banks and the Operating Context** • Rural finance in Nigeria • The Nigerian financial system • Commercial banks in rural finance • Federal government policies • Characteristics of Nigerian community banks	PowerPoint Slides x-y
Lecture and Guided Discussion 2 hours	**Step 5: Undertaking a SWOT Analysis of Commercial Bank Lending to Community Banks** • Review of SWOT analysis from *Assessment of Community Banks* report[1] • Revisit questions introducing this module, referencing both the SWOT analysis and discussion from module.	PowerPoint Slides x-y

[1] *Federal Republic of Nigeria Assessment of Community Banks*. FAO, IFAD, UNDP, CIDA, DIFAD: September 2004.

Module 1 Facilitator Notes

Step 1: Introduction

Lecture and Discussion	**Display** PPT X Goals and Objectives: PRISMS Community Bank Assessment Tool (CBAT) Training Manual
1 minute PowerPoint Slide X	**Describe** The course goals and module sub-goals:

Training Course Goal: To introduce commercial bank participants to the PRISMS Community Bank Assessment Tool (CBAT) and encourage its use as a way to help management identify ways to reduce lending risk and, as a result, encourage commercial bank lending to community banks.

Training Course Sub-goals:

- **Module 1**: Participants will be familiar with the current trends in and status of community bank operations in Nigeria, as well as the economic and political context within which these banks operate. By the end of this module, participants will have constructed a basic matrix outlining both the opportunities and challenges of commercial bank lending to community banks, and articulate how their respective institutions can benefit from lending to community banks

- **Module 2**: Participants will construct and analyze standard financial statements and reports, ratios, and variance analysis, and show the relevance of utilizing both these documents and types of analyses when using the PRISMS CBAT.

- **Module 3**: Participants will understand the theory and principles behind the PRISMS CBAT and the overall structure of the tool.

- **Module 4**: Participants will be proficient in the use of the PRISMS CBAT when assessing community bank proposals for lines of credit

- **Module 5**: Participants will bring together the concepts they have learned in Modules 1-4 by completing a Case Study exercise that simulates a community bank line of credit application process.

Course Format: The format used throughout each module will encourage participation between instructor and participants through a series of guided questions and the presentation both of participants' collective responses, as well as structured responses to issues under discussion.

Duration: 5 days, 8-hour each day, with 2 hour breaks daily (one hour lunch, one-half hour mid-morning and afternoon)

Step 2: Interactive Discussion on the Need and Rationale for Commercial Bank Lending to Community Banks in Nigeria

Lecture and Discussion

Time

Flipchart
Markers

Ask
Why do you think commercial banks should include wholesale lending or lines of credit to community banks in their overall operations?

Write responses on flipchart.

Here are some suggested responses the facilitator could provide as a way to begin to structure and frame the discussions to follow:

- Commercial bank wholesale lending (starting with limited lines of credit) with community banks could open up a new rural market to commercial banks, with the potential to reach about one million clients.[2]
- Through community banks, commercial banks could meet the high effective demand in both rural and non-rural Nigeria for MSME financial services.[3]

Summarize (if possible based on participants' responses) the need and rationale for commercial bank lending to community banks in Nigeria.

.

Step 3: General Perceptions of the Role and Characteristics of Nigerian Community Banks

Lecture and Discussion

Time

Flipchart
Markers

Ask
How do you define "community banks" in Nigeria? How do they compare to standard commercial banks or MFIs? What are your overall perceptions of community banks?

Write responses on flipchart

Summarize (if possible based on participants' responses) the major similarities and differences between community banks and other

---

[2] *Assessment of Community Banks*, p. v.
[3] reference Chemonics demand survey, pg.

financial institutions in Nigeria. Here are some findings from the *Assessment of Community Banks* report to stimulate discussion:

Similarities:

- Community banks are required to submit returns on key financial and operation data to regulatory authorities, including the Central Bank of Nigeria and the National Board for Community Banks.

- Community banks are required to observe a number of prudential requirements, including minimum liquidity ratios, and a maximum exposure in all forms of shareholder funds to a single borrower.

- Community banks are required to exhibit their balance sheet and income statement in their offices and have external audits of their accounts. (Note, however, that few banks comply with this regulation.)[4]

- Community banks are compelled by law to hold annual general shareholder meetings within six months after the end of any given financial year. (Note, however, that this regulation is not adhered to on a uniform or consistent basis.)[5]

- All community banks offer the same types of deposits as do commercial banks, while community banks maintain very low entry barriers but pay out lower savings interest rates.

- In both commercial and community banks, large-sized loans are only granted if substantial collateral can be provided in the form of deposits, land, or other tangible assets. In most cases, loans are to be repaid within nine months.

Differences:

- Unlike commercial banks, community banks do not have check-

---

[4] *Assessment of Community Banks* report, p. 20.
[5] *Assessment of Community Banks* report, p. 25.
[6] *Ibid,* p. iv.
[7] ***Ibid***, p. 13.
[8] ***Ibid***, pg. 32.
[9] ***Ibid***, pg. 26.
[10] The Small and Medium Industries Equity Investment Scheme, or SMIEIS, was established by the Nigerian government in 2001 as a way to capitalize community banks and encourage financial service provision to small and medium-sized enterprises through rural banks. Commercial banks have not fully complied with this directive and are now seeking ways through which to partner with financial intermediaries to be in compliance with SMIEIS in order to avoid CBN sanctions.

clearing authorization, nor are they entitled to deal with undertake transactions with foreign exchange.

- The original mandate of community banks was to service rural populations. As such, they are all located in rural parts of the country, providing them with greater access to rural populations than their commercial bank counterparts.

- Community banks generally serve a low and medium income clientele that is not directly target or served by commercial banks. Unlike commercial banks, community banks' clientele is fairly uniform. This uniformity is a result of the fact that salary earners and pensioners have become the main client group within community banks due to the banks' ability to collateralize small and short-term loans with predictable salary and pension funds.

- Community banks have a lower minimum equity capital requirement for obtaining an license than their commercial bank counterparts, with current rates of NGN 250,000 (less than US $2,000).

- Community banks do not always require full, traditional collateral coverage, accepting instead personal guarantees, moveable assets, and other non-traditional forms of collateral to secure loans.

- Community banks function in both rural and urban centers, with some of their more prosperous banks located in urban centers.

Ask

How do community banks operate?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the key features of community bank operations:

- Of the current 775 community banks operating with a license from the National Board for Community Banks, approximately 532 of these banks also have a valid operating license from the Central Bank of Nigeria. Estimates are that about 750 community banks will survive into the future.[6]

- The average community bank has total assets of NGN 50.9 million (approximately US $392,000), total deposits of NGN 32.0

million (approximately US $247,000), total equity of NGN 12.4 million (approximately US $95,000) and loans outstanding of NGN 17.7 million (approximately US $136,000).[7] **(Display PPT slide, pg. 14 of assessment report.)**

- About two-thirds of all community banks are located in rural areas, with the highest concentration found in the Yoruba-speaking areas of the Southwest (six States). Each community bank is expected to operate in a defined catchment, or geographic, area. Due to the high rural concentration, it is likely that community banks' lending supports agricultural enterprises or activities.

- The original requirements of community banks stipulate that they employ a minimum of 13 staff, regardless of actual workload. This has led, in general, to overstaffing of many community banks.

- Community banks operate through a Decree mandating that the NBCB grant "matching loans" to community banks of up to NGN 500,000 million per bank. This amount was reduced to NGN 250,000 million per bank. By 2003, NGN 58 million of these loans were outstanding and overdue, with many community banks defaulting on repayment.

- Community bank operating hours tend to be more generous than their commercial bank counterparts, with counters open for longer hours each day and Saturday if that day falls on a market day.

Ask

Who are the primary clientele of community banks?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the current client base of Nigerian community banks.

- Approximately 65 percent of the total loans were extended to salary earners, 20 percent to contractors, and the remaining 15 percent to small enterprises, mainly agriculture, trading, transport and handicrafts.[8]

- Community banks clients are generally rural, but some of the more successful community banks reside in urban centers, such as the community bank established by and for members of the Nigeria Police Force.

- Clientele generally derive from low- to middle income economic groups.

- Current clients comprise mostly regular salary earners or those with regular pension incomes. While this was neither the design nor the intention of community banks, this uniformity in clientele is likely a result of community banks' high level of risk aversion. Aside from this group, community banks serve a small number of traders.

- Women are an important group among community bank savings deposit holders, comprising about 20 percent of total savers.[9]

Ask

What are the major products and services provided by and through community banks?

Summarize (if possible based on participants' responses) the products and services generally provided by and through community banks. Here is a representative list of products and services:

- A range of deposits, including savings, time deposits, and targeted deposits, such as "Hadj Savings" for those wanting to save for pilgrimage to Mecca and Medina.

- Issue for the purpose of raising funds, redeemable debentures.

- Ancillary banking services, such as remittance of funds or safe deposit services.

- Invest surplus funds into instruments such as treasury bills or interest-bearing accounts in other banks.

- Loan products comprising simple loan products and an overdraft facility on current accounts for 1 to12 months and short-term loans ranging from 3 to 18 months in duration.

- Overdraft facilities are primarily approved for salary earners, such as the staff of the Local Government Councils, schools and hospitals. Loans of amounts up to three times net salary have been approved, with installment repayment periods over six months through salary deductions. In addition to the bank's securing the loan through salary deductions, the bank requires a letter of guarantee from the employer to secure further these loans.

- Equipment-leasing facilities.

- Other non-banking functions to ensure access of customers to farm inputs.

Ask

Why might commercial banks want to lend to community banks? Why might they *not* want to undertake such lending?

Summarize (if possible based on participants' responses) the benefits and risks of commercial bank lending to community banks.

Benefits:

- Commercial banks have the ***opportunity to reach a vast, untapped rural market*** of up to one million clients through wholesale lending to community banks.

- Willingness on part of the Central Bank of Nigeria to establish an ***adequate rural finance framework*** and sound financial institutions.

.

- ***Firm commitment of the Nigerian government*** to strengthen rural financial intermediaries.

- ***Potential for higher level of capitalization*** exist due to the recently-passed legislation requiring that commercial banks, through the SMIEIS Fund, allocate a minimum of 10 percent of profits to community banks.[10]

- By partnering with community banks as financial intermediaries through which to transfer SMIEIS funds, commercial banks have an ***opportunity to avoid sanctions by the CBN for non-compliance*** with the requirement to transfer up to 10 percent of bank profits to community banks.

Risks:

- ***Weak management of community banks*** is due in part to the lack of skilled staff at all levels and the lack of clear firewalls between Executive Director and Board of Director functions and mandates. Such weak management appears to be more frequent in rural areas.

- ***Weak prudential oversight*** of community banks results from

- ***Poor internal administration*** of community banks further weakens their performance. Generally accepted accounting standards are neither followed nor applied on a regular and consistent basis.

- ***Low levels of capitalization*** further erode the long-term prospects for community bank viability.

- ***High levels of risk aversion*** which are likely dampening community bank's ability to meet the high level of untapped demand for rural financial services and products.

Step 4: The Current Status of Nigerian Community Banks and the Operating Context

Lecture

Time

Flipchart
Markers

Provide an overview of the current status of Nigerian community banks and the context in which they operate, referencing the *Assessment of Community Banks* study.

- ***The Nigerian financial system***: Nigeria has a complex and relatively well-developed financial system, with oversight by the Central Bank of Nigeria, the National Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Ministry of Finance, the National Insurance Commission, and the Financial Services Regulatory Coordination Committee. Despite the large number of formal and informal financial service providers, outreach is still low.

- ***Macroeconomic indicators***: Interest rates fluctuate on a fairly regular basis, with the average rate paid by commercial banks on deposits falling within a range of 3.2 to 5.8 percent. Data from 2004 shows that average monthly prime interest rates charged also fluctuated within a range of 19.1 to 21.1 percent, while the inter-bank rate generally has a wider spread between 12.1 percent to 23.2 percent. The real rates for savers are low given the composite consumer price index of about 17 percent. In addition, the average spread between savings deposits and the maximum lending rates was between 10.8 to 15.4 percent.[11]

- ***Rural finance in Nigeria***: Community banks are, at present, the most conspicuous financial intermediaries in rural parts of Nigeria, with a current total of 775 banks operating nationwide. Microfinance institutions have been operational in Nigeria since the early 1980s, although there is only a handful of successful MFIs in operation, such as the Lift Above Poverty Organization (LAPO). Recent national MFI legislation may promote further growth of MFIs and lead to improvements in their current provision of financial services both to both the urban and rural poor.

- ***Commercial banks in rural finance***: The Nigerian financial sector is dominated by 89 commercial banks, which account for over 90 percent of total sector assets, excluding those of the Central Bank of Nigeria. The ten largest banks have a market share of over 50 percent.[12] Despite their conspicuous role in

[11] ***Assessment of Community Banks***, p. 6.
[12] ***Assessment of Community Banks***, p. 6.

Nigeria's financial sector, commercial banks have not been able to penetrate rural areas at a significant level.

- ***Federal government policies***: Current federal policies continue to support the expansion of financial services into rural areas, with a focus on lending to agricultural-based borrowers and MSME operators. Of particular note is the SMIEIS Fund.

Step 5: Undertaking a SWOT Analysis of Commercial Bank Lending to Community Banks

Lecture and Guided Discussion

Time

Flipchart Markers

Display PPT Slide x, SWOT Analysis of Rural Based Community Banks. The facilitator will lead a discussion on the strengths, weaknesses, threats and opportunities of the Nigerian community banking sector referencing the findings of the *Assessment of Community Banks* report. Note that this is, to date, the most definitive and comprehensive report on Nigerian community banks.

Participants should be urged to begin considering which elements of the following SWOT analysis could be changed, and how the CBAT might help in this process. For now, the facilitator should simply introduce these external findings for purposes of discussion.

Strengths

- Originality of the concept in the financial sector landscape
- Potential for providing relevant and meaningful financial services to rural areas
- Lending monopoly in the formal sector, except where NACRDB intervenes
- Often strong roots in the community
- Good knowledge of rural areas and inhabitants
- Part of the established Nigerian formal financial system since CBN take-over
- Simple and rather secure banking services to salary earners
- Concentration on savings deposits
- Banking procedures simpler than in commercial banks
- Lending not based on immovable property as main collateral
- Existence of an umbrella organization (NACOB)
- Satisfactory capitalization

Weaknesses

- Poor management
- Poor supervision through boards
- Overstaffing
- Low value of total assets
- Insufficient savings mobilization
- Insignificant term deposits
- Lack of penetration of rural areas, average to poor clients, farmers, craftsmen and the service sector
- Insufficient financial analysis
- Absence of any longitudinal data analysis

- Poor public image due to poor past performance and bankruptcy of CBs
- Poor product development and refinement
- Poor market analysis and market potential analysis skills
- Non-competitive interest rates
- Lack of check clearing facilities
- Insufficient loan policies and skills to appraise more complex loans
- Poor debt recovery

Opportunities

- High demand for loans
- No or insignificant lending activities by the formal banking sector to rural areas, with the exception of NACRDB in few areas
- Higher loan volumes to poor and middle level clients, farmers, petty traders, artisans and other service providers
- Deposit insurance through NDIC
- Gain in public image along with better supervision and assistance
- Reducing costs of operations and improved data analysis through computerization in medium terms
- Higher levels of deposits from non-conventional clients

Threats:

- Declining patronage by LGCs
- Lending activities by commercial banks
- Declining income levels leading to lower deposits and shorter terms of deposits
- High general willful default propensity of the Nigerian public
- Increasing costs of pursuing debtors, long duration of court cases
- Increasing poverty levels in Nigeria

The facilitator will now ask participants to revisit the questions introducing this module, referencing the above findings from the external report.

- What is the community bank's *effective demand* for commercial bank financial services?

- What are the *impediments* to commercial banks providing these services?

- What *opportunities* exist for commercial banks to provide such services?

- What are the *challenges* to commercial banks' providing financial services to Nigerian community banks?

Last modified on September 8, 2005

Module 2
Financial Statements and Reports

Goal	Participants will construct and analyze standard financial statements and reports, ratios, and variance analysis, and show the relevance of utilizing both these documents and types of analyses when using the PRISMS CBAT.
Objectives	By the end of Module 2, participants will: 1. Describe the income statement, balance sheet, cash flow statement, portfolio report and non-financial data report, and explain their significance and how they are related. 2. Construct financial statements and reports using the sample data provided from a representative community bank. 3. Explain how the cash flow statement can yield useful information regarding the credit-worthiness of an individual loan applicant or institution. 4. Be familiar with both trend and variance analysis methodology and a set of commonly used financial reporting ratios.
Duration	6 hours

Module Summary

Time and Technique	Session	Materials
Lecturette and discussion 15 minutes	**Step 1: Overview of Goals and Objectives of Financial Statements and Reports** • Facilitator provides an overview of the session goal and objectives.	PowerPoint slides 11-13 (**renumber**)
Guided Discussion Demonstration Activity 1 hour 30 minutes	**Step 2: Income Statement** • Overview of income statement • Income statement construction • Terminology, definitions • Practice exercises	Overhead/handout 2.1 Income Statement Template 2.2 Sample Income Statement 2.3 Class Exercise Instructions w/Income and Expense Information
Guided Discussion Demonstration Activity 1 hour 30 minutes	**Step 3: Balance Sheet** • Overview of balance sheet • Construction of a balance sheet • Terminology, definitions • Practice exercises	Overhead /handout 2.4 Balance Sheet Template 2.5 Sample Balance Sheet 2.6 Class Exercise Instructions w/Balance Sheet information
Guided Discussion Group Activity Demonstration 1 hour 30 minutes	**Step 4: Cash Flow Statement** • Overview of cash flow statement • Cash Flow construction • Terminology, definitions	Overhead 2.7 Classification of Cash Receipts and Payments Overhead/Handout 2.9 Cash Flow Template 2.10 Sample Cash Flow Activity Material 2.8 Cash Flow Activity 2.11 Indirect Cash Flow Example 2.12 Cash Flow Class Exercise Instructions

Discussion Activity 1 hour	**Step 5: Linking Financial Statements** • Importance of understanding the links between financial statements • Links between the financial statements and reports	Overhead/Handout 2.16 Matrix Need handouts 2.2 2.5, 2.10, 2.13
Introduction to Exercise, Class Participation through Group Exercises and Presentations Time	**Step 6: Class Exercise** • Construct financial statements and reports using the sample data provided from a representative community bank in Nigeria. • Groups presentations to class DO WE NEED THIS STEP?	Overhead/Handout x Need handouts x, y
Discussion Time	**Step 7: Ratio, Trend, and Variance Analysis** • Review set of commonly used financial reporting ratios • Discuss trend analysis and review a set of commonly used trend data. • Discuss variance analysis and review a set of commonly used variance data	Overhead/Handouts x, y

Module 2 Facilitator Notes

Step 1:	**Overview of Financial Statements and Reports**[1]
Discussion 10 minutes PowerPoint slides 12-13	**Show PPT 13 and explain objectives of module 2 Financial Statements and Reports. Describe what will be covered during this module. Explain that, while the sample documents refer to MFIs, the financial terminology used throughout this module is fungible and equally as relevant to community bank operations. Moreover, commercial bank officers may want to extend loans to or through MFIs in the future, so learning about MFI operations can prepare them for such activities.** **Ask** What is financial management, and why is this important within the lending process? Identify some of the key components of sound financial management. **Write answers on a flipchart.** • Timely and accurate production of financial reports • Financial records • Recording financial transactions and categorizing them by groups, and summarizing the information • Loan officers should understand how a prospective borrower manages its resources as this will give a strong indication of the likely repayment of any loan extended. **Ask** What types of statements and reports should be included in a sound financial management system? By extension, what level of proficiency should financial analysts have when using these reports? **List answers on flipchart.** After a statement or report has been identified, ask the class for a brief description of the statement and how the analyst should use this statement.

[1] This entire section, Module 2, is adapted from *Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring, Trainer's Guide*. SEEP Network, 2005. While some of the examples used are specific to MFIs, the concept of using standard reporting terminology and statements also applies to credit analysis of individual businesses and operations, including community banks. Including reference to accounts more appropriate for MFI analysis (such as loan income) will provide participants with analytical tools to use if they find themselves needing to assess the credit worthiness of a potential financial intermediary partner, such as a community bank.

	Answers should include the following: • <u>Income Statement (or profit and loss statement)</u> A ***flow*** statement that summarizes all revenues, expenses, gains, and losses over a given period. • <u>Balance Sheet (or statement of financial position)</u> A ***stock*** statement that shows the financial position of the institution at a point in time, including its economic resources, claims on those resources, and the residual interest in them. • <u>Cash Flow Statement</u> A ***flow*** statement that summarizes the inflows and outflows of cash for an institution over a given period. **Explain that credit officers should use the statements and reports in the credit analysis process.** If the applicant cannot provide audited financial statements, the loan officer can work with the applicant to try to construct or reconstruct financial documents, using the structure of the statements below as a template. In fact, undertaking such a reconstruction of financial statements can be a good way for a loan officer to develop a strong understanding of how a prospective borrower manages his resources and runs his business.

Step 2	Income Statement
Guided Discussion Demonstration 1 hour 30 minutes Handouts: 2.1 Income Statement Template 2.2 Sample Income Statement 2.3 Case Study Instructions and Micro MFI Income and Expense Information Overheads: 2.1 Income Statement	**Handout** Give participant's handout 2.1 The Income Statement. **Ask** What is an income statement? **Expected responses:** • It is a flow statement, not a stock statement. The trainer should again explain the difference between these two types of financial documents, highlighting the temporal element of each. • Represents activity over a given period, day, month, quarter or year • Summarizes the revenue and expense transactions for a defined period • Shows profit and loss (which flows to the net worth of the balance sheet) **Summarize the income statement** Unlike the balance sheet, the income statement reflects a dynamic picture of (1) what is earned from the provision of financial services, (2) what the total costs involved in carrying out those activities, and (3) whether a net surplus or deficit (profit or loss) exists for the period. **Show the overhead 2.1 Sample income statement.** Point out that an income statement is divided between revenue accounts and expense accounts. Write Financial Revenue at the top of the income statement (I1) and Financial Expense (I7). Ask participants to fill in their income statements as you go along. **Ask. Write responses on flipchart.** What are revenue accounts? What are expense accounts? **Summarize revenue and expenses.** As defined by the International Accounting Standards (IAS), REVENUE is the gross inflow of economic benefits during a period arising in the course of ordinary activities of an institution when those inflows result in increases in *equity* other than increases relating to contributions from *equity* participants.

	As defined by IAS, EXPENSES are decreases in economic benefits during the accounting *period* in the form of outflows, depletions of *assets,* or incurred *liabilities* that result in decreases in *equity* other than those relating to distributions to *equity* participants. **Say that an income statement usually includes a division of operating accounts and non-operating accounts.** **Write on the overhead** Operating Expense (I16), Non Operating Revenue (I23), Non-Operating Expense ((I24). **Ask** What are operating accounts? What are non-operating accounts? **Summarize** Operating accounts include all *revenue* and *expense* accounts related to the institution's core business—the provision of financial services. Non-operating accounts include all r*evenue* and *expense* accounts not related to the institution's core business—the provision of financial services. This could include business development training or the sale of merchandise. It is important to raise this distinction so that participants are aware that accounts should be segregated in order to track separate streams of income and outflow. Add that donations and grant funds from donors are considered to be non-operating revenue. In this Framework, all donations for loan capital and operating expenses are included in the income statement. Donations are still part of many MFI operations, mainly because many MFIs originated as NGOs that converted to MFIs. Donations might also derive from family contributions and other gifted funds that will not be repaid. In an accounting sense, these still fall within the definition of *subsidy*. **Ask** What accounts are included under financial revenue? Responses include: • Financial revenue from loan portfolio to include interest on loan portfolio and fees and commissions on loan portfolio • Financial revenue from investments

	• Other operating revenue **Write the account names on the overhead.** Participants could use different terminology for account names. The Facilitator must understand the type of account that is being discussed and translate the account to the terminology that is described in the templates used in class. The terminology used in this course, and in the templates, is the terminology that participants are encouraged to use. **Review the definition of each account of financial revenue** As you review the definition of each account identify the cross-reference statement. Note again that many of the accounts listed in these statements will apply to financial institutions, such as MFIs. The statements are general enough to use for community banks, as well. The inclusion of both institution and client account information is made so that participants can use these statements for a broad range of analysis, including an analysis of individual client loan applications, and an analysis of an institution with which it may want to partner, such as a community bank. **Ask participants how you calculate Financial Revenue from Loan Portfolio? (This would be relevant if you were to want to analyze the financial documents of a community bank partner.)** **Response**: Interest on Loan Portfolio + Commission and Fees on Loan Portfolio I3 +I4. Write this calculation on the overhead under calculations for Financial Revenue from Loan Portfolio. **Tell** Financial revenue is the total value earned from the provision of financial services. **Ask** How do we calculate financial revenue? **Response** Financial Revenue from Loan Portfolio + Financial Revenue from Investments + Other Operating Revenue I2 + I5 + I6. Write this calculation on the overhead under calculations for financial revenue (I1). **Ask** What accounts are included under financial expense? Responses include:

	• Financial expense on funding liabilities to include interest and fee expense on deposits and interest and fee expense on borrowing • Other financial expense **Write the account names on the overhead/word document.** Participants might use different terminology for account names. The Facilitator must understand the type of account that is being discussed and if necessary translate that language to use the terminology that is described in the Framework. The terminology in the Framework is the terminology that participants are encouraged to use. **Review the definition of each account** **Ask** How do you calculate Financial Expense on Funding Liabilities? **Response** Interest and Fee Expense on Deposits + Interest and Fee Expense on Borrowings I9 + I10. Write the response on the overhead in the calculation column for Financial Expense on Funding Liabilities (I8). **Ask** How do you calculate Financial Expense? **Response** Financial Expense on Funding Liabilities + Other Financial Expense (I8 + I11) Write the response on the overhead in the calculation column for Financial Expense (I7). **Tell** The Net value of financial earnings from financial services is called Net Financial Income. **Write** Net Financial Income on (I12). **Ask** How do you calculate Net Financial Income? **Response** Financial Revenue – Financial Expense (I1) – (I7).

	Ask What does the net financial income tell you? **Describe Impairment Losses on Loans, Provision Expense for Loan Impairment, and Value of Loans Recovered** <u>Impairment Losses on Loans</u>: Previously knows as net loan loss provision expense, it is ([I14]) Provision for Loan Impairment net of the (I15]) Value of Loans Recovered. This amount is used to create or increase the (B5) Impairment Loss Allowance on the balance sheet <u>Provision Expense for Loan Impairment</u>: Previously known as the Gross Loan Loss Provision Expense, the non-cash expense calculated as a percentage of the value of the loan portfolio that is at risk of default. This value is calculated in the portfolio report. <u>Value of Loans Recovered</u>: Total value of principal recovered on all loans previously written off. This includes principal on partially recovered loans and those recovered in full. Subsequent recoveries of loans previous written off decrease the amount of the (I14) Provision for Loan Impairment, and the net amount is booked as (113) Impairment Losses on Loans. **Ask** What accounts are included under Operating Expense? (These could be the operating expenses of either an individual MSME operator, or those of a partner institution, such as a community bank.) **Responses include**: • Personnel Expense • Administrative Expense to include depreciation and amortization expense and other administrative expense **Write the account names on the overhead.** Participants might use different terminology for account names. The Facilitator must understand the type of account that is being discussed and use the terminology that is described in the Framework. The terminology in the Framework is the terminology that participants are encouraged to use. **Review the definition of each account** When reviewing the definitions remember to discuss how to calculate Administrative expense. The response you are looking for is: Depreciation and amortization expense + other administrative expense. I19 + I20. Remember to write this calculation on the overhead.

	Ask How do you calculate the total Operating Expenses? (I17) Personnel + (I18) Administrative Expenses **Describe Net Operating Income** Net Operating Income is the net earnings from the provision of financial services. To calculate this you must: Net Financial Income - Impairment Losses on Loans – Administrative Expenses I12 – I13 – I18 **Review non-operating revenue and non-operating expense** Summarize or ask participants to review what was discussed about non-operating revenue and expense. <u>Non-operating Revenue</u>: All revenue not directly related to core microfinance operations, such as revenue from business development services, training, consulting services, management information system sales, or sale of merchandise. It does not include donations (see I28). This account also includes any exceptional gains and revenues. Large or relevant non-operating revenue categories should be listed as separate line items as appropriate. <u>Non-Operating Expense</u>: All expenses not directly related to the core microfinance operation, such as the cost of providing business development services or training. This account also includes any exceptional losses and expenses. Large or relevant expense categories should be listed as separate line items as appropriate. **Point out on the overhead these two accounts.** **Describe Net Non-Operating Income/(Expense) and how it is calculated.** The net earnings from products and services not directly related to core microfinance operations. Institutions should disclose large material amounts of non-operating revenue separately by creating accounts under (I23) Non-Operating Revenue or (I24) Non-Operating Expense. **Ask** What is net income (before taxes and donations)? **Response to include** All net earnings from the institution's operations before the inclusion of taxes and donations. **Describe how to calculate Net Income** Net Operating Income + Net Non-Operating Income/(Expense)

	I21 + I22 Write the calculation on the overhead. **Discuss and define Taxes and Net Income (After Taxes and Before Donations.** <u>Taxes</u>: Includes all taxes paid on (I26) Net Income or other measure of profit as defined by local tax authorities <u>Net Income (After taxes and before donations)</u>: All net earnings from the institution's operations, net of (I26) Taxes, and before the inclusion of (I28) Donations. **Ask how Net Income is calculated.** Response Net Income Before Taxes and donations – Taxes I25 – I26 **Discuss donations** It was described earlier that in this Framework all donations are included in the income statement. This includes donations for loan capital and donations for operating expenses. **Write** Donations for Loan Capital (I29) and Donations for Operating Expenses (I30) on the income statement overhead. **Ask** Why are donations in the income statement? To increase transparency. This entry is of particular relevance to MFIs as these institutions continue to receive grants for use in both their operating and lending activities. Again, this may not be as relevant to the operations of community banks in Nigeria, but it is still worth knowing this information in the event that a community bank applicant is receiving any implicit or explicit subsidies to support any part of its operations. The overall importance of including donations or subsidies of any sort in the income statement is to provide the analyst with an objective means through which to determine if a financial institution has the prospect to exist absent the subsidy or donation. In other words, it focuses on the long-term viability and sustainability of the entity. **Show that (I28) Donations is the value of all donations recognized as revenue during the period, whether restricted or not.** To calculate Donations: Donations for Loan Capital + Donations for Operating Expenses (I29) + (I30)

Ask
How do we calculate Net Income (After Taxes and Donations)?
Net Income (After Taxes and Before Donations) + Donations
(I27) + (I28)

Ask
What does Net Income tell you about the institution?

Describe
Institutions may want to create subaccounts under some of the income statement and balance sheet accounts for management purposes. As an example, the Framework contains only two categories of Administrative Expenses: (I19) Depreciation and Amortization; and (I20) Other Administrative Expenses.

Ask
How would you add additional accounts under (I20) Other Administrative Expense?

(I20) Other Administrative Expense
(I20-1) Rent
(I20-2) Transportation Expenses
(I20-3) Office Supplies

Describe
Adding sub- or secondary accounts enables users to track certain accounts particular to their business while maintaining consistency with industry standards. Note that this Framework is not a substitute for a chart of accounts, and any accounts added are for analytical rather than accounting purposes.

Show
Sample income statement (handout 2.2) on overhead projector. Give participants a copy of the income statement.

Practice mapping income and expense information into the income statement.
After introducing the income statement, participants need to practice and use the new information. The trainer should use this opportunity to reinforce the importance of the mapping exercise in the overall development of sound financial statements. Here, mapping is defined as translating an institution's "raw" financial data into the standard definitions and format outlined in this module. For example, if a commercial bank officer is reviewing a loan application from a

	community bank, the officer may want to reconstruct financial statements with the applicant, utilizing the information in this section to "map" data into a format that conforms with generally accepted accounting practices. Once this mapping has taken place, the loan officer can utilize standard tools, such as the Chemonics Community Bank Assessment Tool (CBAT), to assess the soundness of the institution, as part of the overall loan application process. The following "mapping exercise" was developed by The SEEP Network so that external analysts could make meaningful comparative analysis between various MFIs using a standard reporting format. Mapping of community bank data can also achieve the same goal of making data from one institution to another more uniform and, from an accounting standpoint, more meaningful. **Tell** Participants they will start to work with financial information from NigCom, a representative community bank. As managers, your job is to map the income and expense information into the income statement. . **Divide** Participants into pairs. These teams will work together during the training when working on the case study. Participants from the same organization can work together during the case study as this will give them a good opportunity to see how their different operations are inter-connected. **Distribute** Handout 2.3 NigCom Income and Expense Information. This handout has 4 pages: an instruction page, NigCom Income and Expense Information (2 pages), a blank income Statement. **Describe** To participants that in their teams they need to review the income and expense information provided. Based on this information, participants will map NigCom's income statement into the income statement. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for the statement format. Participants need to create an Income Statement for two years. Participants have 30 minutes to work on this. Reinforce the purpose of this exercise, which is to develop standard financial statements and documents so that external reviewers can make meaningful analysis of financial information from one community bank to another. **Review** activity in large group. Depending on time, there are a few ways to process this activity.

	1. Option one: The facilitator can show an overhead of the completed Income Statement. The facilitator can walk participants through the mapping of the income and expense information through question and answer. 2. Option two. Using a blank overhead of the Income Statement the facilitator can ask one group at a time for specific information. For example, ask" What is the Financial Revenue from Loan Portfolio?" Ask what financial information they used to get this financial revenue? Write this information into the overhead. Continue asking each group for specific pieces of information to fill in the Income Statement. **Ask** Participants what was difficult/challenging about mapping the information? How can this be done efficiently in their organizations?

<table>
<tr>
<td>

Step 3:

Guided Discussion Demonstration

1 hour 30 min

Handouts:
2.4 Balance Sheet Template
2.5 Sample Balance Sheet

Overhead:
2.3 Balance Sheet Template

</td>
<td>

The Balance Sheet

Give participants handout 2.4 The Balance Sheet

Ask
What is a balance sheet?
When is a balance sheet produced?

Summarize the balance sheet

- The balance sheet is a *stock* statement.
- Captures the *financial position* or *financial structure* of an MFI or business at a moment in time.
- A balance sheet is usually produced monthly or quarterly (at a minimum, annually.
- The balance sheet summarizes the ending balance of all asset, liability, and equity accounts

Ask
What are the three major categories of accounts of the balance sheet?

- Assets—everything a business *has* (such as investments, vehicles) or is owed (such as microloans, interest receivable);
- Liabilities—everything the business owes to others (such as borrowings, deposits); and
- Equity—the business' net worth; that is, the difference between assets and liabilities.

As the name implies, the balance sheet is presented in a way that shows the following:

Write on flipchart Assets = Liabilities + Equity

Describe short-term and long-term

- Assets and liabilities are divided into short-term and long-term accounts in financial statements. Short-term (or current) assets and liabilities can be turned into cash within a year from the date of the statement or report - not from the date of disbursement, issuance, or purchase.

- In addition, short-term assets and liabilities include any portion of a long-term asset or liability that is receivable or payable within a year, even if the final maturity date is more than a year from the report or statement date.

</td>
</tr>
</table>

Ask
How do you group assets and liabilities on the balance sheet?

According to IAS, the most useful approach to the classification of assets and liabilities on a balance sheet is to group them first by *type* and second by *maturity.*

Ask a participant to review what an asset is.
Everything a community bank or an individual business operator *has* (such as investments, vehicles) or is owed (such as loans, interest receivable); A resource controlled by an institution or a business as a result of past events and from which future economic benefits are expected to flow to the institution.

Generate a list of assets to include on the balance sheet. Ask participants What accounts are included as Assets?

- Write this list on a flipchart.
- Facilitator to remember that the terminology participants' use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then translate that to use the terminology from the Framework.
- Any accounts that are not introduced by the participants must be described by the Facilitator.
- Ask participants to list actual assets from their respective institutions whenever possible, for each category.

Additional talking point about assets on the balance sheet

- Contra Asset Accounts: Most accounts have positive numbers. In a few cases, accounting principles require an account that has a negative number. These subaccounts represent a *reduction* of an asset and are referred to as *contra asset accounts*. A typical contra asset account for a financial institution is (B5) Impairment Loss Allowance (previously known as Loan Loss Allowance), which has the effect of reducing the value of the gross loan portfolio on the balance sheet. You will only encounter such an account if you are analyzing a financial institution or intermediary.

Define and record assets on the balance sheet as presented in the Framework

- Facilitator to specifically note that the Framework balance sheet refers to (B2) Trade Investments and (B8) Other Investments rather than short-term and long-term investments. This reflects IFRS principles that state that a

	financial institution or individual business operator's *use* or *intended use* of a financial asset is more relevant than its actual maturity. • Include a description of how to calculate Net Loan Portfolio, Net Fixed Assets, and Total Assets. **Review what liabilities are. Ask a participant to summarize liabilities.** Everything the community bank or an individual business owner owes to others (such as borrowings, deposits) represents a present obligation of the institution or businessman arising from past events, the settlement of which is expected to result in an outflow from the institution of resources with economic benefits. **Generate a list of liabilities** Ask participants to turn to his or her neighbor and work on a list of accounts to include as liabilities on the balance sheet. (5 minutes) Go around the room and ask each group to name and describe one liability account. Write this on a flipchart. When all accounts have been identified write the liability accounts on the balance sheet. • Facilitator to remember that the terminology that participants use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then use the terminology from the Framework. • Any accounts that are not introduced by the participants must be described by the Facilitator. **Define liabilities on the balance sheet as presented in the Framework** **Review Equity** As defined by IAS, the residual interest in the *assets* of an institution after deducting all its *liabilities* represents the financial institution or individual businessman's net worth. **Generate a list of accounts to include under Equity. Write these on the flipchart** • Facilitator to remember that the terminology participants' use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then use the terminology from the Framework.

	• Any accounts that are not introduced by the participants must be described by the Facilitator. **Define and record equity accounts on the balance sheet as presented in the Framework** Ask participants to list the equity accounts so that you can write them on the balance sheet. **Remember** to use the terminology presented in the framework. **Additional talking point—focus on gifts and SMIEIS Fund contributions to community banks:** • Donations - This Framework recommends the income approach to donations so that all donations for operations and loan funds used in the current operating period are recorded as (I28) Donations on the income statement, which flow into (B25) Donations, Current Year on the balance sheet. At the beginning of a new year, they are transferred from (B25) to (B24) Donations, Previous Years. Donations for operations and loan funds to be used beyond the current operating period are recorded as deferred revenue. If the donation or grant agreement specifies when the donations must be used, record those that must be used within 12 months as (B17) Accounts Payable and Other Short-term Liabilities, and record the remainder as (B20) Other Long-term Liabilities. When a portion of donations is used, that portion is transferred to the income statement (I28) Donations. For the community bank, donations can be defined as contributions to business operations by family members or friends, with the expectation that these funds will not be repaid. - In addition, community banks should consider contributions derived through the SMIEIS Fund as a donation in their accounting reports. - Community banks may record grants for fixed assets as deferred revenue (B20) Other Long-term Liabilities. When the asset is purchased, and he purchase amount is transferred to (I30) Donations for Operating Expense. Again, for the individual MSME operator, “grants” would

	be defined as any contribution or gift to the business operator. - If fixed assets are donated, community banks should record their value as deferred revenue in (B20) Other Long-term Liabilities. Each accounting period, usually monthly or quarterly, an amount equal to the period's depreciation for the donated asset is transferred to (I28) Donations for Operating Expense, and the same amount is credited to (I17) Depreciation and Amortization. If the community bank is not recognizing a fixed asset donation in this manner, it should include the value of the fixed asset as part of the adjustment. Include a description of how to calculate Donated Equity B24 + B25 Retained earnings B27 + B28 Total Equity B22 + B23 +B26 +B29 +B30 + B31 **Handout and show overhead 2.5** **Tell** Participants will continue to work with financial information from NigCom, our representative community bank. They now have the information from NigCom's balance sheet. As was done with the income statement, participants must map the financial information from the balance sheet into the balance sheet format. **Tell** Participants they will work in their same groups as before. **Distribute** Handout 2.6, NigCom's Balance Sheet Information. This handout has 4 pages: an instruction page, NigCom's Balance Sheet (2 pages), a blank sample Balance Sheet. Also included is the NigCom Balance Sheet Information with notes for facilitator, and a completed sample Balance Sheet with Facilitator notes. **Describe** To participants that in their teams they need to review the information provided. Based on this information they need to map NigCom's balance sheet financial information into the sample balance sheet. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for the balance sheet format. Participants need to create a balance sheet for two years. Participants have 30 minutes to work on this.

	Review activity in large group. Depending on time there are a few ways to process this activity. 1. Option one: The facilitator can show an overhead of the completed Balance Sheet. The facilitator can walk participants through the mapping of the balance sheet through question and answer. 2. Option two. Using a blank overhead of the Balance Sheet the facilitator can ask one group at a time for specific information. **Ask** Participants what was difficult/challenging about mapping the information? How can this be done efficiently in their organizations? •

Step 4

Guided Discussion Activity

1 hour 30 min

Handouts:
2.8 Cash Flow Template
2.9 Sample Cash Flow

Overhead:
2.6 Classification of Cash Receipts and Payments
2.8 Cash Flow Template
2.10 Indirect Cash Flow

Activity Material:
2.7 Cash Flow Activity

Prepared Flipchart:
Cash Flow Statement Categories with Definitions

The Cash Flow Statement

Note to Facilitator: This session reviews in detail a Direct Cash Flow Statement. At the end of the session the Indirect Cash Flow Statement is mentioned but not in detail. Depending on time, participant interest, and knowledge the indirect cash flow statement can be expanded or just referenced.

Ask
What is a cash flow statement?
What valuable information does a cash flow statement provide?
Why would a loan officer be interested in analyzing the cash flow statement as part of the credit analysis of a loan applicant?

- The cash flow statement is a flow statement that represents the inflows and outflows of cash during a specified period.
- The cash flow statement summarizes each transaction or event that causes cash to increase (sources of cash) or decrease (uses of cash).
- The cash flow statement

Describe that a cash flow statement classifies the inflows and outflows of cash into three major categories.

- Operating Activities
- Investing Activities
- Financing Activities

The loan officer will always need to be concerned with the cash flow risk of the borrower, namely the risk that the cash generated will not be sufficient to repay the loan. A business may not be able to repay its loan out of profits because its profits may be tied up in inventory or accounts receivable.

Understanding the cash flow of the community bank is one of the most important tasks of the commercial bank loan officer. Note, however, that while the institution or businessman might have cash on had, this does not mean that your loan will be paid off first. The financial institution may decide to repay another debt before paying back its' loan to the commercial bank. Continual monitoring of the community bank may be necessary to understand how funds are flowing through the financial institution. The cash flow statement is a good starting point in this analysis. Character- and enterprise-based assessment will also help the loan officer understand the true flow of the entity's funds, as well as the likelihood of repayment based on the client's character and overall health of the enterprise.

Ask what each of the categories is? Have a prepared flipchart with the following information:

Cash Flow Statement Categories with Definitions

- *Operating Activities*, the cash receipts and payments related to the community bank's ongoing provision of financial services, including lending and deposit services;
- *Investing Activities*, the cash receipts or outlays for acquiring or selling (B10) Fixed Assets or financial investments; and
- *Financing Activities*, the borrowing and repayment of borrowings, the sale and redemption of (B22) Paid-In Capital, and the payment of dividends.

Show overhead 2.6 Classification of Cash Receipts or Payments or a flipchart that has a similar table

So that participants understand the differences of the classifications ask the group to list examples of receipts and payments for each classification. Responses that can be included are on the following page.

Classification	Receipts	Payment
Operating Activities	▪ Principal repayments ▪ Interest and fee receipts on the (B4) Gross Loan Portfolio and investments ▪ Other receipts for the provision of financial services ▪ Funds received from accepting deposits	▪ Loan disbursements ▪ (B2) Purchase of Trade Investments ▪ Interest and fee payments ▪ Payment to Personnel or for (I18) Administrative Expenses ▪ Taxes paid ▪ Funds repaid to depositors
Investing Activities	▪ Proceeds from the sale of an investment ▪ Proceeds from the sale of (B10) Fixed Assets	▪ Purchase of (B8) Other Investments ▪ Purchase of (B10) Fixed Assets
Financing Activities	▪ Funds received from borrowings ▪ Receipt of (B22) Paid-In Capital from the sale of shares or membership	▪ Principal repaid on borrowings ▪ Repurchase of (B22) Paid-In Capital ▪ Payment of dividends

Explain that there are two ways a cash flow statement can be constructed

- Direct method that shows all the cash transactions in and out of the Cash and Due from Banks account.
- The direct method for preparing a cash flow statement is the most intuitive of the methods. It reconstructs the income

	statement by tracing the movement of cash and adds other events not included on the income statement that have caused an inflow or outflow of cash. • Indirect method deduces the movement of cash based on the changes in specific income statement and balance sheet accounts. • It begins with the (I28) Net Income (After Taxes and Before Donations) and then adds back all other sources of cash (such as loan payments) and subtracts all other uses (such as loan disbursements) that can be deduced by changes in balance sheet accounts. **Add that both methods can be used for this Framework.** **Construct, Define and review a direct cash flow statement.** 1. Pass out to all participants 1 or 2 cards from material 2.7 (Constructing a Cash Flow Statement) and a copy of overhead/handout 2.8 Direct Cash Flow Statement Template. Each card has one term written on it from operating activities, investing activities, or financing activities. Depending on how many participants are in the training, each person should get at least one card. If some people need to get more than one card, make sure the cards they have are from the same category. Make sure that the cards are large enough so that people can read them from the back of the room. 2. Instruct participants to group themselves according to what "category" of account they have. For instance, operating, investing, or finances activity. 3. Once all participants are in their appropriate category, tell them to arrange themselves according to how a cash flow statement is constructed. 4. Start with the operating activities group. Ask them to describe how they constructed this category. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart. 5. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate. 6. Ask the investing activities group how they constructed this category. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart.

7. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate.

8. Finish with asking the finances activities group how they constructed their account. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart.

9. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate.

Show overhead 2.8. Starting with the first account of the direct cash flow statement Cash Received from interest, fees, and Commissions on Loan Portfolio, ask the participant with that card to describe the account in more detail. Ask other participants for additions or corrections to the definition. Ask the participant to cross-reference the account. Tell participants the cross-reference if necessary. Write a brief definition and the cross-reference on the overhead/projector. Proceed with working your way through the other terms until the Cash Flow Statement is complete.

Show and handout overhead/handout 2.9 Sample Direct Cash Flow Statement.

State that many of the accounts used for the indirect cash flow statement are the same as those in the direct cash flow statement.

Show overhead 2.10 Indirect Cash Flow Statement.

Review the accounts of the Indirect Cash Flow Statement, specifically identifying the cross-references to the Direct Cash Flow Statement.

Tell Participants they will work on their case study in their same groups as before.

Distribute
Handout 2.12 NigCom Cash Flow. This handout has 3 pages: an instruction page, NigCom's Cash Flow Data, a blank Cash Flow Statement. Also included is a completed Cash Flow statement.

Describe
Participant teams will need to review the information provided. Based

	on this information, they need to map NigCom's cash flow financial information into the cash flow statement. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for cash flow statement format. Participants need to create a cash flow statement. Participants have 30 minutes to work on this. **Review** activity in large group. Depending on time there are a few ways to process this activity. 3. Option one: The facilitator can show an overhead of the completed cash flow statement. The facilitator can walk participants through the mapping of the cash flow through question and answer. 4. Option two. Using a blank overhead of the cash flow statement the facilitator can ask one group at a time for specific information. For example "Describe the financial data for cash flow from operating activities. Write this information into the overhead. Continue asking each group for specific pieces of information to fill in the cash flow statement. **Ask** Participants what was difficult/challenging about mapping the information? How can this be done efficiently in their organizations? **NOTE TO FACILITATOR** At the end of the day there is time allocated for participants to continue with inputting data into the spreadsheet tool.

Step 5 1 hour Overhead/handout 2.16 Matrix to Identify Linkages between Financial Statements	**Linking Financial Statements** **Review key points about financial statements and reports. Emphasize:** • A lot of time was spent on reviewing financial statements, learning how to categorize data into statements and reports, and becoming familiar with new terminology. • The financial statements and reports presented in this chapter include the minimum of information necessary to present accurately an MFI's activities and results. All information presented in this framework is significant and noteworthy. • Every item is also necessary for managers to analyze the MFI's performance and condition and to create performance monitoring reports for themselves and others. • Communicating less (but meaningful) information is sometimes better than providing detailed information without explanation. Executive summaries, narratives, and footnotes are vital to making financial statements transparent and accessible to non-financial readers and financial analysts alike. **Say** The financial statements used in this Framework are linked. Managers should learn the primary connections among the statements. **Ask** Why is it important to know and understand the linkages between the financial statements? What does this tell us? **Describe activity** To understand and become more familiar with how the financial statements are linked we will work on an activity. The purpose of the activity is for participants to compile a list of main links between financial statements that we have worked with. For this activity participants will need their copy of handout 2.2

	Sample Income Statement, handout 2.5 Sample Balance Sheet, handout 2.10 Sample Direct Cash Flow Statement, handout 2.13 Sample Portfolio Report. 1. Describe the outcome of this activity: Each group is to identify as many linkages between the financial statements (income statement, balance sheet, cash flow statement, and portfolio report.) in 20 minutes. Using the handout/overhead 2.16 Matrix to Identify Linkages Between Financial Statements the groups are to write the main links they can identify between the statements and determine the relationship in the last column. There is one example of a link in the matrix. The facilitator can show the overhead 2.16 and describe the example. 2. Divide participants into groups of 3 people. Tell participants that each person needs a copy of the sample income statement, balance sheet, direct cash flow statement, and portfolio report. They need to consult these statements to identify the common links. Remind participants that cross-references are included in their sample statements. 3. Give each participant a copy of handout 2.16. 4. The groups have 20 minutes to work. 5. Process activity. At the end of 20 minutes review the list of links that the groups identified. 6. Ask one group at a time to discuss one link they identified. They need to articulate the link between the statements and then describe the relationship. Write the information on the overhead 2.13 Matrix. Go around the room so all groups discuss at least one link. **Ask again** Why, as managers, do we need to know and understand the links between the financial statements? What information can this tell us or reveal to us?
Step 6	**Class Exercise: Constructing Financial Statements and Reports (do this?)**

Step 7 — Ratio, Trend, and Variance Analysis

Lecture and Discussion

Time:

Ratio Analysis

Ask
Participants how they currently report financial information to various constituents both within and outside of their institutions. If they use ratio analysis, ask what types of ratios they currently use in their analysis, and why they use these.

Present an overview of the importance and purpose of ratios within the context of financial management and reporting.

Managers can use standard financial data to monitor the institution's overall performance against that of other community banks. In addition, maintaining a core set of performance and management ratios is a sound way to monitor internal performance.

Introduce the ratios used in the PRISMS CBAT:

The PRISMS CBAT breaks the ratios into four categories:

Asset Quality:
Determines the quality of the community bank's loan portfolio and the risk of default.

Profitability:
These "bottom-line" ratios are designed to measure the earning power and profitability record of the community bank.

Liquidity and Solvency:
These ratios aim to measure the ability of the community bank to meet its short-term liabilities as they come due.

Efficiency and Productivity:
Measures the efficiency with which resources are employed to earn a profit.

Many of the ratios that you will be calculating with the PRISMS CBAT are derived from the Global MicroRate Africa's Technical Guide on Performance Indicators for microfinance indicators, and can be found in other standard MFI guides, as well.

Ask
Participants why measuring within the above categories is important to community bank operations.

Review a set of commonly used financial reporting ratios, derived from the PRISMS CBAT.

Liquidity & Solvency

1. **Current Ratio:**

Indicates the ability of near-cash assets to pay off the community bank's current liabilities.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

2. **Cash Ratio:**

This ratio can be used to demonstrate the ability of the community bank to pay off current liabilities with highly liquid assets.

$$\frac{\text{Cash + Short-term Investments}}{\text{Current Liabilities}}$$

3. **Cash Flow Ratio:**

Indicates how well the cash flow from the bank's operations can cover the cash needed to settle short-term liabilities.

$$\frac{\text{Cash Flow from Operations}}{\text{Current Liabilities}}$$

4. **Liquidity Ratio**:

This ratio indicates the level of cash and cash equivalents the community bank maintains to cover short-term liabilities. Short-term is defined as assets or liabilities or any portion of these items that have a due date, maturity date, or may be readily covered to cash within 12 months.

<u>Cash + Trade Investments</u>
(Demand Deposits + Short-term Time Deposits + Short-term

Borrowings + Interest Payable on Funding Liabilities + Accounts Payable and Other Short-term Liabilities)

5. **Debt-to-Equity Ratio**:

Measures the overall level of leveraging in the community bank, or "buffer" the institution has to absorb losses after all current and long-term liabilities have been paid.

$$\frac{\text{Liabilities}}{\text{Equity}}$$

6. **Capital Adequacy Ratio**:

Capital adequacy means that there is a sufficient level of capital to absorb potential losses without endangering depositors and creditors. If the ratio has been declining, it may indicate an inability to generate sufficient returns. For most community banks, the first category (0% weight)--which includes cash, central bank balances, and government securities—and the last (100% weight)—which includes loans to private entities—are the most relevant. CBs generally do not have fully secured loans or off-balance sheet items.

$$\frac{\text{Total Equity}}{\text{Total Risk Weighted Assets}}$$

Asset Quality

7. **Portfolio at Risk (PAR)**:

This ratio is the most widely accepted measure of portfolio quality. The most common international measurements of PAR are greater than 30 and 90 days.

$$\frac{\text{PAR} > 30 \text{ Days} + \text{Value of Renegotiated Loans}}{\text{Gross Loan Portfolio}}$$

8. **Provision Expense Ratio:**

Shows what percentage of the PAR is covered by actual loan loss reserves. Indicates how prepared the community bank is for a worst-case scenario.

$$\frac{\text{Loan Loss Provisioning Expense}}{\text{Average Gross Portfolio}}$$

9. **Risk Coverage Ratio**:

Represents the portion of the portfolio at risk that is covered by the community bank's Impairment Loss Allowance.

$$\frac{\text{Impairment Loss Allowance}}{\text{Portfolio at Risk (PAR)} > \text{30 Days}}$$

10. **Write-off Ratio:**

This ratio represents the proportion of the community bank's loans that has been removed from the balance of the gross loan portfolio because it is unlikely to be repaid. This rate varies from institution to institution, depending on management policy.

$$\frac{\text{Value of Loans Written Off}}{\text{Average Gross Loan Portfolio}}$$

Efficiency & Productivity

11. **Operating Expense Ratio**:

This ratio highlights both personnel and administrative expenses relative to the gross loan portfolio. It is regarded as the most commonly used indicator of the community bank's efficiency.

$$\frac{\text{Operating Expense}}{\text{Average Gross Loan Portfolio}}$$

12. **Cost per Borrower:**

This ratio shows the efficiency level of the community bank by showing the average cost of maintaining a borrower on a per-unit basis.

$$\frac{\text{Operating Expense}}{\text{Average Number of Active Clients}}$$

13. **Personnel Productivity**:

This ratio measures the average cost of maintaining one borrower relative to the total number of the community bank's general personnel.

$$\frac{\text{Number of Active Borrowers}}{\text{Number of Personnel}}$$

14. **Loan Officer Productivity**:

This ratio measures the average caseload, or average number of borrowers managed by, each loan officer.

$$\frac{\text{Number of Active Borrowers}}{\text{Number of Loan Officers}}$$

15. Staff Turnover

Cost of Funds

16. Funding Expense Ratio:

Measures the total interest expense incurred by the institution to fund its loan portfolio.

$$\frac{\text{Interest and Fee Expenses}}{\text{Average Gross Portfolio}}$$

17. Cost of Funds Ratio:

This ratio calculates a blended interest rate for all of the community bank's funding liabilities.

$$\frac{\text{Financial Expenses on Funding Liabilities}}{\text{(Average Deposits + Average Borrowings)}}$$

Profitability

18. Return on Equity:

Calculates the rate of return on the Average Equity for the period. Because the numerator does not include non0operating items or donations and is net of taxes, this ratio is typically used to determine commercial viability.

Net Operating Income-Taxes
Average Equity

19. **Return on Assets**:

Measures how well the institution uses its assets to generate returns. This ratio is net of taxes and excludes non0operating items and donations.

Net Operating Income-Taxes
Average Assets

20. **Portfolio Yield**:

The yield on gross portfolio indicates the community bank's ability to generate cash from interest, fees, and commissions on the Gross Loan Portfolio. Revenues that have been accrued, but not paid in cash, are not included.

Cash Received from Interest, Fees, and Commissions on Loan Portfolio
Average Gross Loan Portfolio

21. Net Interest Margin:

Measures the profitability of the CB's loan portfolio after taking into account the cost of funding. For net interest margin to be meaningful, it must be understood in the context of the prevailing interest rate environment in which the CB operates. Using the inter-bank rate or short-term Treasury Bill rate as proxies will help set this context. Initial indicator of an institution's ability to generate revenue to cover its operating expenses.

Net Interest Income
Average Gross Portfolio

22. **Non-Interest Income**:

Indicates how much of the CB's income is not related to its loan portfolio. An exception is extraordinary or one-time income, which should be removed from the calculation so that a true trend can be established.

$$\frac{\text{Non-interest Income}}{\text{Total Operating Income}}$$

Trend Analysis

- Be familiar with trend analysis methodology

Ask
Participants to define "trend analysis" and to describe why trend analysis might be useful to commercial bank operations.

Write responses on flipchart.

Summarize (if possible, utilizing participants' responses) the main components of variance analysis. Responses should include:

Trend analysis is the examination of a financial institution's financial statements and indicators (such as ratios) over a specified period to time. Commercial banks can undertake trend analysis of community banks as a way to determine how the actions of management affect performance.

Describe to participants the value of trend analysis, and the method for performing trend analysis.

Trend analysis can help management understand how certain management decisions impact upon both short- and long-term performance. Here are two ways in which management can undertake trend analysis:

- Compare the current period to the previous period of the same length, such as the previous quarter and the current quarter,
- Annualize the indicators for the current reporting period and compare the annualized indicators to the previous year.

Write on a flipchart and refer to Handout x:
The basic formula for determining the change in an account is a percentage change formula, expressed as follows:

$\mathbf{P^{trend} =}$

$$\frac{\mathbf{P^1 - P^0}}{\mathbf{P^0}}$$

Let's use the following data to undertake some trend analysis:

Here is a sample list of loans disbursed over the past six months by NigCom, our fictitious community bank in rural Nigeria.

Table x

Month	P1	P2	P3	P4	P5	P6
January	250					
February		110				
March			195			
April				225		
May					275	
June						290

Ask
Participants to use the data and formula above to determine the percentage rate of change in the loans disbursed by NigCom.

Answer:

Table y

	P1	P2	P3	P4	P5	P6
Loans Issued	250	110	195	225	275	290
Increase/decrease		(140)	85	30	50	15
% Rate of Change		(56) decrease	77 increase	15.4 increase	22 increase	5.45 increase

Let's discuss the findings of this basic analysis:

It is important to analyze the changes in any data—accounts or ratios—to try to determine why the data is showing an increasing or decreasing trend. In the case of NigCom's above data, we see a significant dip in the number of loans disbursed between periods 1 and 2. Management should look at several categories within the bank's operations during this time to develop plausible and credible explanations for this sudden change in performance. For example, was there a change in the number of loan officers disbursing loans during this time? Could seasonal fluctuations explain the sudden decrease in loans? Was there a change in the effective interest rate, or any other aspect of the loan product, to make it less attractive to clients? How about NigCom's competition—were they offering better options to clients during this time? And what did it take for NigCom to increase the loan disbursement level from period 3 onward?

Ask participants for a list of possible reasons for both the increasing and decreasing trend in NigCom's loan disbursal from P1 to P6. Write responses on a flipchart.

Explain how ratios can be used in undertaking trend analysis. To undertake ratio trend analysis, determine the absolute change between periods rather than the relative change, using the following formula **(write the following formula on a flipchart and refer to Handout x):**

$$\mathbf{R^{trend} = R^1 - R^0}$$

For example, let's refer back to ratio #7, Portfolio at Risk (PAR). Let's say we have a PAR of 8% in P^0, and a PAR of 10% in P^1. In this case, we observe the following trend:

$$\mathbf{PAR^{trend} = 10\% - 8\% = 2\%}$$

Here, we see an increasing trend (by 2 percent) in the community bank's portfolio at risk. What might account for this increase?

Ask participants for a list of possible reasons for the increasing trend in the community bank's portfolio at risk. Write responses on a flipchart. Responses might include the following:

- Seasonal fluctuations resulting in a decrease in productivity and commensurate household income with which to service the debt.
- Insufficient training of clients in the importance of timely and full repayment of loans.
- Poor marketing of products.
- Poor targeting and screening of clients.
- Inadequate collection policies and procedures.

Variance Analysis

Now, let's look at variance analysis. First, ask participants how they would define variance analysis. Write responses on a flipchart. Responses should include the following:

- Variance analysis is a generally accepted management tool ***used to measure management's success, or failure, in meeting the goals*** it has set out in planning documents, such as strategic plans.
- Variance analysis ***compares actual performance*** of the commercial bank ***to the bank's projected or planned performance.***
- The most important part of variance analysis is the ***assessment*** management makes of the comparative data, and whether or not management incorporates this information into future planning and programming activities.

Variance analysis utilizes the following formula (write the formula on a flipchart and refer to Handout x):

$$\mathbf{P^{var}} = \frac{\mathbf{P^{actual}}}{\mathbf{P^{plan}}}$$

This ratio enables management to calculate the relative change between periods. Let's use as an example using NigCom's planned gross portfolio amount and its actual gross portfolio level to determine if the community bank has met its target:

$$\text{Gross Loan Portfolio}^{var} = \frac{1{,}244{,}000}{2{,}225{,}000}$$

= approximately 56%

Ask participants to explain what this percentage indicates about the performance planning of NigCom. Write answers on a flipchart. Answers should include:

NigCom only reached about 56 percent of its target gross portfolio goal during this evaluation period. Either its planning estimates were unrealistic, or some significant shocks prevented NigCom from reaching this goal.

Show participants that the same formula can also be used with ratios:

Let's assume that NigCom projected that its Return on Assets (ROA) level would be 110% in the year under review, but its actual end-year ROA was 120 %.

<u>PAR^{var} = P^{actual}/P^{plan}</u>

= 110/120

= 91.6%

Ask participants to interpret this finding. Write responses on a flipchart. Answers should include:

In this case, NigCom reached nearly 92 percent of its goal.

As is the case with trend analysis, take care to read the data correctly. In the next example, NigCom projected that its ROA level would be 120% by the end of the year in review, but its actual end-year ROA was 110%. In this case, we can compare the absolute difference between the two ratios:

$R^{va}r = R^{actual} – R^{plan}$

ROA^{var} = 110-120

= |-10|

= 10%.

In this case, NigCom missed its target ROA level by 10 percent.

Income Statement Template

Ref.	X-Ref.	Account Name	Calculation
I1			
I2			
I3			
I4			
I5			
I6			
I7			
I8			
I9			
I10			
I11			
I12		**Net Financial Income**	
I13			
I14			
I15			
I16			
I17			
I18			
I19			
I20			
I21		**Net Operating Income**	
I22			
I23			
I24			
I25			
I26			
I27			
I28			
I29			
I30			
I31			

[a] If a community bank uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account.

Sample Income Statement

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
I1		**Financial Revenue**	**18,976,898**	**10,521,727**
I2	C1[a]	Financial Revenue from Loan Portfolio	17,053,668	9,302,491
I3		Interest on Loan Portfolio	13,867,568	7,494,464
I4		Fees and Commissions on Loan Portfolio	3,186,100	1,808,027
I5	C2[a]	Financial Revenue from Investments	1,597,830	1,003,556
I6	C3[a]	Other Operating Revenue	325,400	215,680
I7		**Financial Expense**	**1,287,719**	**853,197**
I8	C5[a]	Financial Expense on Funding Liabilities	1,039,719	797,869
I9		Interest and Fee Expense on Deposits	256,343	250,000
I10		Interest and Fee Expense on Borrowings	783,376	547,869
I11	C6[a]	Other Financial Expense	248,000	55,328
I12		**Net Financial Income**	**17,689,179**	**9,668,530**
I13	C29	Impairment Losses on Loans	439,972	162,862
I14	P8	Provision for Loan Impairment	489,154	297,368
I15	P10	Value of Loans Recovered	(49,182)	(134,506)
I16	C7[a]	**Operating Expense**	**15,072,242**	**6,633,187**
I17		Personnel Expense	8,700,000	4,594,436
I18		Administrative Expense	6,372,242	2,038,751
I19	C28	Depreciation and Amortization Expense	1,597,669	317,057
I20		Other Administrative Expense	4,774,573	1,721,694
I21		**Net Operating Income**	**2,176,965**	**2,872,482**
I22	C22[a]	**Net Non-Operating Income/(Expense)**	**(1,403,143)**	**(1,838,992)**
I23		Non-Operating Revenue	586,471	—
I24		Non-Operating Expense	(1,989,614)	(1,838,992)
I25	C27	**Net Income (Before Taxes and Donations)**	**773,822**	**1,033,490**
I26	C8[a], C30[a]	Taxes	760,816	732,306
I27	B28	**Net Income (After Taxes and Before Donations)**	**13,006**	**301,184**
I28	B25, C20[a], C44[a]	Donations	4,582,000	**3,442,986**
I29		Donations for Loan Capital	—	1,258,291
I30		Donations for Operating Expense	4,582,000	2,184,695
I31		**Net Income (After Taxes and Donations)**	**4,595,006**	**3,744,170**

[a] If a community bank uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account.

NigCom Income And Expense Information
Class Exercise Instructions
Handout 2.3

NigCom, a rural community bank in Nigeria, has applied for a line of credit from the commercial bank in which you are a loan officer. As part of the credit review process, you have decided to "map" the institution's financial data into the SEEP Framework as a way to assess NigCom's performance monitoring system. In order to use the framework, you will need to put the financial statements in the SEEP Framework format. As a loan officer responsible for reviewing the credit application, your job is to map the income and expense information into the SEEP Framework income statement.

1. The task for your team is to create an income statement using the SEEP Framework Format.

2. The first step is to review the income and expense information and the trial balance of NigCom. When reviewing this information you need to determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Income Statement.

3. Map the financial information into the SEEP Framework Income Statement format. To do this, use the worksheet NigCom Income and Expense Information. The last column in this worksheet is to write the reference number for the SEEP Framework Income Statement. The last column is a guide for you to use if you choose.

4. Complete NigCom's SEEP Framework Income Statement for the current year and the past year.

NigCom Income and Expense Information

Handout 2.3

in thousands	From Income Statement		From Trial Balance	Current Year	Last Year	Framework Account
Interest and Fees on Loans	136,896.4	77,975.4	Interest on Loans	128,777.9	67,290.8	
			Registration Fees	6,097.2	3,704.0	
			Loan Application Fees	2,021.3	-	
			Risk Premium		6,980.6	
Direct Expenses						
Interest Expense	3,923.8	1,165.4	Interest on Loan	30.0	124.7	
			Interest on Savings	3,893.8	1,040.7	
Provision for Loan Losses	10,034.8	5,138.1				
Total Direct Expenses	13,958.6	6,303.5				
Net Interest after Provision for Loan Loss	122,937.8	71,671.9				
Other Operating Revenue	1,473.3	814.0	Bad Debt Recovered	503.5		
			Bank Interest Received	13.5	9.5	
			Income on Investments	260.5	254.2	
			Pass book sales	184.5	228.7	
			Sale of Fixed Assets	100.0	-	
			Other	411.3	321.6	
Net Operating Revenue	124,411.1	72,485.9				
Non-Interest Expenses						
Salaries and Benefits	45,252.4	28,575.3				
Administrative Expenses	42,283.6	22,676.7	Finance and Bank Charges	2,029.9		
			Services Charges	725.9		
			Overdraft Interest	1,304.0		
			Occupancy Expenses	2,226.0	1,840.0	
			Travel	15,399.6	9,250.0	
			Telephone	3,302.7	2,540.0	
			Printing and Stationary	4,987.8	3,878.5	
			Board Meetings	1,292.7	1,140.3	

Depreciation of Fixed Assets	5,139.1	3,654.3
Other Expenses	3,108.4	1,791.5
Total Non-interest Expenses	95,783.4	56,697.8
Net Operating Surplus/(Loss)	**28,627.7**	**15,788.1**
Operating Grants	-	748.2
Net Surplus After Grant	**28,627.7**	**16,536.3**

Professional Fees	3,547.7	1,580.7	
Licensing and Insurance	502.6		
Cleaning	873.9	587.4	
Advertising	124.1		
Repairs and Maintenance	5,751.4	586.8	
Training Expenses	2,245.2	1,273.0	
Audit Expense	217.0	580.1	
MIS Expenses	1,964.6		
Miscellaneous	926.8		
Bank Charges		1,211.4	
Service Charges		664.1	
Overdraft Interest		547.3	
Loan Capital Grants	20,897.2	43,159.9	
Fixed Asset Grants	-	-	

NigCom Income and Expense Information - Facilitators Notes

in thousands	From Income Statement		From Trial Balance	Current Year	Last Year	Account
Interest and Fees on Loans	136,896.4	77,975.4	Interest on Loans	128,777.9	67,290.8	I3
			Registration Fees	6,097.2	3,704.0	I4
			Loan Application Fees	2,021.3	-	I4
			Risk Premium		6,980.6	I4
Direct Expenses						
Interest Expense	3,923.8	1,165.4	Interest on Loan	30.0	124.7	I10
			Interest on Savings	3,893.8	1,040.7	I9
Provision for Loan Losses	10,034.8	5,138.1				I14
Total Direct Expenses	13,958.6	6,303.5				
Net Interest after Provision for Loan Loss	122,937.8	71,671.9				
Other Operating Revenue	1,473.3	814.0	Bad Debt Recovered	503.5		I15
			Bank Interest Received	13.5	9.5	I5
			Income on Investments	260.5	254.2	I5
			Pass book sales	184.5	228.7	I6
			Sale of Fixed Assets	100.0	-	I6
			Other	411.3	321.6	I6
Net Operating Revenue	124,411.1	72,485.9				
Non-Interest Expenses						
Salaries and Benefits	45,252.4	28,575.3				I17
Administrative Expenses	42,283.6	22,676.7	Finance and Bank Charges	2,029.9		
			Services Charges	725.9		I19
			Overdraft Interest	1,304.0		I10
			Occupancy Expenses	2,226.0	1,840.0	I19
			Travel	15,399.6	9,250.0	I19
			Telephone	3,302.7	2,540.0	I19
			Printing and Stationary	4,987.8	3,878.5	I19

			Board Meetings	1,292.7	1,140.3	I19
			Professional Fees	3,547.7	1,580.7	I19
			Licensing and Insurance	502.6		I19
			Cleaning	873.9	587.4	I19
			Advertising	124.1		I19
			Repairs and Maintenance	5,751.4	586.8	I19
			Training Expenses	2,245.2	1,273.0	I19
Depreciation of Fixed Assets	5,139.1	3,654.3				I19
Other Expenses	3,108.4	1,791.5	Audit Expense	217.0	580.1	I19
			MIS Expenses	1,964.6		I19
			Miscellaneous	926.8		I19
			Bank Charges		1,211.4	I19
Total Non-interest Expenses	95,783.4	56,697.8	Service Charges		664.1	I19
			Overdraft Interest		547.3	I10
Net Operating Surplus/(Loss)	**28,627.7**	**15,788.1**				
Operating Grants	-	748.2				I30
			Loan Capital Grants	20,897.2	43,159.9	I29
			Fixed Asset Grants	-	-	I30
Net Surplus After Grant	**28,627.7**	**16,536.3**				

SEEP FRAMEWORK INCOME STATEMENT
Handout 2.3

Ref.	Term	Current Year	Last Year
I1	**Financial Revenue**		
I2	Financial Revenue from Loan Portfolio		
I3	Interest on Loan Portfolio		
I4	Fees and Commissions on Loan Portfolio		
I5	Financial Revenue from Investments		
I6	Other Operating Revenue		
I7	**Financial Expense**		
I8	Financial Expense on Funding Liabilities		
I9	Interest and Fee Expense on Deposits		
I10	Interest and Fee Expense on Borrowings		
I11	Other Financial Expenses		
I12	**Net Financial Income**		
I13	Impairment Loss on Loans		
I14	Provision for Loan Impairment		
I15	(Value of Loans Recovered)		
I16	**Operating Expense**		
I17	Personnel Expense		
I18	Administrative Expense		
I19	Depreciation Expense		
I20	Other Administrative Expense		
I21	**Net Operating Income**		
I22	**Net Non-operating Income/(Expense)**		
I23	Non-operating Revenue		
I24	(Non-operating Expense)		
I25	**Net Income (Before Taxes and Donations)**		
I26	Taxes		
I27	**Net Income (After Taxes and Before Donations)**		
I28	Donations		
I29	Donations for Loan Capital		
I30	Donations for Operating Expense		
I31	**Net Income (After Taxes and Donations)**		

SEEP FRAMEWORK INCOME STATEMENT

Facilitator Notes

The result is the following income statement for the past two years.

Ref.	Term	Current Year	Last Year
I1	**Financial Revenue**	**137,866**	**78,789**
I2	Financial Revenue from Loan Portfolio	136,896	77,975
I3	Interest on Loan Portfolio	128,778	67,291
I4	Fees and Commissions on Loan Portfolio	8,119	10,685
I5	Financial Revenue from Investments	274	264
I6	Other Operating Revenue	696	550
I7	**Financial Expense**	**5,228**	**1,713**
I8	Financial Expense on Funding Liabilities	5,228	1,713
I9	Interest and Fee Expense on Deposits	3,894	1,041
I10	Interest and Fee Expense on Borrowings	1,334	672
I11	Other Financial Expenses		
I12	**Net Financial Income**	**132,638**	**77,077**
I13	Impairment Loss on Loans	9,531	5,138
I14	Provision for Loan Impairment	10,035	5,138
I15	(Value of Loans Recovered)	(504)	-
I16	**Operating Expense**	**93,553**	**56,151**
I17	Personnel Expense	45,252	28,575
I18	Administrative Expense	48,300	27,575
I19	Depreciation Expense	5,139	3,654
I20	Other Administrative Expense	43,161	23,921
I21	**Net Operating Income**	**29,555**	**15,788**
I22	**Net Non-operating Income/(Expense)**	**(927)**	**-**
I23	Non-operating Revenue		
I24	(Non-operating Expense)	(927)	
I25	**Net Income (Before Taxes and Donations)**	**28,628**	**15,788**
I26	Taxes		
I27	**Net Income (After Taxes and Before Donations)**	**28,628**	**15,788**
I28	Donations	20,897	**43,908**
I29	Donations for Loan Capital	20,897	43,160
I30	Donations for Operating Expense	-	748
I31	**Net Income (After Taxes and Donations)**	**49,525**	**59,696**

Balance Sheet Template

Ref.	X-Ref.	Account Name	As of 12/31/2004	As of 12/31/2003	Calculation
Assets					
B1					
B2					
B3					
B4					
B5					
B6					
B7					
B8					
B9					
B10					
B11					
B12		Total Assets			
Liabilities					
B13					
B14					
B15					
B16					
B17					
B18					
B19					
B20					
B21		Total Liabilities			
Equity					
B22					
B23					
B24					
B25					
B26					
B27					
B28					
B29					
B30					
B31					
B32		Total Equity			

Overhead and Handout 2.4

Sample Balance Sheet

Ref.	X-Ref.	Account Name	As of 12/31/2004	As of 12/31/2003
		Assets		
B1	**C26, C50**	Cash and Due from Banks	3,261,195	1,146,142
B2		Trade Investments	10,611,928	27,096,586
B3		Net Loan Portfolio	54,338,636	33,471,489
B4		Gross Loan Portfolio	55,609,309	34,701,961
B5		Impairment Loss Allowance	(1,270,673)	(1,230,473)
B6		Interest Receivable on Loan Portfolio	1,604,993	954,993
B7		Accounts Receivable and Other Assets	1,610,308	1,010,308
B8		Other Investments	1,165,420	1,165,420
B9		Net Fixed Assets	5,567,936	4,272,836
B10		Fixed Assets	10,640,051	7,747,282
B11		Accumulated Depreciation and Amortization	(5,072,115)	(3,474,446)
B12		**Total Assets**	**78,160,416**	**69,117,773**
		Liabilities		
B13		Demand Deposits	—	—
B14		Short-term Time Deposits	3,423,878	1,030,868
B15		Short-term Borrowings	2,737,009	1,371,768
B16		Interest Payable on Funding Liabilities	237,177	137,177
B17		Accounts Payable and Other Short-term Liabilities	500,100	548,000
B18		Long-term Time Deposits	3,000,000	3,000,000
B19		Long-term Borrowings	16,661,750	16,661,750
B20		Other Long-term Liabilities	3,699,498	4,199,498
B21		**Total Liabilities**	**30,259,412**	**26,949,061**
		Equity		
B22		Paid-In Capital	12,000,000	10,000,000
B23		Donated Equity	37,175,822	32,593,822
B24		Prior Years	32,593,822	29,150,836
B25	**I28, C20[a], C44[a]**	Current Year	4,582,000	3,442,986
B26		Retained Earnings	(1,401,678)	(914,683)
B27		Prior Years	(1,414,683)	(1,215,867)
B28	**I27**	Current Year	13,006	301,184
B29		Reserves	126,860	489,574
B30		Other Equity Accounts		
B31		**Adjustments to Equity**		
B32		**Total Equity**	**47,901,004**	**42,168,713**

[a] If the community bank uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the institution uses accrual accounting, these values will not be the same as the cross-referenced account.

NigCom Balance Sheet And Trial Balance Information
Case Study Instructions
Handout 2.6

To continue your work in organizing NigCom's financial statements into the SEEP Framework formats, you have been given the balance sheet information. You must map the balance sheet data into the SEEP Framework balance sheet

1. The task for your team is to create a balance sheet using the SEEP Framework Format.

2. The first step is to review the balance sheet and the trial balance from NigCom. When reviewing this information you need to determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Balance Sheet.

3. Map the financial information into the SEEP Framework Balance Sheet format. To do this use the worksheet NigCom Balance Sheet and Trial Balance Information. The last column in this worksheet is to write the reference number for the SEEP Framework Balance Sheet. The last column is a guide for you to use.

4. Complete NigCom's SEEP Framework Balance Sheet for the current year and the past year.

Balance Sheet and Trial Balance Information Handout 2.6

Handout 2.6

in thousands	Current Year	Last Year	From Trial Balance	Current Year	Last Year	Account
Assets	From Balance Sheet					
Cash and Bank Balances	20,444	5,458				
Deposits and Short-term Investments	3,450	9,450				
Loan Portfolio	248,875	179,816				
Less Reserve	(6,177)	(4,058)				
Loan Portfolio (net of reserve)	242,698	175,758				
Other Current Assets	27,414	14,050	Prepayments	1,712	1,421	
			Employee Advances	16,351	5,486	
			Accrued Interest	2,650	2,354	
			Capitalized MIS Expenses	1,913	2,476	
			Subsidiary Investments	4,788	2,313	
Total Current Assets	294,005	204,716				
Fixed Assets (Net)	49,402	40,897	Vehicles	9,067	8,717	
			Computer Equipment	5,987	1,508	
			Furniture	14,232	9,419	
			Machinery	3,992	2,727	
			Land and Building	35,505	33,597	
			Accumulated Depreciation on:			
			Vehicles	(6,820)	(6,891)	
			Computer Equipment	(2,519)	(627)	
			Furniture	(4,767)	(3,697)	
			Machinery	(840)	(151)	
			Land and Building	(4,434)	(3,706)	
Long-Term Investment	22,310	22,360		49,402	40,897	
Total Non-current Assets	71,712	63,257				
Total Assets	365,717.50	267,973.24	0			
Liabilities						
Client Deposits	101,062	58,799	Members Savings	97,168	58,799	
			Interest Due	3,894	-	
Other Liabilities	9,517	3,297	Accounts Payable	463	657	
			Bank Overdraft	3,196	2,380	

			Accrued Audit Fees	350	260
			Due to Subsidiaries	3,604	
Total Current Liabilities	110,579	62,096	Deferred Grants	1,904	
Long-Term Debt	54,805	53,680			
Total Liabilities	165,384	115,776			
Equity					
Loan Fund Grant	99,298	78,401	Previous Year Loan Fund Grant Balance	78,401	35,241
			Increase in Loan Fund Grants	20,897	43,160
Capital Grant	43,310	43,310	Previous Year Capital Grant Balance	43,310	43,310
				-	-
Accumulated Surplus	57,725	30,486	Previous Year Accumulated Operating Surplus	15,788	(3,700)
			Previous Year Accumulated Operating Grants	19,034	18,286
			Net Operating Surplus	28,628	15,788
			Operating Grants	-	748
Total Equity	200,334	152,197	Difference	(5,725)	(637)
Total Liabilities and Equity	365,718	267,973			

Balance Sheet and Trial Balance Information Facilitator Notes

in thousands	Current Year	Last Year	From Trial Balance	Current Year	Last Year	Account
Assets	From Balance Sheet					
Cash and Bank Balances	20,444	5,458				B1
Deposits and Short-term Investments	3,450	9,450				B2
Loan Portfolio	248,875	179,816				B5
Less Reserve	(6,177)	(4,058)				B5
Loan Portfolio (net of reserve)	242,698	175,758				B4
Other Current Assets	27,414	14,050	Prepayments	1,712	1,421	B7
			Employee Advances	16,351	5,486	B7
			Accrued Interest	2,650	2,354	B6
			Capitalized MIS Expenses	1,913	2,476	B10
			Subsidiary Investments	4,788	2,313	B8
Total Current Assets	294,005	204,716				
Fixed Assets (Net)	49,402	40,897	Vehicles	9,067	8,717	B10
			Computer Equipment	5,987	1,508	B10
			Furniture	14,232	9,419	B10
			Machinery	3,992	2,727	B10
			Land and Building	35,505	33,597	B10
			Accumulated Depreciation on:			
			Vehicles	(6,820)	(6,891)	B11
			Computer Equipment	(2,519)	(627)	B11
			Furniture	(4,767)	(3,697)	B11
			Machinery	(840)	(151)	B11
			Land and Building	(4,434)	(3,706)	B11
Long-Term Investment	22,310	22,360		49,402	40,897	
Total Non-current Assets	71,712					

		63,257				
Total Assets	365,717.50	267,973.24	0			
Liabilities						
Client Deposits	101,062	58,799	Members Savings	97,168	58,799	B14
			Interest Due	3,894	-	B16
Other Liabilities	9,517	3,297	Accounts Payable	463	657	B17
			Bank Overdraft	3,196	2,380	B15
			Accrued Audit Fees	350	260	B17
			Due to Subsidiaries	3,604		B17
Total Current Liabilities	110,579	62,096	Deferred Grants	1,904		B17
Long-Term Debt	54,805	53,680				B19
Total Liabilities	165,384	115,776				
Equity						
Loan Fund Grant	99,298	78,401	Previous Year Loan Fund Grant Balance	78,401	35,241	B24
			Increase in Loan Fund Grants	20,897	43,160	B25
Capital Grant	43,310	43,310	Previous Year Capital Grant Balance	43,310	43,310	B24
				-	-	B25
Accumulated Surplus	57,725	30,486	Previous Year Accumulated Operating Surplus	15,788	(3,700)	B27
			Previous Year Accumulated Operating Grants	19,034	18,286	B24
			Net Operating Surplus	28,628	15,788	B28
			Operating Grants	-	748	B25
Total Equity	200,334	152,197	Difference	(5,725)	(637)	B30
Total Liabilities and Equity	365,718	267,973				

Seep Framework Balance Sheet

Handout 2.6

Ref.	X-Ref.	Term	As of 31/12/2004	As of 31/12/2003
		ASSETS		
B1		Cash and Due from Banks		
B2		Short-term Investments		
B3		Net Loan Portfolio		
B4		Gross Loan Portfolio		
B5		Loan Loss Allowance		
B6		Interest Receivable on Loan Portfolio		
B7		Accounts Receivable and Other Assets		
B8		Other Investments		
B9		Net Fixed Assets		
B10		Fixed Assets		
B11		Accumulated Depreciation		
B12		**Total Assets**		
		LIABILITIES		
B13		Demand Deposits		
B14		Short-term Time Deposits		
B15		Short-term Borrowings		
B16		Interest Payable on Funding Liabilities		
B17		Accounts Payable and Other Short-term Liabilities		
B18		Long-term Time Deposits		
B19		Long-term Borrowings		
B20		Other Long-term Liabilities		
B21		**Total Liabilities**		
		EQUITY		
B22		Paid-in Capital		
B23		Donated Equity		
B24		Prior Years		
B25		Current Year		
B26		Retained Earnings		
B27		Prior Years		
B28		Current Year		
B29		Reserves		
B30		Other Equity Accounts		
B31		**Adjustments to Equity**		
B32				

Seep Framework Balance Sheet

Facilitator Notes

Ref.	X-Ref.	Term	As of 31/12/2004	As of 31/12/2003
		ASSETS		
B1		Cash and Due from Banks	20,444	5,458
B2		Short-term Investments	3,450	9,450
B3		Net Loan Portfolio	242,698	175,758
B4		Gross Loan Portfolio	248,875	179,816
B5		Loan Loss Allowance	(6,177)	(4,058)
B6		Interest Receivable on Loan Portfolio	2,650	2,354
B7		Accounts Receivable and Other Assets	18,063	6,907
B8		Other Investments	27,097	24,673
B9		Net Fixed Assets	51,316	43,373
B10		Fixed Assets	70,697	58,445
B11		Accumulated Depreciation	(19,381)	(15,072)
B12		**Total Assets**	365,718	267,973
		LIABILITIES		
B13		Demand Deposits	-	-
B14		Short-term Time Deposits	97,168	58,799
B15		Short-term Borrowings	3,196	2,380
B16		Interest Payable on Funding Liabilities	3,894	-
B17		Accounts Payable and Other Short-term Liabilities	6,321	917
B18		Long-term Time Deposits	-	-
B19		Long-term Borrowings	54,805	53,680
B20		Other Long-term Liabilities		
B21		**Total Liabilities**	165,384	115,776
		EQUITY		
B22		Paid-in Capital		
B23		Donated Equity	161,643	140,745
B24		Prior Years	140,745	96,837
B25		Current Year	20,897	43,908
B26		Retained Earnings	44,416	12,088
B27		Prior Years	15,788	(3,700)
B28		Current Year	28,628	15,788
B29		Reserves		
B30		Other Equity Accounts	(5,725)	(637)
B31		**Adjustments to Equity**		
B32			200,334	152,197

Classification of Cash Receipts and Payments

Classification	Receipts	Payment
Operating Activities		
Investing Activities		
Financing Activities		

Material 2.8 Cash Flow Statement Activity

Cash Received from Interest, Fees, and Commissions on Loan Portfolio Operating Activity	**Net (Purchase)/Sale of Other Investments** Investing Activity
Cash Received from Interest on Investments Operating Activity	**Net (Purchase)/Sale of Fixed Assets** Investing Activity
Cash Received as Other Operating Revenue Operating Activity	**Net Cash from Investing Activities** Investing Activity
Value of Loans Repaid Operating Activity	**Net Cash Received /(Repaid) for Short- and Long-term Borrowings** Financing Activity
(Cash Paid for Financial Expenses on Funding Liabilities) Operating Activity	**Issuance/(Repurchase) of Paid-In Capital** Financing Activity
(Cash Paid for Other Financial Expenses) Operating Activity	**(Dividends Paid)** Financing Activity
(Cash Paid for Operating Expenses) Operating Activity	**Donated Equity** Financing Activity
(Cash Paid for Taxes) Operating Activity	**Net Cash from Financing Activities** Financing Activity
(Value of Loans Disbursed) Operating Activity	**Net Cash Received/(Paid) for Non-Operating Activities** Financing Activity
Net (Purchase)/Sale of Trade Investments Operating Activity	**Net Change in Cash and Due from Banks** Financing Activity
Deposits/(Withdrawals) from Clients Operating Activity	**Cash and Due from Banks at the Beginning of the Period** Financing Activity
Cash Received/(Paid) for Other Operating Assets and Liabilities Operating Activity	**Exchange Rate Gains/(Losses) on Cash and Cash Equivalents** Financing Activity
Net Cash from Operating Activities Operating Activity	**Cash and Due from Banks at the End of the Period** Financing Activity

Overhead and Handout 2.9 **Direct Cash Flow Statement Template**

Ref.	X-Ref.	Account Name	Period	Period	Calculation
Cash Flows from Operating Activities					
C1					
C2					
C3					
C4					
C5					
C6					
C7					
C8					
C9					
C10					
C11					
C12					
C13					
Cash Flows from Investing Activities					
C14					
C15					
C16					
Cash Flows from Financing Activities					
C17					
C18					
C19					
C20					
C21					
C22					
C23					
C24					
C25					
C26					

Sample Direct Cash Flow Statement

Ref.	X-Ref.	Term	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
Cash Flows from Operating Activities				
C1	**I2[a]**	Cash Received from Interest, Fees, and Commissions on Loan Portfolio	16,403,668	8,847,498
C2	**I5[a]**	Cash Received from Interest on Investments	1,597,830	1,003,556
C3	**I6[a]**	Cash Received as Other Operating Revenue	325,400	215,680
C4	**C31**	Value of Loans Repaid	137,620,072	107,900,427
C5	**I8[a]**	(Cash Paid for Financial Expenses on Funding Liabilities)	(939,719)	(810,692)
C6	**I11[a]**	(Cash Paid for Other Financial Expenses)	(248,000)	(55,328)
C7	**I16[a]**	(Cash Paid for Operating Expenses)	(13,522,473)	(7,426,274)
C8	**I26[a]**	(Cash Paid for Taxes)	(760,816)	(732,306)
C9	**C32, P2**	(Value of Loans Disbursed)	(159,603,437)	(121,456,864)
C10	**C33**	Net (Purchase)/Sale of Trade Investments	16,484,658	3,406,301
C11	**C34**	Deposits/(Withdrawals) from Clients	2,393,010	1,030,868
C12		Cash Received/(Paid) for Other Operating Assets and Liabilities	(1,100,000)	(1,010,308)
C13	**C37**	**Net Cash from Operating Activities**	**(1,349,808)**	**(9,087,441)**
Cash Flows from Investing Activities				
C14	**C38**	Net (Purchase)/Sale of Other Investments	—	334,580
C15	**C39**	Net (Purchase)/Sale of Fixed Assets	(2,892,769)	(747,282)
C16	**C40**	**Net Cash from Investing Activities**	**(2,892,769)**	**(412,702)**
Cash Flows from Financing Activities				
C17	**C41**	Net Cash Received /(Repaid) for Short- and Long-term Borrowings	1,365,241	6,533,518
C18	**C42**	Issuance/(Repurchase) of Paid-In Capital	2,000,000	1,000,000
C19	**C43**	(Dividends Paid)	(500,000)	—
C20	**I28[a], C44, B25**	Donated Equity	4,582,000	3,442,986
C21	**C45**	**Net Cash from Financing Activities**	**7,447,241**	**10,976,504**
C22	**I22[a], C46**	Net Cash Received/(Paid) for Non-Operating Activities	(1,403,143)	(1,838,992)
C23	**C47**	**Net Change in Cash and Due from Banks**	**1,801,521**	**(362,632)**
C24	**C48**	**Cash and Due from Banks at the Beginning of the Period**	**1,146,142**	**900,000**
C25	**C49**	Exchange Rate Gains/(Losses) on Cash and Cash Equivalents	313,532	609,774
C26	**C50**	**Cash and Due from Banks at the End of the Period**	**3,261,195**	**1,146,142**

[a] If a community bank uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account. In the example above, the community bank uses accrual-based accounting for financial revenue, financial expense, and operating expenses so that (C1), (C5), and (C7) are not the same value as their income statement references.

Sample Indirect Cash Flow Statement

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
Cash Flows from Operating Activities				
C27	**I25[a]**	Net Income (Before Taxes and Donations)	2,176,965	2,872,482
C28	**I19**	Depreciation and Amortization	1,597,669	317,057
C29	**I13**	Impairment Losses on Loans	439,972	297,368
C30	**I26[a], C8**	(Cash Paid for Taxes)	(760,816)	(732,306)
C31	**C4**	Value of Loans Repaid	137,620,072	107,765,921
C32	**C9, P2**	(Value of Loans Disbursed)	(159,603,437)	(121,456,864)
C33	**C10**	(Increase)/Decrease in Trade Investments	16,484,658	3,406,301
C34	**C11**	Increase/(Decrease) in Deposits	2,393,010	1,030,868
C35		(Increase)/Decrease in Receivables and Other Assets	(1,250,000)	(1,465,301)
C36		Increase/(Decrease) in Payables and Other Liabilities	(447,900)	(1,122,967)
C37	**C13**	Net Cash from Operating Activities	**(1,349,808)**	**(9,087,441)**
Cash Flows from Investing Activities				
C38	**C14**	(Increase)/Decrease in Other Investments	—	334,580
C39	**C15**	(Increase)/Decrease in Book Value of Gross Fixed Assets	(2,892,769)	(747,282)
C40	**C16**	Net Cash from Investing Activities	**(2,892,769)**	**(412,702)**
Cash Flows from Financing Activities				
C41	**C17**	Increase/(Decrease) in Short- and Long-term Borrowings	1,365,241	6,533,518
C42	**C18**	Increase/(Decrease) in Paid-In Capital	2,000,000	1,000,000
C43	**C19**	(Dividends Paid)	(500,000)	—
C44	**C20, I28[a], B25**	Donated Equity	4,582,000	3,442,986
C45	**C21**	Net Cash from Financing Activities	**7,447,241**	**10,976,504**
C46	**I22[a], C22**	Net Cash Received/(Paid) for Non-Operating Activities	**(1,403,143)**	(1,838,992)
C47	**C23**	Net Change in Cash and Due from Banks	**1,801,521**	**(362,632)**
C48	**C24**	Cash and Due from Banks at the Beginning of the Period	**1,146,142**	**900,000**
C49	**C25**	Effect of Exchange Rate Changes on Cash and Cash Equivalents	313,532	608,774
C50	**C26, B1**	Cash and Due from Banks at the End of the Period	**3,261,195**	**1,146,142**

NigCom Cash Flow Information

Case Study Instructions

Handout 2.12

In an effort to understand more clearly how funds flow into and out of the community bank you are reviewing, you will now reconstruct a standard cash flow statement from the raw data provided to you by the applicant. It is safe to assume that most community banks will not create this document on its own. You can use the chart provided that compares how balance sheet accounts have increased or decreased. NigCom did not provide you with detailed information for 2002, so you decide to construct a cash flow for 2004, showing the movement in cash from the end of 2003 to the end of 2004. Using the financial data presented, create a cash flow using the indirect method.

1. The task for your team is to create a cash flow statement for NigCom, using the indirect method, for the period from the end of 2003 to the end of 2004.

2. The first step is to review the financial data. When reviewing this information, determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Indirect Cash Flow.

3. Map the financial information into the SEEP Framework Cash Flow format.

Cash Flow Information

Handout 2.12

	Current Year	Previous Year	Difference Net Change
Loans to Clients			
Beginning	179,816		
Loans Disbursed	620,532		
Loans Repaid	(543,696)		
Principal Before Write-Off	256,652		
Write-off of Bad Debt	(7,777)		
Principal Balance At End	248,875		
Demand Deposits	-	-	-
Short-term Time Deposits	97,168	58,799	38,369
Long-term Time Deposits	-	-	-
Total Deposits			38,369
Short-term Investments	3,450	9,450	(6,000)
Interest Receivable on Loan Portfolio	2,650	2,354	296
Accounts Receivable and Other Assets	18,063	6,907	11,156
Other Investments	27,097	24,673	2,424
Total Other Assets			13,876
Interest Payable on Funding Liabilities	3,894	-	3,894
Accounts Payable and Other Short-term Liabilities	6,321	917	5,404
Other Long-term Liabilities	-	-	-
Total Liabilities			9,298
Other Investments	27,097	24,673	2,424
Fixed Assets	70,697	58,445	12,252
Short-term Borrowings	3,196	2,380	816
Long-term Borrowings	54,805	53,680	1,125
Total Borrowings			1,942

SEEP Framework Cash Flow

Handout 2.12

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
		Cash Flows from Operating Activities		
C27	**I25[a]**	Net Income (Before Taxes and Donations)		
C28	**I19**	Depreciation and Amortization		
C29	**I13**	Impairment Losses on Loans		
C30	**I26[a], C8**	(Cash Paid for Taxes)		
C31	**C4**	Value of Loans Repaid		
C32	**C9, P2**	(Value of Loans Disbursed)		
C33	**C10**	(Increase)/Decrease in Trade Investments		
C34	**C11**	Increase/(Decrease) in Deposits		
C35		(Increase)/Decrease in Receivables and Other Assets		
C36		Increase/(Decrease) in Payables and Other Liabilities		
C37	**C13**	Net Cash from Operating Activities		
		Cash Flows from Investing Activities		
C38	**C14**	(Increase)/Decrease in Other Investments		
C39	**C15**	(Increase)/Decrease in Book Value of Gross Fixed Assets		
C40	**C16**	Net Cash from Investing Activities		
		Cash Flows from Financing Activities		
C41	**C17**	Increase/(Decrease) in Short- and Long-term Borrowings		
C42	**C18**	Increase/(Decrease) in Paid-In Capital		
C43	**C19**	(Dividends Paid)		
C44	**C20, I28[a], B25**	Donated Equity		
C45	**C21**	Net Cash from Financing Activities		
C46	**I22[a], C22**	Net Cash Received/(Paid) for Non-Operating Activities		
C47	**C23**	Net Change in Cash and Due from Banks		
C48	**C24**	Cash and Due from Banks at the Beginning of the Period		
C49	**C25**	Effect of Exchange Rate Changes on Cash and Cash Equivalents		
C50	**C26, B1**	Cash and Due from Banks at the End of the Period		

NigCom's Cash Flow

Facilitator Note

Ref.	X-Ref.	Term	From 1/1/2004 to 31/12/2004	From 1/1/2003 to 31/12/2003
Cash Flows from Operating Activities				
C26	**I21**	Net Operating Income	29,555	
C27	**I19**	Depreciation	5,139	
C28	**I13**	Impairment Loss on Loans	9,531	
C8	**I26***	(Cash Paid for Taxes)	-	
C29		Value of Loans Repaid	543,696	
C30	**P2**	(Value of Loans Disbursed)	(620,532)	
C31		(Increase)/Decrease in Short-term Investments	6,000	
C32		Increase/(Decrease) in Deposits	38,369	
C33		(Increase)/Decrease in Receivables and Other Assets	(13,876)	
C34		Increase/(Decrease) in Payables and Other Liabilities	9,298	
C35		**Net Cash from Operating Activities**	**7,179**	
Cash Flows from Investing Activities				
C36		(Increase)/Decrease in Long-Term Investments	(2,424)	
C37		(Increase)/Decrease in the Book Value of Gross Fixed Assets	(12,252)	
C38		**Net Cash from Investing Activities**	**(14,676)**	**-**
Cash Flows from Financing Activities				
C39		Increase/(Decrease) in Short-and Long-term Borrowings	1,942	
C40		Increase/(Decrease) in Paid-in Capital	-	
C41		Dividends paid		
C42	**I28*, B25**	Donated Equity	20,897	
C43		**Net Cash from Financing Activities**	**22,839**	
C21	**I22***	Net Cash Received/(Paid) for Non-operating Activities	**(927)**	
C44		**Net Change in Cash and Due from Banks**	**14,414**	
C45		**Cash and Due from Banks at the Beginning of the Period**	**5,458**	
C46		Effect of Exchange Rate Changes on Cash and Cash Equivalents	571	
C47	**B1**	**Cash and Due from Banks at the End of the Period**	**20,444**	**5,458**

Sample Portfolio Report

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004		From 1/1/2003 to 12/31/2003	
			Number of Loans	Value of Portfolio	Number of Loans	Value of Portfolio
Portfolio Activity						
P1, P2	**C9, C32**	Loans Disbursed	32,148	159,603,437	26,990	121,456,864
P3, P4	**B4**	Loans Outstanding	14,587	55,609,309	11,183	34,701,961
Movement in Impairment Loss Allowance						
$P5^{0}$	**$B5^{0}$**	Impairment Loss Allowance, Beginning of Period		1,230,473		933,150
$P5^{1}$	**$B5^{1}$**	Impairment Loss Allowance, End of Period		1,270,673		1,230,473
P6, P7		Loans Written Off	147	448,954	0	0
P8	**I14**	Provision for Loan Impairment		489,154		297,368
P9, P10		Loans in Recovery or Recovered	14	49,182	53	134,506
Portfolio Aging Schedule						
			Number of Loans	**Value of Portfolio**	**Loss Allowance Rate (%)[a]**	**Impairment Loss Allowance**
P11, P12		Current Portfolio	8,729	51,155,003	0	-
P13, P14		Portfolio at Risk 1 to 30 days	2,110	2,224,372	10	222,437
		Portfolio at Risk 31 to 60 days	2,022	1,112,186	25	278,047
		Portfolio at Risk 61 to 90 days	927	556,093	50	278,047
		Portfolio at Risk 91 to 180 days	556	166,828	75	125,121
		Portfolio at Risk more than 180 days	204	244,681	100	244,681
P15, P16		Renegotiated Portfolio 1–30 days	28	55,609	50	27,805
		Renegotiated Portfolio > 30 days	11	94,536	100	94,536
P3, P4	**B4**	Loans Outstanding	14,587	55,609,309		1,270,673

Overhead and handout 2.13

NigCom's Portfolio Report
Class Exercise Instructions
Handout 2.14

Next, you and your class partners will prepare a standardized portfolio report for NigCom.

1. The task for your team is to review the prepared Portfolio Report to determine if NigCom has appropriately represented the Portfolio Activity, Movement in Impairment Loss Allowance, and the Portfolio Aging Schedule.

2. If your group determines that data in the report needs to be modified, identify that information and determine what you would do to the data.

NigCom's Portfolio Report

Handout 2.14

Ref.	X-Ref.		From 1/1/2004 to 31/12/2004		From 1/1/2003 to 31/12/2003	
			Number of Loans	**Value of Portfolio**	**Number Of Loans**	**Value of Portfolio**
Portfolio Activity						
P1, P2	**C9, C30**	Loans Disbursed during the period	52,146	620,532	28,440	361,190
P3, P4	**B4**	Loans Outstanding, end of period	31,254	248,875	21,053	179,816
Movement in Impairment Loss Allowance						
			Number of Loans	**Value of Portfolio**	**Number of Loans**	**Value of Portfolio**
P5^0	**B5^0**	Loan Loss Allowance, beginning of period		4,058		-
P5^1	**B5^1**	Impairment Loss Allowance, end of period		6,010		4,058
P6, P7		Loans Written Off	1,155	8,083		-
P8		Provision Expense for Loan Impairment		10,035		4,058
P9		Loans Recovered		504		0
Portfolio Aging Schedule						
			Number of Loans	**Value of Portfolio**	**Loan Loss Allowance Rate**	**Loan Loss Allowance**
P10, P11		Current Portfolio	23,286	223,646	1%	2,236
P2,P 13		Portfolio at Risk 1 to 30 days	4,315	12,328	1%	123
		Portfolio at Risk 31 to 60 days	1,974	4,650	25%	1,163
		Portfolio at Risk 61 to 90 days	687	2,368	50%	1,184
		Portfolio at Risk 91 to 180 days	401	1,286	50%	643
		Portfolio at Risk over 180 days	120	459	100%	459
P14, P15		Renegotiated Portfolio	420	3,469	1%	35
		Renegotiated Portfolio over 31 days	51	669	25%	167
P3, P4	**B4**	Gross Loan Portfolio	31,254	248,875		6,010

Sample Non-Financial Data Report

	Account Name	As of 12/31/2004	As of 12/31/2003
Operational Data			
N1	Number of Active Clients	14,658	11,458
N2	Number of New Clients during Period	7,584	7,589
N3	Number of Active Borrowers	13,472	10,857
N4	Number of Voluntary Depositors	752	254
N5	Number of Deposit Accounts	752	254
N6	Number of Savers Facilitated	13,005	11,023
N7	Number of Personnel	115	89
N8	Number of Loan Officers	75	48
Macroeconomic Data			
N9	Inflation Rate	5.6%	4.3%
N10	Market Rate for Borrowing	9.5%	8.6%
N11	Exchange Rate (Local Currency: U.S. Dollar, Euro, or other)	48.0	45.0
N12	Gross National Income (GNI) per capita	12,000.0	12,000.0

Matrix to Identify Linkages Between Financial Statements

Income Statement (Table 2.1)	Balance Sheet (Table 2.3)	Cash Flow Statement (Tables 2.6 and 2.8	Portfolio report (Table 2.10)	Relationship
(I14) Provision for Loan Impairment	(B5) Impairment Loss Allowance		(P7) Value of Loans Written Off	$B5^1 = B5^0 + CI14^1 – P7^1$

Overhead/Handout 2.16

Matrix to Identify Linkages Between Financial Statements

Facilitator Notes:

Income Statement (Table 2.1)	Balance Sheet (Table 2.3)	Cash Flow Statement (Tables 2.6 and 2.8	Portfolio report (Table 2.10)	Relationship
(I14) Provision for Loan Impairment	(B5) Impairment Loss Allowance		(P7) Value of Loans Written Off	$B5^1 = B5^0 + CI14^1 - P7^1$
(I19) Depreciation and Amortization Expense	(B11) Accumulated Depreciation and Amortization	(C28) Depreciation and Amortization		$B11^1 = B11^0 + I19^1$
(I28) Donations	(B25) Donated Equity, Current Year	(C20, C44) Donated Equity		$B24^1 = B24^0 + I28^0$
(I27) Net Income (After Taxes and Before Donations)	(B28) Retained Earnings, Current Year			I27 = B28
	(B1) Cash and Due From Banks	(C23) Net Change in Cash and Due from Banks; (C25) Exchange Rate Gains/(Losses) on Cash and Cash Equivalents		$B1^1 = B1^0 + C23 + C25$
	(B4) Gross Loan Portfolio	(C9) Value of Loans Disbursed; (C4) Value of Loans Repaid	(P4) Value of Loans Outstanding; (P7) Value of Loans Written Off; (P2) Value of Loans Disbursed	$B4^1 = B4^0 + C9 - C4 - P7$

Module 3
Introduction to the PRISMS Community Bank Assessment Tool (CBAT)

Goal

Participants will understand the theory and principles behind the PRISMS CBAT and the overall structure of the tool.

Objectives

By the end of Module 3, participants will:

1. Understand how to use the PRISMS CBAT to examine the financial performance of the community bank, utilizing a series of financial ratios to determine the profitability, liquidity, operating efficiency and asset quality of the community bank.

2. Understand how to use the tool to examine a community bank's management and governance structure, utilizing a series of interview questions for staff at various levels within the organization. The analysis will focus on four key management areas: executive management and organizational culture; the board of directors and governance; internal controls; and management information systems.

3. Be able to explain and discuss the relationship between basic financial analysis covered in Module 2 and the PRISMS CBAT.

Duration

20 minutes

Module 3 Summary

Time and Technique	Session	Materials
Lecture and discussion Time	**Step 1: Introduction to Module 3** • Review module objectives	PowerPoint Slide x
Lecture and Guided Discussion Time	**Step 2: Assessing the Financial Performance of the Community Bank** • The rationale for financial assessment • General methodology of financial assessment • Using the PRISMS CBAT to undertake financial performance assessment of community banks	Flipchart Markers
Lecture Time	**Step 3: Assessing the Management and Governance of the Community Bank** • The rationale for assessing the management and governance structure of community banks • General methodology of management and governance assessment • Using the PRISMS CBAT to undertake community bank management and governance assessment	PowerPoint Slides x-y
Lecture and discussion Time	**Step 4: The Relationship Between Financial Analysis, Sound Methodology, and the PRISMS CBAT** • The importance of sound financial data • Interpreting results of the CBAT analysis • Reporting CBAT analysis results	

Module 3 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 3 Introduction to the PRISMS Community Bank Assessment Tool (CBAT) **Describe** The objectives and discuss the topics for this module.

By the end of Module 3, participants will:

- Understand how to use the PRISMS CBAT to examine the financial performance of the community bank, utilizing a series of financial ratios to determine the profitability, liquidity, operating efficiency and asset quality of the community bank.

- Understand how to use the tool to examine a community bank's management and governance structure, utilizing a series of interview questions for staff at various levels within the organization. The analysis will focus on four key management areas: executive management and organizational culture; the board of directors and governance; internal controls; and management information systems.

- Be able to explain and discuss the relationship between basic financial analysis covered in Module 2 and the PRISMS CBAT.

Step 2: Assessing the Financial Performance of the Community Bank

Lecture and Discussion

Time

Flipchart Markers

Ask
Do participants believe that management of community banks undertakes regular and consistent assessments of their institution's financial performance? If so, how? If not, why not?

Write responses on a flipchart.

Ask
What is the rational for regular financial performance assessments in the general management process of a community bank?

Write responses on flipchart.

Summarize (if possible, using participant's responses) the relevance and characteristics of sound financial management policy.

- A major weakness of community banks in Nigeria is ***the inability of management to provide convincing or credible financial statements and business planning documents***. Undertaking both regular internal, and periodic external, assessments of the enterprise can provide you with useful information about the current and future prospects for the entity's viability in the absence of these financial documents.

- One of the most important components of financial analysis is cash flow analysis. While cash flow analysis can give information about the businessman's current cash receipts and payments, it generally provides an incomplete basis for assessing prospects for future cash flows because it cannot show inter-period relationships. Many current cash receipts, especially from operations, have their origins from activities of earlier periods, and many current cash payments are intended, or expected, to result in future, not current, cash receipts. So, statements of earnings and comprehensive income, especially if used in conjunction with statements of financial position, usually provide a better basis for assessing future cash flow prospects of an entity than do cash flow statements alone. Still, *financial statement analysis alone cannot help predict future prospects for loan repayment.*

- Both internal and external assessment of the institution's financial performance provides management with the opportunity to assess both current and projected performance. ***Such analysis is critical to the long-term viability of the community bank, including its ability to attract and retain investors to its operations***.

Ask
What is the general methodology used by commercial banks, or microfinance institutions, to assess its current and projected financial performance?

Write responses on a flipchart.

Summarize (if possible, based on participants' responses) the main components of commercial bank and MFI financial performance assessment, and the importance of financial transparency.

Financial transparency is critical to the long-term viability of any financial intermediary. Here is a list of some of the elements typically involved in the collection, analysis, and disclosure of MFI financial information, which we will use as a proxy for community banks.[1]

- **Financial Transparency** concerns the production, accuracy testing, dissemination, and use of information related to a financial institution's financial performance.

- **Information Systems,** generally referred to as MIS, is a system (computerized or paper-based) that gathers, stores, organizes, and helps management retrieve the information generated by the institution's operations. If developed appropriately, the MIS processes inputted data into information that allows management, staff, and other stakeholders to analyze and act upon the information.

- **Internal Controls** are the institution's systems (human resources, organization, operating procedures, MIS) used to minimize risk. In mature institutions, such controls are located both in the normal operations, and in an internal audit department that reports directly to the Board of Directors.

- **External Audit** is a formal, independent review of an

[1] For a complete discussion of these terms, refer to the technical note, *Financial Transparency: A Glossary of Terms. T*he Consultative Group to Assist the Poorest, from which much of this section is drawn.

institution's financial statements, records, transactions, and overall operations. The most commonly used external audit is the financial statement audit that tests the reliability of the institution's financial reports alongside generally accepted accounting principles.

- **Assessment and Performance Measurement**, otherwise known as evaluations, include a broad range of tools, such as institutional appraisals, rating exercises, investor "due diligence" reports, and donor assessments, when applicable. All such tools are used to determine how well an institution performs both financially and operationally, and how strong the management team is to carry out such performance.

- **Peer Group Benchmarking** is undertaken to assess an institution's performance against its peer group counterparts, using measures of comparability related to the region in which the institution operates, its size, client base, products, and other factors. When assessing MFIs, commercial bank managers, current and prospective investors and donors, and others have ready access to benchmarking databases, such as the *Microbanking Bulletin*.

- **Performance Standards** are normative levels established by a particular industry for specific performance measurements. An example commonly used within the microfinance industry relates to portfolio quality, where the normally excepted range of 5 percent PAR over 30 days is standard. While commercial banking follows Basle standards, no such standards exist for either the microfinance industry, or for community banks in Nigeria.

- **Rating** measures the credit risk of an institution by assigning to it a specific grade that is made available to prospective investors. The rating reflects the institution's likelihood of repaying its debts in full and on time. The ratings undertaken on commercial banks typically focus on credit risk related to the bank's fundamental performance, its role in the local financial system, and current exogenous market trends and factors , such as level of

---

[2] The SEEP Global Performance Monitoring Tool was developed to assist microfinance managers in the development of industry standard reporting documents for internal and external consumption. The tool is free, and available through SEEP's website at http://www.seepnetwork.org. The accompanying tool training manual can be purchased through SEEP by way of the same address. In addition, SEEP supports periodic trainings in the use of the Framework and tool. Information on trainings can also be obtained through SEEP's general website, or by contacting Sharyn Tenn at: tenn@seepnetwork.org

competition and the overall regulatory environment. Quantitative factors include capital adequacy, liability structure, liquidity, and portfolio quality. Non-quantitative factors include credit policy and operations, governance (supervision, management, and operations), and organization capacity.

- **Regulation and Supervision** refers to a set of rules that govern the intermediation of financial resources between both savers and borrowers, and the systematic oversight of such providers to ensure their compliance with these rules. The rationale behind regulating financial intermediaries is simple—to protect the depositor's funds, and to preserve the stability and integrity of the broader financial system within which the institution operates, a system that is based on a foundation of trust and confidence.

Explain
How can we use the PRISMS CBAT to undertake financial performance assessment of community banks?

The PRISMS CBAT addresses the following elements from the list of financial transparency elements above:

- **Financial Transparency**
- **Internal Controls**
- **Assessment and Performance Measurement**
- **Performance Standards**
- **Regulation and Supervision**

As such, the PRISMS CBAT is an important tool for management to use to assess how well it is achieving financial transparency within its respective financial institution.

PRISMS CBAT Methodology:
The first phase of the PRISMS CBAT is a diagnostic analysis that examines the financial performance of the community bank, utilizing a series of financial ratios to determine the profitability, liquidity, operating efficiency, and asset quality of the community bank.

Ask
Why would it be important for the commercial bank to undertake such an analysis if it is considering extending a line of credit to the community bank?

Write responses on a flipchart. Responses should make reference to

the following:

Emphasis has been placed on those ratios that indicate the likelihood of default should the community bank receive a line of credit. In particular, the community bank's short-term liquidity and financial management practices are examined. Focus on the short-term liquidity of the bank is given because the line of credit will likely require regular monthly repayments.

Ask
Which of the tool's ratios have the potential to yield the most useful information regarding the bank's ability to repay a short-term liability, such as a line of credit?

Write responses on a flipchart.

Answer:

Current ratio
Cash ratio
Cash flow ratio
Liquidity ratio
Debt-to-Equity ratio
Capital adequacy ratio

Critical Assumptions:

- Note that the developers of the tool assume that the commercial bank will have its own systems and methodologies in place for evaluating the size and terms of the line of credit.

- In addition, this initial phase of the diagnostic requires a relatively experienced financial analyst from the commercial bank, who is familiar with financial statements and operations of Nigerian community banks.

- The analyst will need at least three years of audited financial statements from the community bank in order to be able to make a reasonable opinion as to whether the bank will be able to manage its liquidity and operations effectively to be able to pay down the line of credit. Moreover, the developers of the tool assume that the community bank adheres to accepted accounting practices and that the financial statements used as input to the tool are reliable. ***If the statements are not audited, this must be noted in the analysts' report.***

Assessing and Reporting the PRISMS CBAT Phase 1 Analysis:

- Standard industry ratios do not yet exist for community banks in Nigeria. In many cases, optimal and acceptable levels for each ratio have been noted based on ratios for small banks or microfinance institutions in the region. Commercial banks are strongly encouraged to work with community banks to develop performance standards.

- **EXPLAIN HOW ANALYST SHOULD DETERMINE AND INTERPRIT SCORE.**

- Management can develop tailored reporting templates in which to incorporate data from the Phase 1 analysis, for both internal stakeholders (Executive Director, Financial Accountant, loan officers…) and external stakeholders (Board of Directors, investors and shareholders, regulatory authorities…). Some examples of templates used within microfinance institutions can be found in the SEEP Global Performance Management Tool.[2]

Step 3: Assessing the Management and Governance of the Community Bank

Lecture and Discussion X minutes	**Ask** What role does management and governance play in commercial bank operations? What is the rationale for periodically assessing the management and governance structure of community banks?
Flipchart Markers	**Write responses on flipchart**

Summarize (if possible based on participants' responses) ways in which the good management and governance are critical to sound performance of a community bank.

- **<u>Sound internal management:</u>** Financial institutions must develop and adhere to sound internal controls to ensure the financial integrity necessary to garner and sustain clients' confidence in the institution's ability to secure their savings and provide long-term financial services and products. But having a set of written control systems on the shelf is not sufficient for ensuring sound internal management; written policy must be enforced by and through a core team of management and staff committed to maintaining the institution's integrity.

- **Governance through a Board of Directors**: The board of directors is the ultimate governing body of any financial institution, with the final responsibility for overseeing management. The Board must comprise members with expertise in fields such as finance, accounting, banking, law and business.

- **Appropriate boundaries between internal management and the Board of Directors**: External auditors are usually engaged by, and are ultimately responsible to, the financial institution's board of directors. It is the responsibility of the Board to maintain both the integrity and quality of external auditing of the institution. For larger community banks, the Board may find it useful to appoint an audit committee whose oversight will extend to internal and external audits, internal controls, and external reporting. A sound audit committee will comprise non-management directors and, if necessary, external accountants and finance specialists. For those smaller community banks, the audit committee can comprise a director with both financial and audit expertise to assume the responsibility for leading the Board's audit oversight. The board and audit committee will need continuous support from management and staff. The institution must establish appropriate and impermeable firewalls between internal institution management (i.e., the Executive Director) and Board members, and should monitor the ongoing independence of an internal auditor that reports to the Board.

Ask
What is the general methodology used in your institutions for assessing the management and governance structure of the bank?

Explain
How we can use the PRISMS CBAT to undertake an assessment of the management and governance structure of a community bank?

The PRISMS CBAT addresses the following management and governance elements:

- **Internal Controls:** The tool contains questions that help management determine its capacity to develop and implement a formal internal control system that aims to reduce inaccurate and/or incomplete financial statements and general ledger information. The tool investigates issues related to internal and external audits, account processing controls, and physical and transaction controls.

- **Regulation and Supervision:** The PRISMS CBAT aims at showing the robustness of the institution's board and governance structure, coving issues such as the process of board meetings, the relationship between the Board and management, and issues related to Board succession.

Explain

What ***methodology*** does the PRISMS CBAT use to assess the community bank's management and governance capacity?

The second phase of the tool examines the management and governance of the community bank, utilizing a series of interview questions for staff at various levels within the community bank. As discussed above, this phase of the tool focuses on evaluating management and operations in four main areas:

- **Executive management and organizational culture**
- **The board of directors and governance**
- **Internal controls**
- **Management information systems (MIS)**

This phase of the tool will also help the analyst to understand several of the ratios calculated in the first phase of the diagnostic. In order to answer the questions outlined in the second phase of the tool, it is recommended that the analyst visit the community bank and speak directly with at least two to three staff members at all levels of the organization, as well as managers at the executive level, and members of the board of directors.

Review

What is the *objective* of this phase?

The objective of this phase of the PRISMS CBAT is to identify any weaknesses in management or governance that could cause unexpected shocks within the institution that could seriously affect the operations and/or profitability of the community bank.

Ask

Why would it be important to assess the potential for unexpected shocks on a community bank requesting a line of credit from a commercial bank?

Write responses on a flipchart.

Responses should include some reference to:

A community bank's ability to make monthly repayments on a line of credit is directly related to its ability to maintain a steady stream of liquid assets and other resources with which to make short-term repayments. The bank's ability to make these payments are a function of its overall internal management of resources, and the external supervision of this management performed by a board of directors and other external evaluators. Several of the indicators included in the PRISMS CBAT, if used on a regular basis, and if employed with sound financial data, can provide management with critical information regarding its liquidity status.

Explain

The scoring and reporting methodology of the PRISMS CBAT.

Commercial bank analysts will record *actual* responses to each of the questions listed in the separate sections of the tool, in the left-most column to the right of each question. Numerical values are assigned both to *optimal* and *acceptable* responses. The analyst will total all values for individual responses and compare this against the guidance provided in the text accompanying the tool. Note that there are not "ideal" responses to any of the questions asked throughout the tool. Rather, the tool provides guidance to analysts that should help shape and inform the analyst's interpretation of his results. The key to the success of the tool lies in the analysis following the scoring. The tool provides some indication of factors that should be viewed as "red flags". For example,

INSERT EXAMPLE OF GUIDANCE PROVIDED WITHIN TOOL HERE.

Because compliance with local and national regulation is such an important component of the community bank's operations, the tool devotes a separate analysis sheet to matters related to compliance. Moreover, this sheet precedes the rest of the analysis due to the importance of confirming if the community bank is, in fact, registered and licensed to operate. If commercial banks cannot lend to unregistered and unlicensed community banks, there is no point in continuing with the analysis.

Step 4: The Relationship Between Financial Analysis, Sound Methodology and the PRISMS CBAT

Lecture and Discussion

Time:

Ask
What is the importance of using ***sound financial data*** when using the PRISMS CBAT?

Write responses on a flipchart. Responses should include some of the following elements:

- The PRISMS CBAT, like any other financial management tool, is only as good as the data going into it, and the user inputting that data. The CBAT processes data; it does not create it. It is critical, therefore, for analysts to input sound financial data, and for analysts to be well versed in basic financial principles and methodology.

- A valuable potential output of the PRISMS CBAT is data that be compared from one community bank to another. If this is done, community banks can develop a core group of peer institutions whose data can be compared on a benchmarked basis. Analysts hoping to create comparable data must input comparable, quality financial information into the tool itself.

Explain
How analysts can establish a "common denominator" that will allow for comparability of results from one community bank to another.

- Analysts should establish a sample with size and composition using the following guidelines:

Loan officers: minimum of 3

Community bank senior management: Approximately 4, comprised of the Executive Director, Operations Manager, CFO, and CEO.

Internal auditor: 1

Board members: No more than 7.

MIS manager: 1

Clients or borrowers: No more than 5

-

Explain
How analysts can create a context of trust and confidence necessary to encourage honest and accurate responses to CBAT questions.

- Respondents are not required to identify themselves on response sheets.

- The PRISMS CBAT user should record all responses to questions.

- All responses should be pooled together so that the identity of any single respondent cannot be easily determined.

- All response sheets should be kept in a secure location throughout the analysis process, and none of the results should be shared with any persons outside of the community bank under analysis and those staff in the commercial bank most directly concerned with and involved in the loan evaluation process.

Explain
How should analysts go about with the process of *interpreting* results of the CBAT analysis?

Write responses on a flipchart. Responses should include some of the following elements:

- Analysts should ***calculate the totals*** for each category and determine the overall percentage total (with 100 percent as the highest score) for each section. Analysts should make note of the suggestions listed in the "comments" section of each category when deriving their totals, and note these comments alongside the totals.

- Using the information provided in the "comments" section, analysts should indicate any "red flags", or issues of concern, that the analysis raises. For example, **GIVE TWO EXAMPLES OF "RED FLAGS".**

Explain
How should the analyst go about with the process of ***reporting*** CBAT analysis results? Ask participants to read through the tool framework when coming up with their responses.

Write responses on a flipchart. Responses should include some of the following elements:

- ***Senior management staff*** will benefit from the PRISMS CBAT analysis as it can help them to know if their daily operations, and longer-term strategic planning, are working toward institutional viability.

- ***Credit and loan officers*** can use the results of the tool analyses to determine if they are reaching the right client base with their products.

- ***Product design staff*** can utilize the tool data to ascertain whether products are suitable for the current or projected client base, and if they are keeping up with current or projected competition.

- ***Board of Directors' staff*** will be able to use the tool analyses to evaluate the performance of the community bank's internal management

- ***Regulatory authorities*** can assess the community bank's compliance with regulation through a careful review of the management portion of the tool's analysis.

- ***Current and prospective donors*** can utilize the results of a PRISMS CBAT to make certain projections about their current donations, and any future donations.

- ***Investors and shareholders***, like the donors above, can use the results of a PRISMS CBAT analysis as part of their own investment strategies.

Commercial bank analysts should take great care in explaining to their community bank counterparts that **the results of the PRISMS CBAT analysis will be confidential,** and that all responses will remain with only the commercial bank and community bank staff.

Module 4
Utilizing the PRISMS CBAT to Assess Community Bank Performance

Goal

Participants will be proficient in the use of the PRISMS CBAT when assessing community bank proposals for lines of credit.

Objectives

By the end of Module 4, participants will:

1. Be proficient in undertaking a pre-assessment of community bank financial statements, such as the balance sheet, income and cash flow statements, and map data from these documents into standard, generally accepted financial reporting format.

2. Be proficient in applying he PRISMS CBAT to a community bank's mapped financial documents.

3. Be able to analyze and discuss findings from a practice application of the tool on mapped community bank data.

4. Participate in and analyze the findings of a SWOT analysis of commercial bank lending to community banks, using as reference tools both the application of the CBAT from this module, and the review of an external SWOT analysis of community banks in general from Module 1.

Duration

6 hours

Module 4 Summary

Time and Technique	Session	Materials
Lecture and discussion Time	**Step 1: Introduction to Module 4** • Goal of Module 4 • Objectives of Module 4	PowerPoint Slide x
Lecture and Guided Discussion Time	**Step 2: Pre-assessment of Community Bank Financial Documents** • The importance of external audits • Roles of the Executive Director and Board of Directors in the production of sound financial documents • The importance of standardizing financial documents	Flipchart Markers
Lecture Time	**Step 3: Mapping Data from Financial Documents to Standard Format** • Definition of financial mapping • Why is financial mapping important? • A brief explanation of financial mapping	PowerPoint Slides x-y
Lecture Time	**Step 4: Applying the PRISMS CBAT to Standardized Financial Documents** • Establishing the ground rules regarding acceptable documentation • Initial desk analysis of data	PowerPoint Slides x-y
Lecture and discussion Time	**Step 5: Assessing and Reporting on Findings from Tool Application** • Totaling scores • “Red Flags” requiring further analysis • Dissemination of data findings	PowerPoint Slides x-y

Lecture and discussion Time	**Step 6: Undertaking a SWOT Analysis of Commercial Bank Lending to Community Banks** • Review assessment of community banks SWOT from Module 1 • Define how the PRISMS CBAT can address SWOT findings	PowerPoint Slides x-y

Module 4 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 4: Utilizing the PRISMS CBAT to Assess Community Bank Performance **Describe** The objectives and discuss the topics for this module.

By the end of Module 4, participants will:

- Be proficient in undertaking a pre-assessment of community bank financial statements, such as the balance sheet, income and cash flow statements, and map data from these documents into standard, generally accepted financial reporting format.
- Be proficient in applying he PRISMS CBAT to a community bank's mapped financial documents.
- Be able to analyze and discuss findings from a practice application of the tool on mapped community bank data.
- Participate in and analyze the findings of a SWOT analysis of commercial bank lending to community banks, using as reference tools both the application of the CBAT from this module, and the review of an external SWOT analysis of community banks in general from Module 1.

Step 2: Pre-assessment of Community Bank Financial Documents

Lecture and Discussion

Time

Flipchart Markers

Ask
How might commercial banks objectively assess the current and projected performance of community bank loan applicants? What documents and financial data would they rely upon in making an assessment?

Write responses on a flipchart.

Ask
What is the purpose of undertaking both internal and external audits of financial institutions? How do you think such audits should be undertaken?

Write responses on a flipchart. Summarize (if possible based on participants' responses) the importance of external audits in the general operations of the community bank.

Responses should include some of the following elements:

At a minimum, any financial intermediary or institution should undertake internal or external audits on a quarterly basis. Most regulatory authorities will require that financial institutions provide them with annual audit reports undertaken by an external auditor. Both internal and external audits should review the institution's balance sheet, income statement and, if available, its cash flow statement.

Ask
What do participants consider to be the appropriate roles and responsibilities of the community bank's Executive Director and Board of Directors in the production of sound financial documents?

Write responses on flipchart.

Responses should include some of the following elements:

- It is crucial that the financial institution ensure impartiality of the audit by assigning any internal audit to an auditor who reports directly to the Board of Directors, and not to his supervisor, who is usually the institution's Executive Director.

- Both the Board of Directors and Executive Director should possess the financial, management and, if possible, legal skills and background necessary to undertake meaningful analysis of both internally and externally audited financial reports and statements. Both parties should be capable of looking behind the numbers and using tools of analysis, such as ratios, to assess the true performance of the institution.

- The Executive Director should not be given the authority to appoint directly any members of the Board of Directors. Moreover, senior management should ensure that relatives, business partners, or others with significant links to the community bank not comprise the Board as a way to encourage an environment of objectivity among the Board.

- Finally, the Executive Director should ensure that any Board members who take out loans from the community bank pay back their loans on time, and in full, to show other clients that no special treatment is given to them.

Ask
What is the importance of standardizing financial documents? Why might standardized financial documents be important when undertaking the PRISMS CBAT, for example?

Write responses on flipchart.

Responses should include some of the following elements:

- The PRISMS CBAT is a tool for management that can, if properly used, provide them with useful and robust data necessary for making crucial management decision. But it is only a tool--***its output is as good as its input***. Management must ensure, to the extent possible, that the data they use in the analysis derived from the community banks' financial statements is sound, reliable, and follows generally accepted accounting principles.

- If the financial data used through the PRISMS CBAT by many community banks is sound, managers within the commercial bank sector can begin to make meaningful comparative analysis of several community banks. This can only happen if there is a common denominator of sound data being used by all managers utilizing the PRISMS CBAT to analyze a pool of community banks.

Step 3: Mapping Data from Financial Documents to Standard Format

Lecture and Discussion
X minutes

Flipchart
Markers

Ask
What types of financial documents could you expect to obtain from community banks for use in your due diligence as part of the banks' credit applications? How might you characterize the overall quality of the documents you might be able to access?

Write responses on flipchart

Ask
If the financial documents you receive from the community banks are not audited, or are of a quality that does not reflect generally accepted accounting standards, what might you need to do to make these statements—and the data comprising the statements—more in line with standard financial documents?

Summarize (if possible based on participants' responses) ways in which commercial banks might need to modify the financial documents they obtain from community banks.

- Commercial bank managers may need to work with community bank staff to ***clarify that the elements*** comprising key financial categories within the financial statements follow standard definitions. For example, they may want to undertake a random sample analysis of several elements of the assets, liabilities, and owner's equity sections of the balance sheet as a way to test the robustness of the entire document. Translating the raw data from the community bank into generally accepted format is often referred to as "mapping" the data.

- If statements and documents are not audited, this ***should be noted*** in the PRISMS CBAT final report.

- If management is interested in undertaking a full "mapping" of the community bank's data to generally accepted format, they can use tools from the microfinance sector to undertake such an activity, such as those that can be found in The SEEP Network's Framework tool. . (The SEEP tool and training manuals are free and available to the public, and can be downloaded from the http://www.seepnetwork.org website.)

.

Step 4: Applying the PRISMS CBAT to Standardized Financial Documents

Lecture and Discussion

Time:

Ask
At what point might loan officers decide that they should reject an application? Is there—or should there be-- a "cut off point" that your bank generally follows when making loan approval decisions, wherein some applications' simply do not meet the stated and explicit requirements of the bank's lending policy?

Summarize (if possible, based on participants' responses) ways in which commercial banks can, and should, determine an absolute "cut off" point below which they will not consider lending to a community bank. The characteristics of this analysis might include some of the following elements:

- Most, if not all, commercial banks will have a clearly stated policy that outlines the basic requirements for approving a line of credit, or any other loan. This policy is related, among other things, to the bank's risk appetite, its own need to adhere to regulatory oversight requirements, and its short- and long-term investment strategies and resources.

- Absent such clear directives, commercial bank management will need to assess the risks of the loan application alongside its own loan loss reserve base. If the commercial bank does not have sufficient reserves to cover any loan in its entirety, and if the quality of the loan application is poor, the bank should consider not approving the full request initially. Instead, it can approve a smaller request as a way to benchmark the community bank's performance and use this information as a basis upon which to approve future, possibly larger, tranche disbursements.

- The loan officer should decide which ratios within the PRISMS CBAT are critical for the application analysis, focusing on those ratios that measure the liquidity of the community bank. Examples of key ratios include: current ratio, PAR, write-off ratio, risk coverage ratio, liquidity ratio, and cash flow ratio. Each of these ratios can provide management with information regarding the potential of the community bank to repay a monthly line of credit.

Explain
The initial step you will use when undertaking a PRISMS CBAT analysis is to ***undertake a desk analysis*** of the community bank's financial data and documentation. This desk analysis will comprise the following:

- Request the following documents (audited preferred) from the community bank: balance sheet, income statement, and the cash flow statement.
- If you are unclear of the meaning of any elements contained within these documents, you can use the "pop up" definitions contained within the tool spreadsheets.
- If you require clarification from community bank staff on any numbers within the statements, you will need to meet with community bank staff to get this clarification. You may need to ask for certain documentation to support these numbers, such as invoices, receipts, etc.
- Determine—and stick to—your own bank's cut off point, beyond which you will not go to approve an application.
- Read through the entire tool and determine which sections can be completed with the financial statements alone. This will include the ratios, and several sections within the Internal Controls section, for example.
- ***Undertake the Compliance section before all other sections***. If the community bank is not in compliance, it will not be necessary for the loan officer to continue with the analysis. At this point, the analysis should end, and the commercial bank can notify the community bank that it will only consider its application once full compliance and registration requirements have been met.

Step 5: Assessing and Reporting on Findings from Tool Application

Lecture and Discussion

Time:

Explain
How should analysts total their scores on the PRISMS CBAT?

- Points are assigned to each section of the tool. The analyst should total each section, noting any significant low or high points in the comments section for each section.

- Upon completion of the scoring of each section, the analyst should total all separate sections to arrive at a final score for the entire assessment. The total score should be assessed against a highest value of 100.

Explain
What are the "red flags" that analysts should be looking for when undertaking a PRISMS CBAT? Why is this type of analysis at least as important, if not more important, than simply "tallying up" a total? Ask participants to go through each section of the tool narrative and identify a list of "red flag" issues that the analyst should review carefully alongside any particular score.

Summarize (if possible, based on participants' responses) why analysts should not rely too heavily upon simple numerical scores deriving from the PRISMS CBAT analysis.

- The analyst cannot be absolutely certain that the data he enters into the tool is completely accurate. As a result, he cannot be certain that any analysis derived through this data is itself without error.

- The analyst should look beyond the numbers and focus on issues related to management and governance. Such analysis is important because successful management and governance are critical to the overall success of the community bank.

- Some "red flags" include the following:

Management/Executive Team: How often does the management team meet to review the performance of the institution? Are minutes taken at staff and management meetings, and is there follow-up on action items?

Internal Controls/Internal and External Audits: Does the institution have an internal auditor that reports to the Board of Directors?

Internal Controls/Physical and Transaction Controls: On a scale of 1 to 5, rate the extent to which duties are suitably segregated to minimize the possibility that one individual can perpetrate and conceal errors or irregularities in the normal course of their duties.

Relationship of Board and Management: How many members of the board have familial/friend relationships with other board members or management? Are directors committed to management's strategy as well as to repayment of personal loans?

Internal Controls/Security: Are controls such as passwords and firewalls in place to ensure that all transactions are valid, complete and have been appropriately authorized?

Management Information Systems/Hardware and Software: Does the community bank utilize specialized accounting software?

MIS/Reports: How often and with what time lag are financial reports produced?

Explain
How, and to whom, should analysts disseminate their PRISMS CBAT data findings?

- Commercial bank analysts should meet with community bank senior management and key staff (CFO, auditor, MIS specialist…) prior to undertaking the assessment to ensure that all critical documents are in order, and for initial clarification. During this meeting, the analyst should explain to community bank staff that the responses to all questionnaires are strictly confidential, and that all responses will be anonymous.
- Upon completion of the full assessment, the analyst should meet with community bank staff to present both findings and analysis. The analyst does not need to give a response to the loan application at this time.
- It is at the discretion of the community bank if they wish to share the results of the PRISMS CBAT analyst to any of their internal or external stakeholders, such as the Board of Directors or regulatory authorities.
- The commercial bank analyst should only share the results of the assessment with commercial bank staff directly involved in the loan approval process.

Step 6: Undertaking a SWOT Analysis of Commercial Bank Lending to Community Banks

Lecture and Discussion

Time

Ask
How might the PRISMS CBAT help analysts undertake a SWOT analysis that will help them determine the risk level of a particular application for a line of credit?

Methodology to use in this section:
Ask participants to refer to the SWOT analysis provided to them during the discussion of Module 1. Participants should focus on the bold-faced "weakness" indicators and match these with the most appropriate evaluation category in the PRISMS CBAT. There is no "right answer" in this section; rather, participants can find many different questions within the tool to address several of the SWOT analysis sections. The point of

this exercise is to encourage dialogue and active usage of the tool.

For example, looking at “overstaffing”, the analyst can use the Management Team/Culture question, “Does the organizational structure and management style appear to promote accountability and efficiency in operations?”

Strengths

- Originality of the concept in the financial sector landscape
- Potential for providing relevant and meaningful financial services to rural areas
- Lending monopoly in the formal sector, except where NACRDB intervenes
- Often strong roots in the community
- Good knowledge of rural areas and inhabitants
- Part of the established Nigerian formal financial system since CBN take-over
- Simple and rather secure banking services to salary earners
- Concentration on savings deposits
- Banking procedures simpler than in commercial banks
- Lending not based on immovable property as main collateral
- Existence of an umbrella organization (NACOB)
- Satisfactory capitalization

Weaknesses

- **Poor management**
- **Poor supervision through boards**
- **Overstaffing**
- Low value of total assets
- Insufficient savings mobilization
- Insignificant term deposits
- Lack of penetration of rural areas, average to poor clients, farmers, craftsmen and the service sector
- **Insufficient financial analysis**
- **Absence of any longitudinal data analysis**
- Poor public image due to poor past performance and bankruptcy of CBs
- Poor product development and refinement
- Poor market analysis and market potential analysis skills
- Non-competitive interest rates
- **Lack of check clearing facilities**
- **Insufficient loan policies and skills to appraise more complex loans**
- **Poor debt recovery**

Opportunities

- High demand for loans

- No or insignificant lending activities by the formal banking sector to rural areas, with the exception of NACRDB in few areas
- Higher loan volumes to poor and middle level clients, farmers, petty traders, artisans and other service providers
- Deposit insurance through NDIC
- Gain in public image along with better supervision and assistance
- Reducing costs of operations and improved data analysis through computerization in medium terms
- Higher levels of deposits from non-conventional clients

Threats:

- Declining patronage by LGCs
- Lending activities by commercial banks
- Declining income levels leading to lower deposits and shorter terms of deposits
- High general willful default propensity of the Nigerian public
- Increasing costs of pursuing debtors, long duration of court cases
- Increasing poverty levels in Nigeria

Module 5
Course Overview and Case Study

Goal

Participants will bring together the concepts they have learned in modules 1 through 4 by completing a case study exercise that simulates a community bank line of credit application process.

Objectives

By the end of Module 5, participants will:

1. Articulate the major challenges and opportunities of commercial bank lending to community banks.

2. Incorporate the principles of the "Five C's of Lending" into a simulated credit analysis.

3. Utilize the PRISMS CBAT in the credit analysis process.

Duration

20 minutes

Module 5 Summary

Time and Technique	Session	Materials
Lecture and discussion Time	**Step 1: Introduction to Module 5** • Overview of Goals and Objectives	PowerPoint Slide x
Lecture and Guided Discussion Time	**Step 2: Overview of Community Banks in Nigeria** • Similarities and differences with other financial intermediaries • Key features of community banks • Products and services	Flipchart Markers
Lecture Time	**Step 3: Overview of Elements of the PRISMS CBAT** • Purpose • Structure of tool • Methodology • Dissemination and distribution of results	PowerPoint Slides x-y
Lecture and discussion Time	**Step 4: Simulated Credit Line Application Review with Class Presentations** • Purpose of case study • Methodology of case study •	PowerPoint Slides x-y
Lecture and discussion Time	**Step 5: Completion of Course Evaluations** • **xxx** • **xxx**	Handouts x, y

Module 5 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 5 Course Overview and Case Study **Describe** The objectives and discuss the topics for this module. By the end of Module 5, participants will: • Articulate the major challenges and opportunities of commercial bank lending to community banks. • Incorporate the principles of the "Five C's of Lending" into a simulated credit analysis. • Utilize the PRISMS CBAT in the credit analysis process.

Step 2: Overview of Community Banks in Nigeria

Lecture and Discussion

Time

Flipchart Markers

Ask
Recalling what we learned about community banks in Nigeria in Module 1, how might we characterize these financial institutions?

Write responses on a flipchart.

Ask

Write responses on flipchart. Responses should include some of the following:

Summarize (if possible based on participants' responses) the major similarities and differences between community banks and other financial institutions in Nigeria. Here are some findings from the *Assessment of Community Banks* report to stimulate discussion:

Similarities:

- Community banks are required to submit returns on key financial and operation data to regulatory authorities, including the Central Bank of Nigeria and the National Board for Community Banks.
- Community banks are required to observe a number of prudential requirements, including minimum liquidity ratios, and a maximum exposure in all forms of shareholder funds to a single borrower.
- Community banks are required to exhibit their balance sheet and income statement in their offices and have external audits of their accounts. (Note, however, that few banks comply with this regulation.)[1]
- Community banks are compelled by law to hold annual general shareholder meetings within six months after the end of any given financial year. (Note, however, that this regulation is not adhered to on a uniform or consistent basis.)[2]
- All community banks offer the same types of deposits as do commercial banks, while community banks maintain very low

[1] *Assessment of Community Banks* report, p. 20.
[2] *Assessment of Community Banks* report, p. 25.

entry barriers but pay out lower savings interest rates.

- In both commercial and community banks, large-sized loans are only granted if substantial collateral can be provided in the form of deposits, land, or other tangible assets. In most cases, loans are to be repaid within nine months.

Differences:

- Unlike commercial banks, community banks do not have check-clearing authorization, nor are they entitled to deal with undertake transactions with foreign exchange.

- The original mandate of community banks was to service rural populations. As such, they are all located in rural parts of the country, providing them with greater access to rural populations than their commercial bank counterparts.

- Community banks generally serve a low and medium income clientele that is not directly target or served by commercial banks. Unlike commercial banks, community banks' clientele is fairly uniform. This uniformity is a result of the fact that salary earners and pensioners have become the main client group within community banks due to the banks' ability to collateralize small and short-term loans with predictable salary and pension funds.

- Community banks have a lower minimum equity capital requirement for obtaining an license than their commercial bank counterparts, with current rates of NGN 250,000 (less than US $2,000).

- Community banks do not always require full, traditional collateral coverage, accepting instead personal guarantees, moveable assets, and other non-traditional forms of collateral to secure loans.

- Community banks function in both rural and urban centers, with some of their more prosperous banks located in urban centers.

Ask

How do community banks operate?

---

[3] *Ibid,* p. iv.
[4] ***Ibid***, p. 13.
[5] ***Ibid***, pg. 32.
[6] ***Ibid***, pg. 26.

Write responses on flipchart.

Summarize (if possible based on participants' responses) the key features of community bank operations:

- Of the current 775 community banks operating with a license from the National Board for Community Banks, approximately 532 of these banks also have a valid operating license from the Central Bank of Nigeria. Estimates are that about 750 community banks will survive into the future.[3]

- The average community bank has total assets of NGN 50.9 million (approximately US $392,000), total deposits of NGN 32.0 million (approximately US $247,000), total equity of NGN 12.4 million (approximately US $95,000) and loans outstanding of NGN 17.7 million (approximately US $136,000).[4] **(Display PPT slide, pg. 14 of assessment report.)**

- About two-thirds of all community banks are located in rural areas, with the highest concentration found in the Yoruba-speaking areas of the Southwest (six States). Each community bank is expected to operate in a defined catchement, or geographic, area. Due to the high rural concentration, it is likely that community banks' lending supports agricultural enterprises or activities.
- The original requirements of community banks stipulate that they employ a minimum of 13 staff, regardless of actual workload. This has led, in general, to overstaffing of many community banks.

- Community banks operate through a Decree mandating that the NBCB grant "matching loans" to community banks of up to NGN 500,000 million per bank. This amount was reduced to NGN 250,000 million per bank. By 2003, NGN 58 million of these loans were outstanding and overdue, with many community banks defaulting on repayment.

- Community bank operating hours tend to be more generous than their commercial bank counterparts, with counters open for longer hours each day and Saturday if that day falls on a market day.

Ask

Who are the primary clientele of community banks?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the current client base of Nigerian community banks.

- Approximately 65 percent of the total loans were extended to salary earners, 20 percent to contractors, and the remaining 15 percent to small enterprises, mainly agriculture, trading, transport and handicrafts.[5]

- Community banks clients are generally rural, but some of the more successful community banks reside in urban centers, such as the community bank established by and for members of the Nigeria Police Force.

- Clientele generally derive from low- to middle income economic groups.

- Current clients comprise mostly regular salary earners or those with regular pension incomes. While this was neither the design nor the intention of community banks, this uniformity in clientele is likely a result of community banks' high level of risk aversion. Aside from this group, community banks serve a small number of traders.

- Women are an important group among community bank savings deposit holders, comprising about 20 percent of total savers.[6]

Ask

What are the major products and services provided by and through community banks?

Summarize (if possible based on participants' responses) the products and services generally provided by and through community banks. Here is a representative list of products and services:

- A range of deposits, including savings, time deposits, and targeted deposits, such as "Hadj Savings" for those wanting to save for pilgrimage to Mecca and Medina.

- Issue for the purpose of raising funds, redeemable debentures.

- Ancillary banking services, such as remittance of funds or safe deposit services.

- Invest surplus funds into instruments such as treasury bills or interest-bearing accounts in other banks.

- Loan products comprising simple loan products and an overdraft facility on current accounts for 1 to12 months and short-term loans ranging from 3 to 18 months in duration.

- Overdraft facilities are primarily approved for salary earners, such as the staff of the Local Government Councils, schools and hospitals. Loans of amounts up to three times net salary have been approved, with installment repayment periods over six months through salary deductions. In addition to the bank's securing the loan through salary deductions, the bank requires a letter of guarantee from the employer to secure further these loans.

- Equipment-leasing facilities.

- Other non-banking functions to ensure access of customers to farm inputs**.**

Step 3: Overview of the Elements of the PRISMS CBAT

Lecture and Discussion
X minutes

Flipchart
Markers

Ask
From what you have learned thus far, identify the key elements of the PRISMS CBAT.

Write responses on flipchart

Summarize (if possible, based on participants' responses) the key elements of the PRISMS CBAT.

- The ***purpose*** of the PRISMS CBAT is to provide commercial bank management—particularly credit and loan officers—with an analytical tool that can help the analyst determine the long-run viability of a community bank and, as a result, its likelihood of repaying a line of credit.

- The ***structure*** of the tool is as follows: The tool is broken into two phases—a diagnostic phase and an interview phase. The first phase requires the analyst to review key community bank financial statements and documents, such as the balance sheet, income statement, and cash flow statement. The analyst uses these, and other, documents to derive and examine key ratios that will yield useful information regarding the community bank's financial status. While guidance and definitions are provided for each ratio, the tool requires that the analyst examine ratios together, noting the interconnectedness between certain ratios. The analyst should also look for "red flags", such as those suggested in Module 4, and hone in on these issues alongside deriving totals for each section.

- During the second phase of the tool, the analyst will use the PRISMS CBAT format and structured questions to interview staff at various levels within the community bank. This phase of the tool focuses on evaluating management and operations in four main areas: executive management and organizational culture; the board of directors and governance; internal controls; and management information systems. The objective of this phase is to identify any weaknesses in management or governance that could cause unexpected shocks within the community bank which would seriously affect the operations and/or profitability of the institution.

- The recommended ***methodology*** for undertaking a PRISMS CBAT analysis is as follows: First, the analyst should meet with senior staff from the community bank to explain both the purpose for undertaking the PRISMS CBAT, as well as the methodology. The analyst should highlight the confidential nature of the entire process. The analyst should then undertake the review of financial documents and seek clarification from community bank staff on any aspects of the documents that are unclear. At this stage, the analyst may need to "map" the community bank's raw financial data into a format that conforms more closely to standard accounting practices. Working with the community bank at this stage can be useful way for the commercial bank to learn more about the community bank's overall operations. Once the ratios have been calculated from the document review, the analyst will begin the second phase of the analysis. Upon completion of the totaling of scores for each section, the analyst should arrange to meet with key staff once again to present his findings, and then present the same findings to internal commercial bank staff involved in the credit review process for the community bank at hand.

- The ***results*** of the PRISMS CBAT analysis can be disseminated and distributed to internal commercial bank staff directly involved in the loan review process. Community bank staff will determine which of its internal and/or external stakeholders will receive results of the analysis.

Step 4: Simulated Credit Line Application Review with Class Presentation

Lecture and Discussion

Time:

Explain
Participants should break into small groups of between 2-3 members, designating the following roles to each member: loan applicant from community bank, loan officer from commercial bank, and observer. Each group will receive the following documents to use during this exercise:

- Case Study
- "Five C's" of Lending Checklist
- PRISMS CBAT
- "Red Flags" Checklist

Participants will assign roles to each member, with each member carrying the following responsibilities during the group's case study presentation to the class:

- The loan applicant from the community bank will present his/her application to the bank for review. The applicant should be prepared to answer any questions asked by the loan officer during the initial presentation of the application.

- The loan officer from the commercial bank will review the loan application and ask the applicant for clarification on any part of the application during the initial review. The loan officer will make the assessment of the application, with assistance from the applicant.

- The observer will take notes during the initial application review process and present the final decision on the application to the class. The applicant and loan officer can assist the observer during the presentation.

Step 5: Completion of Course Evaluations

Explain
Participants will complete the course evaluation, Handout x, and hand

these in to the instructor.

Module 5
Case Study

Simulated Credit Line Application Review with Class Presentation

Explain
Participants should break into small groups of between 2-3 members, designating the following roles to each member: loan applicant from community bank, loan officer from commercial bank, and observer. Each group will receive the following documents to use during this exercise:

- Case Study
- "Five C's" of Lending Checklist
- PRISMS CBAT
- "Red Flags" Checklist

Participants will assign roles to each member, with each member carrying the following responsibilities during the group's case study presentation to the class:

- The ***loan applicant*** from the community bank will present his/her application to the bank for review. The applicant should be prepared to answer any questions asked by the loan officer during the initial presentation of the application.

- The ***loan officer*** from the commercial bank will review the loan application and ask the applicant for clarification on any part of the application during the initial review. The loan officer will make the assessment of the application, with assistance from the applicant.

- The ***observer*** will take notes during the initial application review process and present the final decision on the application to the class. The applicant and loan officer can assist the observer during the presentation.

Background Information

NigCom, a community bank located in (region), has applied for a line of credit of (amount) from your commercial bank. NigCom is a fully registered and licensed community bank that has been offering financial services to its rural clients for over five years. They would like to increase the amount of loans they can offer to their clients, and expand their outreach to the growing small and medium enterprise sector in their immediate catchment area. You are the analyst tasked with reviewing NigCom's application for credit. You are fortunate to have at your disposal a new tool called the PRISMS Community Bank Assessment Tool (CBAT), a checklist of standard lending principles commonly referred to as the "Five C's" of lending, and a list of key issues—or "red flags""—to note when you are undertaking the PRISMS CBAT analysis.

The first step you take is to meet with key NigCom staff. During this meeting, you inform NigCom staff that you will be undertaking a PRISMS CBAT analysis of the institution as part of your due diligence in reviewing the loan request. You ensure NigCom staff that the questions asked throughout the process will be held in the strictest confidence, and that the identity of the respondents will not be compromised as all respondents will remain anonymous. You ask the Executive Director to provide you with key financial statements that you will need to begin the diagnostic phase of the analysis. After two meetings with NigCom financial staff to clarify several sections of the financial documents, you undertake Phase 1, the diagnostic of the Tool, by completing a full set of ratios.

You then begin the second phase of the assessment, which consists of a series of interviews undertaken over a three-day period. You notice the following during this phase of the assessment:

- The Executive Director is a charismatic leader with a well-known reputation both within and outside of Nigerian community bank circles for his having transformed the community bank under his supervision into a profitable entity within a two-year period. He is forceful and dynamic, and he has drawn much attention to his bank through both self-promotion and promotion of his bank's services and products.

- While they do not say so directly, you sense that the bank's staff is overworked, stressed, and not feeling that they are valued members of the institution. You note from e-mail dates and times that staff frequently works extended hours, including weekends. There has been a fairly high level of turnover over the past year, and you hear through informal channels that staff still with the bank is pursuing other job opportunities.

- While board members appear to meet regularly and keep records of their meetings, the available notes give little indication of the extent to which members initiate discussion and attempt to resolve serious management issues. You also learn from several staff that the Executive Director has appointed most members of the Board, and it is unclear what criteria he used in many cases of appointment. Reading through the past year's minutes, you note that the Board has approved a significant salary increase for the Executive Director as well as several other benefits associated with his position. While this may not in itself be a cause of concern, you question the justification for such expenditures in light of NigCom's steady decline in Nigerian community banks' share of clients, as reflected in its steadily declining client base.

- The bank is requesting an extension of one year on the principal of a US$750,000 loan it received from an international NGO interested in building community bank capacity in rural regions. At the same time, you discover that the bank has approximately US $1.0 mn in a current account of a local commercial bank, earning little interest. You are unable to obtain much information from staff, including the CFO, about the rationale for keeping such a large amount of cash on hand, and deferring the repayment of an outstanding loan.

- A local bilateral development organization has approached the community bank with the suggestion that they apply to participate in an upcoming trade fair that will bring prospective equity investors together with community banks to support private sector investment in community banks. In addition to acting as a facilitator for this event, the bilateral organization is also offering to provide the stronger community banks with a grant of approximately US$500,000 for loan seed capital. However, the development organization has shared with you the results of a recent independent assessment of NigCom which does not shed favorable light on the senior management of the institution, citing specifically several concerns related to the Executive Director himself. You infer from these comments that the bilateral organization may not approve NigCom's application for these opportunities unless there is a significant change in its management structure, which could include removing the Executive Director.

The following are results of your ratio analysis:

- Current Ratio: 1.98
- Portfolio at Risk (PAR): 12%
- Write-off Ratio: 5% of PAR
- Risk Coverage Ratio: 65% of PAR
- Liquidity Ratio: 0.75
- Cash Flow Ratio: 0.85

The next page shows the numerical results of your completed PRISMS CBAT analysis. On the basis of these results, and your assessment of findings from interviews, please complete your assessment of NigCom's application for a line of credit and present your findings to your bank's senior loan officer (in this case, your fellow class participants).

MANAGEMENT TEAM	Actual	*Optimal*	*Acceptable*	*Explanation*
Culture				
Does the organizational structure and management style appear to promote accountability and efficiency in operations?	**2**	*Yes (5)*	*Yes, but some training is still needed (3)*	Are there significant lags in decision-making or are day-to-day decisions made quickly? Are all staff empowered to contribute ideas in staff meetings? Is training encouraged and made available to help staff gain additional skills? Does management recognize the importance of technology?
Does the culture foster productivity and high service quality? Is there an emphasis placed on customer service?	**4**	*Yes (5)*	*Yes, but some training is still needed (3)*	Do staff at lowest levels feel empowered to make decisions, correct errors quickly, and put the client first? For example, do they need to ask a manager before crediting a customer's account when an error has been made?
On a scale of 1 to 5, rate the job satisfaction of employees.		*5*	*3*	
Does the institution have a history of bad debts/non-repayment to lenders?	*2*		*Yes, but management has changed and is committed to good budgeting and financial management (3)*	While this is unlikely given community bank's low access to commercial credit, the bank should check for any outstanding loans or lines of credit.
Management/Executive Team				
On a scale of 1 to 5, rate the adequacy of the management team's skills for meeting the institution's current needs.	**2**	*5*	*3*	The management team possesses the necessary skills to carry out its responsibilities, is committed to the organization, and is characterized by cohesiveness and clear objectives that are communicated throughout the institution.
On a scale of 1 to 5, rate the adequacy of the management team's skills for managing future growth.	**2**	*5*	*3*	The management team routinely identifies opportunities for growth and possesses the skills to develop new products and distribution methods to better serve clients. Management also possess the skills to evaluate new opportunities and makes decisions based on analytical reviews of information.
Rate management's ability to effectively and accurately address the main risks/challenges facing the institution.	**2**	*5*	*3*	Important decisions are taken on a timely basis and grounded in technical criteria.
Does management maintain open communication with staff as well as clients?	**2**	*Yes (5)*	*Yes, in most cases (3)*	Communication tends to be open and flow freely at all levels of the organization.
How often does the management team meet with staff?	**2**	*Weekly (5)*	*Monthly (3)*	Weekly or bi-weekly meetings are ideal to ensure that important issues are communicated to staff as promptly as possible.
How often does the management team meet to review the performance of the institution?	**3**	*Monthly (5)*	*Quarterly (3)*	Relate different sets of data - operating or financial - to one another such as comparisons of actual to budgeted performance
Are minutes taken at staff and management meetings, and is there follow up on action items?	**3**	*Yes (5)*	*Yes, minutes are taken but not consistently followed up on (3)*	It is important to verify that important issues are communicated to all staff and that the executive team is following up on action items.
Financial Manager				
On a scale of 1 to 5, rate the adequacy of his/her financial skills for meeting the institution's current needs.	**3**	*5*	*3*	He/She creates and reviews reports on a regular basis and identifies potential problems and cash shortfalls well in advance. This person can identify errors in the information and correct them. He/she regularly makes recommendations to the CEO based on the information.
On a scale of 1 to 5, rate the adequacy of his/her financial skills for managing future growth.	**3**	*5*	*3*	He/she can evaluate the financial impact of new opportunities for growth.
Operational Structure				
Are lines of authority clear?	**2**	*Yes (5)*	*Yes, in writing but not in practice (3)*	In particular, not everyone should report to the CEO. Supervisory authority should be delegated and those in supervisory roles trained accordingly.
Are there redundancies in key operation decision-making processes?	**2**	*Minimal redundancies (5)*	*Several redundancies, but that don't slow the decision-making process significantly (3)*	The goal of the institution should be to only develop redundancies in the decision-making process where absolutely necessary to ensure proper controls. For example, the financial manager should not have to sign off on every decision made by the institution's underwriter. However, in the case of loans greater than a certain amount, the financial manager may be required review the recommendation of the underwriter.

How standardized are operational procedures?	**3**	*Highly standardized but flexible (5)*	*Standardization throughout loan application and distribution process (3)*	The institution's key policies and processes are documented and updated as needed. They have been communicated to personnel who use them in their targets and its policies and procedures.
Compliance				
In the community bank registered with and licensed by the CBN?	**5**	*Yes (5)*	*Yes (5)*	The CB should be licensed by the CBN and in compliance with reporting requirements. If not, the bank runs the risk of default if the CB is forced to shut down by the CBN.
Does the CB provide quarterly reports to the CBN?	**5**	*Yes (5)*	*Yes (5)*	The CB should be licensed by the CBN and in compliance with reporting requirements. If not, the bank runs the risk of default if the CB is forced to shut down by the CBN.
Are the CB's accounts audited annually by a qualified external auditor? Are those financial statements exhibited in the CB office?	**5**	*Yes (5)*	*Yes (5)*	The CB should be licensed by the CBN and in compliance with reporting requirements. If not, the bank runs the risk of default if the CB is forced to shut down by the CBN.
Do the Memos and Articles of Incorporation/Association permit the CB to borrow from commercial sources? To what limit?	**5**	*Yes (5)*	*Yes (5)*	It is assumed that if the CB is pursuing a line of credit, that its articles of incorporation would allow it to borrow from a bank, but this should be confirmed.
Succession				
If any of the key leaders leave, are there others in the institution who could replace their contributions?	**2**	*Yes, already identified by CEO and communicated to board (5)*	*Yes, CEO has someone in mind, but not yet communicated (3)*	The CEO should training up potential replacements and involving them in key decisions.
On a scale of 1 to 5, rate the level and availability of training opportunities for staff.	**3**	*5*	*3*	Training is encouraged and training opportunities are provided to train staff from within and to avoid challenges in recruiting people with the needed qualities outside the institution. Staff have mentors and coaches. (5 = 80% of staff have been availed the opportunity and resources to continue with training in their respective fields/areas of operations; 3 = less than 50%)

Module 5
Case Study
Trainer's Notes

Simulated Credit Line Application Review with Class Presentation

Explain
Participants should break into small groups of between 2-3 members, designating the following roles to each member: loan applicant from community bank, loan officer from commercial bank, and observer. Each group will receive the following documents to use during this exercise:

- Case Study
- "Five C's" of Lending Checklist
- PRISMS CBAT
- "Red Flags" Checklist

Participants will assign roles to each member, with each member carrying the following responsibilities during the group's case study presentation to the class:

- The ***loan applicant*** from the community bank will present his/her application to the bank for review. The applicant should be prepared to answer any questions asked by the loan officer during the initial presentation of the application.

- The ***loan officer*** from the commercial bank will review the loan application and ask the applicant for clarification on any part of the application during the initial review. The loan officer will make the assessment of the application, with assistance from the applicant.

- The ***observer*** will take notes during the initial application review process and present the final decision on the application to the class. The applicant and loan officer can assist the observer during the presentation.

Background Information

NigCom, a community bank located in (region), has applied for a line of credit of (amount) from your commercial bank. NigCom is a fully registered and licensed community bank that has been offering financial services to its rural clients for over five years. **This is positive as it shows that the bank takes the issue of compliance with regulatory authorities serioiusly.** They would like to increase the amount of loans they can offer to their clients, and expand their outreach to the growing small and medium enterprise sector in their immediate catchment area. You are the analyst tasked with reviewing NigCom's application for credit. You are fortunate to have at your disposal a new tool called the PRISMS Community Bank Assessment Tool (CBAT), a checklist of standard lending principles commonly referred to as the "Five C's" of lending, and a list of key issues—or "red flags""—to note when you are undertaking the PRISMS CBAT analysis.

The first step you take is to meet with key NigCom staff. During this meeting, you inform NigCom staff that you will be undertaking a PRISMS CBAT analysis of the institution as part of your due diligence in reviewing the loan request. You ensure NigCom staff that the questions asked throughout the process will be held in the strictest confidence, and that the identity of the respondents will not be compromised as all respondents will remain anonymous. You ask the Executive Director to provide you with key financial statements that you will need to begin the diagnostic phase of the analysis. After two meetings with NigCom financial staff to clarify several sections of the financial documents, you undertake Phase 1, the diagnostic of the Tool, by completing a full set of ratios.

You then begin the second phase of the assessment, which consists of a series of interviews undertaken over a three-day period. You notice the following during this phase of the assessment:

- The Executive Director is a charismatic leader with a well-known reputation both within and outside of Nigerian community bank circles for his having transformed the community bank under his supervision into a profitable entity within a two-year period. He is forceful and dynamic, and he has drawn much attention to his bank through both self-promotion and promotion of his bank's services and products.

- While they do not say so directly, you sense that the bank's staff is overworked, stressed, and not feeling that they are valued members of the institution. **Red flag: Management/Executive Team: The management team does not meet often to review the performance of the institution, and staff are not comfortable raising key issues and concerns with the Executive Director for fear of retribution.** You note from e-mail dates and times that staff frequently works extended hours, including weekends. **Red flag: While it may be good on the surface to have a hard-driving, committed Executive Director at the helm of the institution, you sense**

that staff are "burned out" and that they will continue to leave. You sense this from an overall atmosphere of low morale. While staff are clearly committed to the mission of the institution, they do not feel like valued members of the institution. There has been a fairly high level of turnover over the past year, and you hear through informal channels that staff still with the bank is pursuing other job opportunities.

- While board members appear to meet regularly and keep records of their meetings, the available notes give little indication of the extent to which members initiate discussion and attempt to resolve serious management issues. You also learn from several staff that the Executive Director has appointed most members of the Board, and it is unclear what criteria he used in many cases of appointment. **Red flag: Board/Governance: Relationship of Board and Management. Board members may have been appointed on the basis of their relationship with and to the Executive Director, and not as a result of their commitment to the bank's mission and what their expertise could bring to the role of oversight. Most of the members have business backgrounds only, with only one having strong financial skills and background.** Reading through the past year's minutes, you note that the Board has approved a significant salary increase for the Executive Director as well as several other benefits associated with his position. While this may not in itself be a cause of concern, you question the justification for such expenditures in light of NigCom's steady decline in Nigerian community banks' share of clients, as reflected in its steadily declining client base. Finally, while the bank has a clearly written policy that the internal auditor reports directly to the Board, this does not appear to be the case in practice. **Red flag: Internal Controls: Internal and External Audits. Does the institution have an internal auditor that reports to the board of directors?**

- You learn from staff that the Executive Director has taken out several loans and that many of these have not been repaid. You question many of the staff to ensure that bias does not contaminate your assessment, but most staff provides this same information through responses to different questions. You also confirm through various staff questions as well as written policy documents that the Executive Director has access to all of the institution's codes and passwords. **Red flag: Internal Controls/Internal and External Audits. On a scale of 1 to 5, rate the extent to which duties are suitably segregated to minimize the possibility that one individual can perpetrate and conceal errors or irregularities in the normal course of their duties. Red Flag: Physical and Transaction Controls/Security. Are controls such as passwords and firewalls in place to ensure that all transactions are valid, complete and have been appropriately authorized? Red flag: Board/Governance/Relationship of Board and Management. Are directors committed to management's strategy as well as to repayment of personal loans?**

- The bank is requesting an extension of one year on the principal of a US$750,000 loan it received from an international NGO interested in building community bank capacity in rural regions. At the same time, you discover that the bank has approximately US $1.0 mn in a current account of a local commercial bank, earning little interest. You are unable to obtain much information from staff, including the CFO, about the rationale for keeping such a large amount of cash on hand, and deferring the repayment of an outstanding loan. **Red flag: Internal Controls/Internal and External Audits. Do administrative systems comply with written policies and procedures?**

- A local bilateral development organization has approached the community bank with the suggestion that they apply to participate in an upcoming trade fair that will bring prospective equity investors together with community banks to support private sector investment in community banks. In addition to acting as a facilitator for this event, the bilateral organization is also offering to provide the stronger community banks with a grant of approximately US$500,000 for loan seed capital. However, the development organization has shared with you the results of a recent independent assessment of NigCom which does not shed favorable light on the senior management of the institution, citing specifically several concerns related to the Executive Director himself. You infer from these comments that the bilateral organization may not approve NigCom's application for these opportunities unless there is a significant change in its management structure, which could include removing the Executive Director. **Red flag: While not part of the formal CBAT assessment, you consider this information useful as it provides some indication of what the local environment's perception is of NigCom's management. You also understand that NigCom may be forfeiting a unique growth opportunity (i.e., the opportunity to participate in the investor's fair and the availability of seed capital) if it does not make some major changes in its management structure. As a potential investor in NigCom, you have a vested interest in knowing what other potential or actual investors think of NigCom's current management structure and the implications of that management structure of future performance.**

The following are the results of several of the key ratios you have calculated:

- **Current ratio**: (Current Assets/Current Liabilities). Score: 1.98. Recall that this ratio indicates the ability of near-cash assets to pay off the current liabilities. The optimal range is any number >1.2. The acceptable range is between 1.0 and 2.0. While NigCom falls just within the acceptable range, you may want to track this indicator closely to make sure that they maintain either an increasing rate of current assets or a decreasing rate of current liabilities in order to maintain an overall acceptable current ratio.

- **Portfolio at Risk (PAR):** (Outstanding Balance on Arrears over 30 days + Total Gross Outstanding Refinanced (Restructured) Portfolio/Outstanding Gross Portfolio). Score: 12%. This ratio measures loan portfolio quality by indicating the portion of the portfolio that is "contaminated" by arrears and therefore at risk of not being repaid. Generally, any PAR exceeding a score of 10% should be cause for concern, unless most loans are backed by bankable collateral. Write offs can make this number deceiving. NigCom is well over the acceptable PAR range, which should give rise to some concern on your part. You should discuss with NigCom staff why they believe the PAR is so high, and compare this rate over a minimum 5-year period of time to determine if the overall trend is increasing.

- **Write-off ratio:** (Value of Loans Written-Off/Average Gross Portfolio). Score: 5% of PAR. This ratio represents loans that the community bank has removed from its books because of a substantial doubt that they will be recovered. Both the optimal and acceptable scores would be anything less than or equal to 10% of total PAR. Accounting transaction to prevent assets from being unrealistically inflated by loans that may not be recovered. High write-off ratio can help explain a low PAR when the community bank has taken aggressive write-offs in an attempt to "sanitize" its portfolio. This can indicate portfolio quality issues. From the score you have derived, it does not appear that NigCom is trying to hide bad debt, as the PAR remains high at 12%.

- **Risk coverage ratio:** (Loan Loss Reserves/(Outstanding Balance of Loans Affected by Arrears over 30 days + Refinanced Loans). Score: 65% of PAR. This ratio shows what percent of the PAR is covered by actual loan loss reserves. It indicates how well prepared the institution is for a worst-case scenario. An optimal score would be 100% of PAR, while an acceptable score would be one falling within a range of 80-100% of PAR. Where collateral-backed lending makes up the majority of the portfolio, a ratio well below 100% is common. To understand this ratio, it is essential to check whether good PAR numbers—and therefore a favorable Risk Coverage Ratio—is the result of good lending decisions or massive write-offs. In the case of a score of 65%, you should be concerned that NigCom may not have sufficient reserves to cover the expected monthly repayments of an extended line of credit.

- **Liquidity ratio:** (Cash and Liquid Assets/Total Deposits). Score: 0.75. This is the simplest measure of the community bank's ability to meet its short-term obligations to deposit holders. The optimal range is any score over 0.75, while an acceptable score would fall within a range of 0.5-1.0. With a score of 0.75, NigCom appears to have sufficient cash and liquid assets with which to service its short-term debts.

- **Cash-flow ratio**: (Cash Flow from Operations/Current Liabilities). Score: 0.85. This ratio indicates how well the cash flow from operations covers the cash needed to settle liabilities in the short term. An optimal score would be any value greater than 1.0, while an acceptable number would fall within a range of 0.75 to 1.5. With a score of 0.85, NigCom appears to be capable of servicing its short-term debts immediately with available cash from its reserves.

The next page shows the numerical results of your completed PRISMS CBAT analysis. On the basis of these results, and your assessment of findings from interviews, please complete your assessment of NigCom's application for a line of credit and present your findings to your bank's senior loan officer (in this case, your fellow class participants). There are no "right answers" in this exercise. Rather, the purpose of the Case Study is to have you look carefully at the results of your PRISMS CBAT assessment and use these numbers as a basis for further investigation into some serious issues related to the management and governance structures of the community bank as these will impact upon the bank's ability to service its debt. In addition, one participant may approve NigCom's loan on the basis of the information provided, while another may not. This may be a function of, among other things, each participant's individual commercial bank's risk appetite, and other factors related to its lending policy.