SACCO/MFI ACCOUNTING AND FINANCIAL MANAGEMENT TRAINING AND MENTORING CONSULTANCY

FINAL REPORT—WIDE DISTRIBUTION

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Rural SPEED

Rural Savings Promotion & Enhancement of Enterprise Development

SACCO/MFI ACCOUNTING AND FINANCIAL MANAGEMENT TRAINING AND MENTORING CONSULTANCY

FINAL REPORT

Rural SPEED
A USAID funded project
Contract No. PCE-I-00-99-00003-00 TO 826

This report submitted by Chemonics International Inc.

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Executive Summary

Since 1987, the Government of Uganda (GOU) has instituted major economic policy reforms to encourage the financial sector to become increasingly efficient, productive, and competitive. Uganda is well on its way to having a vibrant and reasonably deep financial services sector, with fifteen commercial banks, seven commercial credit institutions, one licensed and four potentially licensed micro-deposit taking institutions (MDIs), numerous microfinance institutions (MFIs), and member-owned savings and credit cooperatives (SACCOs). Despite recent growth and liberalized economic policies, only ten percent of the rural population has access to basic financial services. In addition, both the formal and the informal financial sectors still require structural changes to be able to provide the range and depth of financial services that individuals and businesses require.

Rural SPEED's objective is to deepen and strengthen Uganda's financial sector in response to this rural sector demand for financial services. The increased provision of financial services should leverage economic activity to complement other USAID/Mission programs in rural areas. The resulting increase in economic activity should aid the GOU in achieving the target economic growth rates proposed in Poverty Eradication Action Plan. The Rural SPEED project is supporting and executing activities in the following key areas:

- Institutional Capacity Building; and
- New Product Development and Service Delivery

Much of this support is provided through short-term technical assistance and ongoing project support to partner institutions. This consultancy was designed to train sixty representatives from thirty SACCOs in the Kabale and Mbarara regions. These participants were primarily board treasurers and accountants, however, a small number of managers and branch managers also attended. The training covered successful financial management models, board and management policies and procedures, double entry accounting systems, improved reporting and portfolio tracking systems. The principal tasks were to:

- Develop a five-day training module to cover;
  - Financial management structure, procedures and controls;
  - Accounting procedures and formats; and
  - Performance ratios and their interpretation based on those contained in the PMT package;

- Deliver two, five-day accounting and financial management workshops to 30 SACCO/MFI participants each in Kabale and Mbarara;

- Conduct nine one-day mentoring sessions to Rural SPEED's partner SACCOs;

- Conduct a one-day assessment of AMFIA; and

- Prepare a final report covering the training and mentoring sessions, with recommendations for further capacity building.

The principle activity accomplished under this consultancy was the organization of the two five-day training workshops. The purpose of these workshops was to present improved accounting and financial management procedures and practices, to provide the participants with the tools to better analyze their institution's performance and to provide good information for management decisions. The workshop was divided into two parts, with two days focused on basic accounting principles and practices and three days focused on financial performance ratios and improved reporting formats for the income statement and balance sheet.

After completing the basic accounting review, the training examined why MFI interest rates need to differ significantly from those of banks and other financial institutions. It further introduced the concept of a break-even calculation to set loan interest rates. The training instructed the participants on how to calculate the interest rate that should be charged by each institution. During the discussions, the participants revealed that their interest rates have generally been set using guesswork and not based on a cost analysis of the institution.

In addition, a sample chart of accounts was introduced along with a model income statement and balance sheet. The advantage of these model financial reports is to provide comparative information in a simple format, which will improve the management and board's ability to make decisions to improve their institution's performance.

During the final three days of the workshop, the program explored a limited but critical number of performance ratios, including institutional self-sufficiency and portfolio at risk. With respect to the portfolio report, the training was divided into seven performance areas, each of which is comprised of a number of indicators. The use of these indicators will permit managers and board members to quickly and accurately pinpoint trouble areas and thus make the necessary adjustments to resolve the problems before they become too serious. The seven performance areas are:

- Profitability;
- Liquidity;
- Operating efficiency;
- Loan officer productivity;
- Capital;
- Outreach to loan clients; and
- Portfolio Quality.

In all, thirty-six performance ratios were presented, defined and discussed during the workshop. These ratios cover the key performance areas. All can be manually calculated.

A total of fifty-three SACCO/MFI participants completed the training during the two workshops. Twenty-eight participants were present at the Kabale workshop and twenty-five participants assisted at the Mbarara workshop. To evaluate the participants comprehension of the material covered during the work shop, a short test was prepared for each session. The test covered the main topics presented, without the need to use calculators, in order to give the board treasurers an equal chance to score well.

The average score for the twenty-eight participants at the Kabale workshop was 17 points or 47%, which is low. However, the SACCOs/MFIs in the Kabale region have received very little outside technical assistance and training. Their knowledge of appropriated accounting procedures and practices was quite limited. For many, this was the first time that they had received this type of training. The average test score at the Mbarara workshop was higher at 24 points or 56%. In fact, sixteen of the twenty-one Mbarara participants who took the test scored 50% or higher, with the highest score being 81%. This is due to the fact that the skills levels were significantly higher for these participants. It is encouraging that the more experienced and competent managers and board members scored so well. This is a good indicator of future application of the principles and procedures covered during the workshop.

After completing the two workshops, nine one-day SACCO/MFI mentoring visits were conducted. The SACCO mentoring focused on briefing the board members on the general financial management weaknesses learned during the training, which were:

- Delinquency management/loan loss provisioning/loan write-offs;
- Self-sustainability;
- Introduction and explanation of the proposed reporting format for the income statement and balance sheet; and
- Depreciation

In addition, a thorough examination of the financial documents and procedures used by each of the staff members was carried out to evaluate their strengths and weaknesses. This meant one-on-one meetings with the loan officers, accountants, managers, cashiers, ledger keepers, and secretaries. Often staff members were fulfilling multiple roles within the institutions, on an as needed basis, to fill in for any staff members who were absent or on leave. While this is normal and customary for small institutions, it does lead to some confusion and inefficiency in the operations. It can also lead to a lack of checks and balances in the internal controls.

Finally, a one-day assessment visit was conducted with the Ankore Microfinance Institutions Association (AMFIA) in Mbarara. This assessment looked at their financial management systems and technical support capacity.

During both the training and mentoring visits it was clear that the primary challenge for the institutions is managing delinquency. It appears that most institutions are only aware of the excuses given by the delinquent members and not the reasons leading to delinquency. To deal with delinquency it is therefore recommended that:

► The board and management review the loan polices and procedures at least once a year and every six months, if possible.

► The loan officers are evaluated to see if they are correctly applying the policies. If they are not then they should be warned and given a chance to change. If change does not occur within a reasonable time then they should be replaced.

► The loan committee members are evaluated to see if they are correctly applying the policies. If they are not then they should be warned and given a chance to change. If change does not occur within a reasonable time then they should be replaced.

► The delinquent loans in the portfolio should be aged into the six categories and the portfolio at risk rates should be calculated for each age category, for PAR > 1 day, and PAR > 30 days, at the end of each month. This information must be communicated to the board.

- The loan loss provisioning is done monthly, based on the risk percentages.

- All loans greater than 12 months past due are written off and transferred to a "Written-off Loans" register.

- Training on business analysis of loans should be prepared and conducted to teach loan officers and loan committee members how to properly evaluate business loan.

- Higher rates of interest are charged on repeat loans to previously delinquent clients, after a 6-9 month waiting period. Additional collateral or guarantors should be required as well.

- Guarantors are required to come to the office with the client before the loan is disbursed to ensure that they fully understand their liability as a guarantor.

- When land is given as collateral, the institutions should require some form of additional guarantee, which will cover one or two installments, and which can rapidly be seized and sold, if the client is delinquent.

- New delinquent loan collection strategies are developed to reduce the number and amount of delinquencies.

Since none of the institutions trained or mentored are using any means of testing for self-sufficiency, it is recommended that:

- For institutions, which currently have "soft" interest rate loans from MSCL or a similar institution, they calculate the "Operating Self-sufficiency Ratio" and the "Financial Self-sufficiency Ratio" at the end of each month.

- For institutions, which do not have any outside borrowing, they should still do the "Operating Self-sufficiency Ratio" monthly and do the "Financial Self-sufficiency Ratio", if and when they are seriously considering some form of external borrowing, to evaluate if their current interest will still support the cost of external funds.

The current financial reporting in most, if not all institutions, is inadequate and does not follow generally accepted accounting principles. It is therefore recommended that:

- The proposed income statement format is adopted at all of the institutions.

- The proposed balance sheet format is adopted at all of the institutions.
- Once the institutions have used the new formats for approximately six months, then a standard chart of accounts should be introduced.

In all of the institutions, depreciation is done yearly instead of monthly. There was a serious misunderstanding about the role and purpose of depreciation, which is to account for the use of a fixed asset during the time in which it is used; i.e., each month. It is therefore recommended that:

- ► All of the institutions depreciate fixed assets on a monthly basis.
- ► A minimum value is set before an item can be considered a fixed asset. It is recommended that this be set around 150,000 to 200,000 UShs.

At this time the majority of the institution visited use the calendar year as their financial year, however, two have different financial years. While the actual dates for the financial year are not essential to proper financial management, most banks and international lending institutions require financial reporting on a calendar year basis. This will lead to twice the work load in preparing an interim year-end report for December and then a formal year-end report at the end of their actual financial year.

- ► It is therefore recommended that those institutions change their financial year to the calendar year, beginning in January 2007.

Many of the institutions are not accruing expenses and income as required under the generally accepted accounting principles. It is therefore recommended that:

- ► All institutions immediately implement accrual accounting procedures for income and expense items.

While most institutions are using double entry accounting principles, some are not doing it properly. It is therefore recommended that:

- ► All institutions immediately implement double entry accounting, if they are not currently using it.

In all of the institutions visited, multiple internal vouchers are used for double entry transactions, specifically for loan repayment from savings. Instead of having one voucher with both the debit and credit accounts on it, they use one voucher slip per account transaction. This is inefficient and time consuming. It is therefore recommended that:

- ► A model internal voucher book is designed for these transfers.

While most institutions are doing cash counts on a regular basis, improvement is possible. Each institution should ensure that:

- ► The cashier(s) and the accountant do a daily cash count at the end of the day;
- ► The manager does a weekly, unannounced cash count and one on the last working day of the month;
- ► The Board (Treasurer) does a cash count at least once monthly;

- ► The Supervisory and Audit Committee does a cash count quarterly, at least, and more often if possible. They should further be present on the last working day of the financial year for the cash count.

Since none of the institutions are actually analyzing their performance using the PMT ratios, it is difficult to say where they stand. It is therefore important that:

- ► Those institutions begin making calculations manually for most of the ratios. These ratios should be compared to the Uganda benchmarks and used by the board to make an institutional growth plan.

- ► Gender disaggregated data should be collected and analyzed to determine specific products and services for women members.

During the training and site visits, it was observed that the staff and board roles and responsibilities are not always clear. This is not simply a “paper” description issue. It is an application issue. As such:

- ► Boards should exercise oversight and not micro-management.

- ► Boards should closely monitor loan repayment rates, portfolio at risk ratios and delinquency. They should become involved early on to assist management to collect delinquent loans, instead of being informed once it is too late.

- ► Managers should communicate fully and transparently to stakeholders.

- ► The Supervisory and Audit Committee’s role must be clarified and a set of working procedures and documents developed to guide them in their tasks.

In conclusion, the training and mentoring has been very useful in uncovering institutional weaknesses. It has reinforced proper accounting practices and procedures, such as accrual and double entry accounting, improved monthly reporting formats, monthly loan loss provisioning based on portfolio at risk percentages, loan write-offs after 12 months, and monthly depreciation. All of the institution, which participated in the training workshops, can now calculate and interpret a number of key financial performance ratios and use this information to better guide their institutions.

The critical issue is the implementation and use of the improved practices and procedures, which were covered during the training workshops and mentoring visits. If these recommended changes are implemented, with a view to having them all in place by the end of December 2005, then management performance should greatly improve over the next year. Information will be available to make proper decisions, instead of using guesswork as was often done in the past. More training and mentoring type follow-up is still necessary to achieve the objective of independent and financially self-sufficient SACCOs.

1. Background

1.1 Introduction

Since 1987, the Government of Uganda (GOU) has instituted major economic policy reforms to encourage the financial sector to become increasingly efficient, productive, and competitive. Uganda is well on its way to having a vibrant and reasonably deep financial services sector, with fifteen commercial banks, seven commercial credit institutions, one licensed and four potentially licensed micro-deposit taking institutions (MDIs), numerous microfinance institutions (MFIs), and member-owned savings and credit cooperatives (SACCOs). Despite recent growth and liberalized economic policies, only ten percent of the rural population has access to basic financial services. In addition, both the formal and the informal financial sectors still require structural changes to be able to provide the range and depth of financial services that individuals and businesses require.

Commercial lending and the majority of microfinance lending activities remain confined to urban and peri-urban areas due to the high cost and low return of rural outreach. In addition, interest rates remain high, adequate forms of collateral do not exist due to continuing disorganization within the land registry system and the financial and social costs of selling mortgaged land and properties after seizure. Furthermore, there is little accountability and proper supervision of Tier 4 institutions, such SACCOs, especially in the rural areas.

To stay true to the goals set in the GOU's Poverty Eradication Action Plan (PEAP), Uganda must achieve an annual economic growth rate of seven to eight percent to reduce overall poverty to ten percent by 2017. All citizens, especially the poorest, must benefit from economic growth and have access to financial services, such as savings and credit. The USAID/Uganda's 2002-2008 Strategy calls for expanded, sustainable economic opportunities for rural sector growth, through promotion of a connection between productive strategies implemented by the private sector in rural areas and expansion of the financial services sector to these areas. Rural Savings Promotion and Enhancement of Enterprise Development (Rural SPEED) was thus designed to help achieve this goal.

Rural SPEED's objective is to deepen and strengthen Uganda's financial sector in response to this rural sector demand for financial services. The increased provision of financial services should leverage economic activity to complement other USAID/Mission programs in rural areas. The resulting increase in economic activity should aid the GOU in achieving the target economic growth rates proposed in Poverty Eradication Action Plan. The Rural SPEED project is supporting and executing activities in the following key areas:

A. Institutional Capacity Building

- Savings Mobilization;
- Agriculture Finance;
- Non-agriculture Finance; and,
- Bank//MDI/MFI/SACCO Linkages.

B. New Product Development and Service Delivery

- Extending savings services to rural people;
- Multiplying and expanding rural savings and credit transactions through formal wholesale borrowing and depositing with commercial banks;
- Providing a locally-based, locally-knowledgeable rural financial intermediary capable of prudently lending for agricultural activities;
- Training a large number of SACCO representatives in standard model for financial management, including roles of committees, roles of management, policies and procedures, paper-based accounting systems, paper-based portfolio tracking systems (including PEARLS); and,
- Training on the calculation and use of the Performance Monitoring Tool (PMT) for standardized reporting to Rural SPEED and other donor programs; and,
- Directly mentoring of ten partner organizations, through short term technical assistance and ongoing project support.

1.2 Scope of Work

The objective under the scope of work (SOW) was to train sixty (60) representatives from thirty (30) SACCOs in the Kabale and Mbarara regions. The participants were primarily board treasurers and accountants, however, a number managers and branch managers also attended. The training covered successful financial management models, board and management policies and procedures, double entry accounting systems, improved reporting and portfolio tracking systems. The principal tasks to be completed under this SOW were to:

- Prepare in advance documents including, policies and procedures, paper accounting systems and paper-based portfolio tracking systems to develop the training module;
- Modify the documents to reflect Ugandan norms for the training;
- Develop a five-day training module to cover:
  - Financial management structure, procedures and controls;
  - Accounting procedures and formats; and
  - Performance ratios and their interpretation based on those contained in the PMT package;
- Deliver two, five-day accounting and financial management workshops to 30 SACCO/MFI participants each, in Kabale and Mbarara;
- Conduct nine one-day mentoring sessions with Rural SPEED’s partner SACCOs;
- Conduct a one-day assessment of AMFIA; and
- Prepare a final report covering the training and mentoring sessions, with recommendations for further capacity building.

As such, the work plan dates for the assignment under the SOW are shown in Table 1.

Table 1 Consultancy Work Plan Calendar

FROM	TO	ACTIVITY
August 13, 2005	August 13, 2005	Preparations and Travel to Amsterdam
August 14, 2005	August 14, 2005	Travel from Amsterdam to Uganda
August 15, 2005	August 15, 2005	Initial meetings with Rural SPEED staff
August 16, 2005	August 17, 2005	Field Visit to 2 SACCOs
August 18, 2005	August 20, 2005	Research and Development of Materials
August 22, 2005	August 22, 2005	Travel to Kabale
August 23, 2005	August 27, 2005	Kabale Workshop
August 28, 2005	August 28, 2005	Travel to Mbarara
August 29, 2005	September 02, 2005	Mbarara Workshop
September 03, 2005	September 02, 2005	Mentoring Visit to Kamukuzi
September 05, 2005	September 05, 2005	Mentoring Visit to Kyamuhunga
September 06, 2005	September 06, 2005	Mentoring Visit to Kitagata
September 07, 2005	September 07, 2005	Mentoring Visit to Muhame
September 08, 2005	September 08, 2005	Mentoring Visit to Rubabo
September 09, 2005	September 09, 2005	Mentoring Visit to Nyarwanya
September 10, 2005	September 10, 2005	Mentoring Visit to RUSCA
September 11, 2005	September 11, 2005	Travel to Shuuku for Board Meeting
September 12, 2005	September 12, 2005	Mentoring Visit to Shuuku
September 13, 2005	September 13, 2005	Mentoring Visit to Ankole
September 14, 2005	September 14, 2005	Assessment Visit to AMFIA
September 15, 2005	September 15, 2005	Travel to Mbarara and Work on Report
September 16, 2005	September 17, 2005	Work on Report
September 19, 2005	September 19, 2005	Presentation of Report
September 20, 2005	September 20, 2005	Final Revisions and Travel to Kenya
September 21, 2005	September 21, 2005	Travel from Kenya to Toledo, Ohio

The total number of work days under the assignment was 35, including travel to and from the United States.

2. Activity Summary

2.1 Accounting and Financial Management Training Workshops

One of the primary activities accomplished under this consultancy was the two five-day training workshops. The purpose of these workshops was to present improved accounting and financial management procedures and practices so as to provide the participants with the appropriate tools to better analyze their institution's performance, especially to be able provide good information for management decisions. The workshop was divided into two parts, with the first two days working on basic accounting principles and practices and the remaining three days focusing on financial performance ratios and improved reporting formats for the income statement and balance sheet. During the five-day workshops, the following topics were discussed and examples given to provide a hands-on learning experience.

- Meaning and importance of accounting in MFIs;
- Meaning and importance of financial management;
- Accounting principles and concepts;
- Fundamental principles and concepts;
- Accounting treatment of key transactions;
- Double entry bookkeeping;
- Double entry rules;
- Recording transactions of a typical MFI;
- Cash and bank related transactions;
- Prepayments and other current assets;
- Fixed assets an other non current assets;
- Short-term and long-term loans;
- Interest income;
- Provision for bad and doubtful debts (loan loss provisions);
- Other payables, accruals and short term provisions;
- Revenue and expenditure recognition;
- Expenditure controls;
- Components of financial statements;
- Chart of accounts;
- The balance sheet;
- Categorization of balance sheet items;
- Current assets;
- Non–current assets;
- Current liabilities;
- Non–current liabilities;
- Equity;
- Income statement, including definition and categorization of line items;
- Income;
- Financing expenses;
- Operating expenses;
- Grant income;
- Pricing Financial Services;
- Role of interest rate rates on institutional sustainability;

- Key determinants of MFI interest rates, which are costs of funds, loan losses/write offs and operating costs;
- Size of the loan portfolio;
- Repayment rate;
- Idle funds;
- Competition;
- Regulatory requirements;
- Social–Political considerations; and
- Loan terms

The detailed workshop programs are presented in Appendix A (Kabale) and Appendix B (Mbarara).

After completing the basic accounting review, the training examined the reason MFI interest rates need to differ significantly from those of banks and other financial institutions, based on:

- Loan size
- High operational costs
- Nature of clients
- Nature of collateral

After covering why the interest rates are different, the concept of a break-even calculation to set interest rates was discussed. In the example provided, the training showed the participants how to calculate the interest rate that should be charged by each institution. During the discussions of this calculation, the participants revealed that their interest rates have generally been set using guesswork and are not based on a cost analysis of the institution. The method used to price financial services, based on the breakeven interest rate for an institution, can be found in Appendix C.

In addition, a sample chart of accounts (Appendix D) was introduced, along with a model income statement (Appendix E) and balance sheet (Appendix F). The advantage of these model financial reports is to provide comparative information in a simple presentation format. This improves the management and board’s ability to make decisions to improve their institution’s performance. The suggested formats will not add any additional work time each month, once the first month is completed. It has been proposed by Judith Aguga Acon that Rural SPEED create an Excel template for these reports to ensure that all of the institutions are capable of implementing the changes rapidly.

It is interesting to note that the majority of the SACCOs/MFIs are not doing monthly balance sheets and often are only preparing monthly, cumulative income statements. The suggested formats will ensure that all institution prepare and present to their boards proper monthly financial statements.

During the final three days of the workshop, the program focused on a limited but critical number of performance ratios, especially those for institutional self-sufficiency and portfolio at risk ratios. With respect this portfolio reporting, the training was divided into seven key areas, each of which is comprised of a number of indicators. The use of these indicators will permit managers and board members to quickly and accurately pinpoint trouble areas and thus make the necessary adjustments to resolve the problems before they become too serious.

The seven performance areas covered were:

- Profitability;
- Liquidity;
- Operating efficiency;
- Loan officer productivity;
- Capital;
- Outreach to loan clients; and
- Portfolio Quality.

In all, thirty-six performance ratios were presented, defined and discussed during the workshop. All of the ratios covered for the key performance areas can be manually calculated. These ratios are:

PROFITABILITY INDICATORS

P1 **Operating Self-sufficiency**
Operational self-sufficiency = (Total operating income) / [(Total financing expenses + Provision for loan losses + Total operating expenses)]

P2 **Financial Self-sufficiency**
Financial self-sufficiency = (Total operating income) / [(Total financing expenses + Provision for loan losses + Total operating expenses + Adjustment for inflation + Adjustment for subsidized funding)]

P3 **Return on Assets**
Return on Assets = [(Profit or loss from operations) after taxes] / (Average assets)

P5 **Return on Equity**
Return on equity = [(profit or loss from operations) after taxes for the current period] / (Average equity)

LIQUIDITY INDICATORS

L1 **Liquidity Ratio**
Liquidity ratio = [(Cash) + (current accounts) + (other bank deposits < 1 year in term) + (short-term investments)] / (Total assets)

L2 **Current ratio**
Current ratio = (Short-term assets) / (Short-term liabilities)

OPERATING EFFICIENCY INDICATORS

E1 **Operating Expense Ratio**
Operating expense ratio = (Total operating expenses during the period) / (Average gross loan portfolio)

E3 **Operating Costs per Loan Disbursed**
Operating costs per loan disbursed = (Total operating expense for the current period) / (Average number of loans disbursed during current period)

E7 **Average Number of Active Loan Clients per Branch**
Average number of active loan clients per branch = (Number of active loan clients) / (Number of branches)

E2 **Operating Costs per Loan Outstanding**
Operating costs per loan outstanding = (Total operating expenses) / Average number of loans outstanding)

E4 **Operating Costs per UShs Disbursed in Loans**
Operating costs per UShs disbursed in loans = (Total operating expenses for the current period) / (Total amount of loans disbursed for the current period)

LOAN OFFICER PRODUCTIVITY

LP1 **Average Loan Portfolio Outstanding per Loan Officer**
Average loan portfolio outstanding per loan officer = (Total gross loan portfolio) / (Total number of loan officers)

LP2 **Average Number of Active Loan Clients per Loan Officer**
Average number of active loan clients per loan officer = (Number of active loan clients) / (Total number of loan officers)

CAPITAL RATIOS

C1 **Debt to Equity Ratio**
Debt to equity ratio = (Total liabilities) / (Total equity)

C2 **Capital Adequacy Ratio**
Capital adequacy ratio = (Total equity) / (Total assets)

Debt Ratio
Debt ratio = (Total liabilities) / (Total assets)

C3 **Cost of Funds Ratio**
Cost of funds ratio = (Total financing costs) / (Average funding liabilities)

OUTREACH TO LOAN CLIENTS

O3 **Percentage of Total Loans with a Disbursed Amount ≤ UShs 200,000**
Percentage of total loans with a disbursed amount ≤ UShs 200,000 = (Number of loans with a disbursed amount ≤ UShs 200,000) / (Total number of loans disbursed during the period)

O1 **Percentage of Active Loan Clients Receiving Loans as a Group Member**
Percentage of active loan clients receiving loans as a group member = (Number of active loan clients receiving loans as members of a group) / (number of active loan clients)

O2 **Percentage of Active Loan Clients Receiving Loans as Individuals**
Percentage of active loan clients receiving loans as individuals = (Number of active loan clients receiving loans as individuals) / (number of active loan clients)

O4 **Percentage of Total Loans with a Disbursed Amount >3,000,000 UShs**
Percentage of total loans with a disbursed amount >3,000,000 UShs = (Number of loans with a disbursed amount >3,000,000 UShs) / (Total number of loans disbursed during the period)

O5 **Percentage of Active Loan Clients in Rural Branches**
Percentage of active loan clients in rural branches = (Number of active loan clients in rural branches) / (number of active loan clients)

PORTFOLIO QUALITY

LOAN LOSS RATIOS

PAR 1 - 30 days = (Value of the outstanding loan balance with loan between 1 and 30 days in arrears, at the end of the period)/ (Value of loans outstanding, at the end of the period)

PAR 61 - 60 days = (Value of the outstanding loan balance with loan between 31 and 60 days in arrears, at the end of the period)/ (Value of loans outstanding, at the end of the period)

PAR 61 - 90 days = (Value of the outstanding loan balance with loan between 61 and 90 days in arrears, at the end of the period)/ (Value of loans outstanding, at the end of the period)

PAR 91 - 120 days = (Value of the outstanding loan balance with loan between 91 and 120 days in arrears, at the end of the period)/ (Value of loans outstanding, at the end of the period)

PAR 121 - 180 days = (Value of the outstanding loan balance with loan between 121 and 180 days in arrears, at the end of the period)/ (Value of loans outstanding, at the end of the period)

PAR > 180 days = (Value of the outstanding loan balance with loan greaten then 180 days in arrears, at the end of the period) / (Value of loans outstanding, at the end of the period)

PAR ≥ 1 day = (Value of the outstanding loan balance in arrears ≥ 1 day, at the end of the period) / (Value of loans outstanding, at the end of the period)
PAR > 30 days = (Value of the outstanding loan balance in arrears ≥, 30 days at the end of the period) / (Value of loans outstanding, at the end of the period)

Loan Loss Ratio
Loan loss ratio = (Value of loans written off during the period) / (Average gross portfolio)

Q8 Loan Loss Reserve Ratio
Loans loss reserve ratio = (Loan loss reserve) / (Gross loan portfolio)

Q9 Risk Coverage Ratio
Risk coverage ratio = (Loan loss reserve) / (portfolio at risk > 30 days)

Q10 Effective Repayment Rate
Effective repayment rate = [(All payments received during the period, including arrears recovered) – (loan prepayments)] / (Scheduled amount of payments due during the period, including arrears)

Q12 Quarterly Growth in Value of Loan Portfolio
Quarterly growth in value of loan portfolio = [(Gross loan portfolio at the end of the current period) – (Gross loan portfolio at the end of the previous period)] / (Gross loan portfolio at the end of the previous period)

While it would be easier to calculate these ratios, if the institutions had access to a computer and knowledge of Microsoft Excel software, all of these ratios can be calculated manually, provided the financial information is available using the suggested model financial report formats. A CGAP model for reporting on loan performance (Appendix G) was given to the participant to show them how other institutions present their portfolio reports. A sample reporting format for loan delinquency aging was also presented to the participants (Appendix H), since it is critical that the institutions age their loan delinquencies properly and then provision for loan losses based on that aging.

Delinquency is probably the most serious threat to sustainability for all of the institutions trained. As such the following Uganda benchmarks for loan loss provisioning percentages were given to the participants.

- For loans 1 – 30 days past due 10% of the outstanding principal past due
- For loans 31 – 60 days past due 25% of the outstanding principal past due
- For loans 61 – 90 days past due 50% of the outstanding principal past due
- For loans 91 – 120 days past due 75% of the outstanding principal past due
- For loans 121 – 180 days past due 85% of the outstanding principal past due
- For loans > 180 days past due 100% of the outstanding principal past due

This implies that the institutions must recognize the risk of loss by provisioning on a monthly basis, using the above calculation and then by expensing the difference between the previous month's loan loss provision and the current calculation. It was pointed out that delinquency has a serious negative effect on the institution.

In all, fifty-three SACCO/MFI participants completed the training. Twenty-eight participants were present at the Kabale workshop (Appendix I) and twenty-five participants assisted at the Mbarara workshop (Appendix J).

To evaluate the participants comprehension of the material covered during the workshop, a short test was prepared. The test covered the main topics presented, and did not require the use of calculators, in order to give the board treasurers an equal chance to score well. The actual tests, with sample answers, can be found in Appendix K (Kabale) and Appendix L (Mbarara). The detailed participant test results are shown in Appendix M (Kabale) and Appendix N (Mbarara).

The average score for the twenty-six participants tested at the Kabale workshop was 17 points or 47%, which is low. However, the SACCOs/MFIs in the Kabale region have received very little outside technical assistance and training. This was their first real training on improved accounting practices and financial performance analysis. Given that no follow up (mentoring) visits were conducted with the institutions, it is difficult to say if the improved reporting tools will be implements as recommended. It is encouraging that thirteen of the participants scored 50% or higher on the test. While the test was simple, many of the participants are not used to taking tests and as such did not conduct a serious review of their notes the night before.

The average test score at the Mbarara workshop was higher that from the Kabale workshop, at 24 points or 56%. In fact, sixteen of the twenty-one participants who took the test scored 50% or higher, with the highest score being 81%. This is due to the fact that the skills levels were significantly higher for these participants. This should not be surprising since nine of these institutions are already Rural SPEED partners and have received other trainings in the past from different support institutions. It should be noted that three participants did not return on the last day of training to take the test and one person used his notes throughout the entire test, even though he was warned several time to stop. His test was not corrected.

It is encouraging that the more experienced and competent managers and board members scored so well, since this is a good indicator of future application of the principles and procedures covered during the workshop.

After completing the test and written evaluation of the workshops, an oral review of the expectations was conducted to see if the participants had achieved their goals. Their expectations were as follows:

Workshop Expectation – Kabale Participants

- Gain more knowledge of how to run a SACCO;
- Learn how to have a self-sustaining SACCO;
- Gain knowledge about how to grow and develop SACCOs;
- Learn about linking SACCOs with donors;;
- Understand the means and ways of acquiring grants;
- Acquire skills in accounting;
- Learn how to prepare accounting statements;
- Improve skills as a treasurer;
- Learn skills in keeping finance for treasurers;
- Learn how to provision for bad loans;
- Learn about the Performance Monitoring Tool (PMT) ratios;
- Learn about different methods of depreciation and how to apply them, such as straight line, reducing balance and sum of digits;
- Discuss how frequently a treasurer should "audit" the books of his SACCO/MFI; and
- Learn how to do the accounting treatment of recovered loans, which were previously written off.

Workshop Expectations – Mbarara Participants

- Better capacity to solve the financial problems of the membership;
- Have an excellent knowledge about Microfinance;
- Improve their financial skills;
- Learn about financial analysis;
- Acquire skills in financial management;
- Learn about international accounting standards for MFIs; and
- Learn how to handle delinquency

Overall, the participants in both workshops were satisfied that the training had met their expectations and that it had given them the knowledge and tools needed to improve their institution's financial management.

At the very end of the training, the participants identified the following lessons learned during the workshops:

- The concept of monthly loan loss provisioning is very important;
- Interest rates on loan products should be set using break-even analysis (pricing);
- Loans past due must be written off after 12 months, in order to give an accurate picture of the loan portfolio;
- There is a need to account for expenses and income on an accrual basis;
- They now understand how to use the performance ratios, which were presented to assess and manage their institution's performance;

- They now understand the relevance of producing the income statement and balance sheet being produced on a monthly basis;
- It is necessary to evaluate the minimum level of cash on hand needed and that too much is not an effective use of the asset;
- The format in which the information is presented is important. It can increase one's ability to understand the information and to be able to use it to make decisions;
- Loan officers have an integral (critical) place in the loan recovery process;
- There are different methods of depreciating fixed assets and that depreciation should be done on a monthly basis; and
- It is important to be able to calculate and interpret many of the PMT ratios.

In addition, the participants learned more about the Rural SPEED project, especially its objectives and the areas of assistance that it can offer to SACCOs. They were further given a one-page handout on the requirement for submitting a grant request proposal to Rural SPEED (Appendix M).

The participants prepared daily written summaries, in teams, on all of the topics covered that day. The summaries were then presented the following morning as a review to start the day. These summaries are attached as Appendix N (Kabale) and Appendix O (Mbarara). They indicate how well each session was understood.

2.2 Mentoring Visits

There were two main reasons for the nine one-day SACCO/MFI mentoring visits, which were conducted under this consultancy. First, it was important to meet with as many board members as possible to brief them on the general financial management weaknesses learned during the training. Second, a thorough examination of the financial documents and procedures used by each of the staff members was needed to evaluate their strengths and weaknesses.

During the board briefing four topics were discussed:

- Delinquency management/loan loss provisioning/loan write-offs;
- Self-sustainability;
- Introduction and explanation of the proposed reporting format for the income statement and balance sheet; and
- Depreciation

This generally meant meetings with the loan officers, accountants, managers, cashiers, ledger keepers, and secretaries. Often staff members fulfill multiple roles in the institutions, on an as needed basis, to fill in for any staff members who might be absent or on leave. While this is normal and customary for small institutions, it does lead to some confusion and inefficiency in the operations. It can also lead to a lack of checks and balances in the internal controls systems.

After the SACCO mentoring visits, a one-day assessment visit was conducted with the Ankore Microfinance Institutions Association (AMFIA) in Mbarara. This assessment looked at financial management systems and technical support capacity. The highlights of each of the mentoring visits are presented in chronological order below.

2.2.1 Kamukuzi Village Trust, Ltd.

This visit took place on Saturday, September 3, 2005. During the mentoring visit the following board and staff members were present:

<u>Board Members</u>	
Bamwesigye Godfrey	Assistant Secretary
Mumpaire Fred	Treasurer
Asiimwe Denis	Board Member
Mubiru Hope	Board Member
Dr. Malsiko Gad	Board Member
Rwomushana Mary	Board Member
<u>Staff</u>	
Kwinkinzi Ronald	Loan officer
Tusiime Josepheny	Cashier
Natirinda Anita	Accounts Clerk
Musinguzi Dick	Loan officer/Accountant
Nakkazi Doreen	Accountant

While Kamukuzi is still officially an MFI, it has completed the registration requirements to transform itself into a SACCO. It is currently waiting for the approval of its application.

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- ► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- ► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- ► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- ► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- ► To make sure that the loan officers stop collecting delinquent loan payment in the field.

- ► The pressing need to develop a loan analysis form, which contains business income, expenses, cash flows and a balance sheet presentation of assets, liabilities and equity of the business.

- ► The institution could improve the coding of its loans to directly identify the loan cycle, simply by adding a dash and 2 digits to the current unique client loan number; i.e., for example, 937-02 would represent the second loan for client number 937.

- ► The cashier should not have both safe keys. Two different people should hold the safe keys to ensure that no one is ever able to open the safe by themselves.

2.2.2 Kyamuhunga People Savings Co-operative, Ltd.,

This visit took place on Monday, September 5, 2005. During the mentoring visit the following board and staff members were present:

<u>Board Members</u>	
Batuna Yerokamu	Chairman
Mujuni Edward	Vice-chairman
Fr. Birungi Vincent	Treasurer
Byekwaso Wilson	Member
Rusiimun Grace	Member
<u>Staff</u>	
Muhebwe Harriet Katiti	Manager
Mwebe Ronald	Loan officer
Bamwine Henry	Loan officer
Nahabwe Sharon	Accountant
Kyohairwe Shallon	Cashier
Bahame Joseph	Accounts assistant
Florence Byarugaba	Secretary/Cashier

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- ► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- ► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- ► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- ► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- ► There is a need to analyze a new loan product, such as the solar panel, to see if it is profitable before introducing the product.

- The institution has solicited Rural SPEED's assistance in designing a specific, short-term (3 days) market loan product to take advantage of the weekly market on Tuesday. The loan product would be disbursed on Monday and repaid on Wednesday. The suggested interest rate would be 1% per day.

- There appears to be a problem in members requesting school fee loans and then using the money for their business. This is likely caused by a shorter waiting period for school fee loan approval than business loan approval. The institution should look into this and see if it is possible to speed up the business loan approval process so that loans disbursed are actually used for the proposed purposes.

2.2.3 Kitagata Development Savings and Credit Cooperative, Ltd.

This visit took place on Tuesday, September 6, 2005. During the mentoring visit the following board and staff members were present:

<u>Board Members</u>

Joyce Kateghangwa	Member
Olly Muhoozi	Chairman loans' committee
Emmanual Mwebese	Chairman
James Kataryebwa Katta	Treasurer
Frederick Katabez	Member

<u>Staff</u>

Harriat Komujuni	Manager
Aggrey Aimesyoone	Banking officer
Nathan Twinomupishe	Credit officer
Edger Mwesigwa	Cashier/accountant/credit officer
Christine Tumukunde	Cashier

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendation, which should be highlighted, is:

- ► The institution could improve the coding of its loans to directly identify the loan cycle, simply by adding a dash and 2 digits to the current unique client loan number; i.e., for example, 937-02 would represent the second loan for client number 937.

- ► To make sure that the loan officers stop collecting delinquent loan payment in the field.

2.2.4 Muhame Financial Savings and Credit, Ltd.

This visit took place on Wednesday, September 7, 2005. During the mentoring visit the following board and staff members were present:

Board Members	
Sam Kahindi	Chairman
Audrey Mshemeire	Vice-chairperson
Stephen Katwiromun	Member
Staff	
Naboth Kafabuwe	Loans officer
Cresent Twebaze	Loans officer
Angela Boonabaana	Ledger keeper
Babrah Tumusiime	Cashier
Kenneth Mucunguzi	Accountant

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- ► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- ► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- ► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- ► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- The 1st written reminder letter concerning a delinquent loan should be personally delivered to the client and not simply given to "just anyone" to deliver the letter to the client. This would ensure that the delinquent member actually receives the letter that day.

- The clients should be given a copy of the final signed loan agreement and not expected to make a photocopy of the contract himself before approval. This cost could be added to the loan fee so that the client has an original copy.

- The security should be signed out in the security register after the loan repayment is complete, even if it is used for another loan. In that case, it should be signed back in again but as a new entry.

2.2.5 Rubabo Peoples Cooperative Savings and Credit Society, Ltd.

This visit took place on Thursday, September 8, 2005. During the mentoring visit the following board and staff members were present:

<u>Board Members</u>	
Mr. Tuhaise Peter	Chairman
Mrs. Masheija	Treasurer
Mrs. Ndyamwijuka Jovent	Board Member
Mrs. Kiiza Beebwe Emily	Board Member
Mr. Muhanji Celeb	Board Member
Mrs. Wenamanya Margaret	Supervisory Committee
<u>Staff</u>	
Turyahabwe Esau	Manager
Turinawe Christopher	Accountant
Asiimwe Ivan	Loan Officer
Byamugisha Joramu	Loan Officer
Twineki Felly	Secretary/Cashier
Tusiime Teopista	Cashier

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- Currently, the loans' committee minutes do not include the names and amounts of the loans approved. They are in a separate unsigned register. The name and amount of each loan approved by the loans' committee must be included in the minutes. In addition, all loans' committee members present at the meeting must sign the minutes, not just the chairman of the loans' committee.

- To make sure that the loan officers stop collecting delinquent loan payment in the field.

- The transport fee for delinquent loans should be a fixed amount based on distance from the office. It should be individual and not a single amount divided between all of the delinquent clients visited during that trip.

- Securities, other than land, need to be seized and sold when clients become significantly delinquent, maybe after 2 or 3 months.

2.2.6 Nyarwanya Savings and Credit Society, Ltd.

This visit took place on Friday, September 9, 2005. During the mentoring visit the following board and staff members were present:

Board Members	
Kijunjuure Africano	Vice-chairman
Twinomujunu W. Makky	Treasurer
Biryabarema Geoffrey	Board Member
Muhoozi Gard	Board Member
Mujuni Emmy	Board Member
Bananuka John Bosco	Board Member
Tumushabe Robert	Board Member
Kigango Anee	Board Member
Rubarenzya Calorine	Board Member

Staff	
Kigango Fred	Manager
Oryoroba James	Accountant
Mveuatwna Edward	Loan Officer
Tumtende Adrine	Cashier
Turinaure Jenipher	Secretary

Tumishabe Teddy Office Messenger

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- ► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.
- ► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.
- ► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.
- ► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- ► This institution should begin using a daily “Waste Sheet,” which would improve their ability to check and verify all transaction.
- ► The institution continues to hold an amount for the value of its shares in the failed Uganda Co-operative Bank in its balance sheet. Since this bank has been liquidated, it is doubtful if the shares have any value. They should be removed from the balance sheet and considered a loss for the time being. If someday, they should be redeemable, then, at that time only, they can be brought back into the balance sheet as exceptional income.
- ► To make sure that the loan officers stop collecting delinquent loan payment in the field.

2.2.7 RUSCA Ltd.

This visit took place on Saturday, September 10, 2005. During the mentoring visit the following board and staff members were present:

Board Members	
Kakondo Simeon Banturaki	Chairman
Bekiita Olive	Treasurer
Staff	
Ndyamuba Amon	Manager
Tumwesiga Chripus Herbert	Accountant
Sabiiti Job	Field Officer
Kamugisha Stuart	Loan Officer
Kirono Bernard	Ledger Keeper
Kambarara Jescah	Cashier

RUSCA is still registered as an MFI. It has not yet begun the process of conversion into a SACCO. This needs to be done soon or they risk not being allowed to mobilize savings since they will be in non-compliance with the Bank of Uganda legislation. Rural SPEED should insist on this conversion as a condition to continuing support.

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. Only two board members were present so the no commitment was made on any of the topics discussed.

It was recommended that:

► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

► Delinquency is a very serious problem that must be dealt with immediately. The portfolio at risk > 1day rate is 29% and the portfolio at risk > 30 days is 25%. This puts more than 25% of the outstanding portfolio at risk and could lead to the institution's collapse if not addressed quickly.

- The loans' committee should be put in place. Currently, loans are recommended by the loan officers and approved by the accountant and the manager. The board is not involved in the process.

- The payment of interest on the fixed deposit account is done at maturity. It is currently paid monthly, which is not correct. The monthly amount should still be calculated and placed in the interest payable (liability) account. It will only be paid out if the client respects the terms of the fixed-deposit and does not withdraw early.

2.2.8 SHUUKU Credit and Savings Cooperative

This visit took place on Monday, September 12, 2005. During the mentoring visit the following board and staff members were present:

Board Members	
Bitangaaza Elphez	Vice-chairman
Mugishe Israel	Chairman Loans Committee
Munyabwera Alfred	Treasurer
Tuuahwwa Mrison	General Secretary
Staff	
Tukamwhaba Miriam	Manager
Mujuni Deo	Accountant
Mubangizi Deo	Senior Loan Officer
Ahimbisibwe Albert	Loan Officer

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.

It was recommended that:

- The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- The operating self-sufficiency and financial self-sufficiency ratio be calculated

- monthly and used by the board to assess changes in performance.

- The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendation, which should be highlighted, is:

- ► There should be a clause added to their loan agreements, which would state that the loan amount can be recalled immediately if the money is not used for the stated loan purpose. This would discourage clients from changing the loan purpose once the money is received.

2.2.9 Ankole Farmers and Traders Savings and Credit Society, Ltd.

This visit took place on Tuesday, September 13, 2005. During the mentoring visit the following board and staff members were present:

<u>Board Members</u>	
Asiimwe Annah	Treasurer
Mwine Adonia	Board Member
Baguma David	Board Member
<u>Staff</u>	
Nahamya Wycliffe	Managing Director
Namukasa Madina	Loan Officer
Tuhew Job	Loan Officer
Mbonye Beatrice	Cashier
Kyokusiima Annet	Office Attendant

The meeting with the board members covered four topics, delinquency, self-sustainability, suggested reporting format, and depreciation. The board members agreed to discuss the suggested changes and make a decision on their implementation.
It was recommended that:

- ► The delinquency issue be thoroughly reviewed and changes implemented, including policy and application review, monthly loan loss provisioning using age category risk percentage and writing off loans past due greater than 12 months.

- ► The operating self-sufficiency and financial self-sufficiency ratio be calculated monthly and used by the board to assess changes in performance.

- ► The suggested monthly income statement and balance sheet formats are adopted as soon as possible or by December 2005 at the latest.

- ► Depreciation is done on a monthly basis.

In addition, individual interviews were conduced with the staff members. During these interviews, a number of issues were raised, especially in regards to loan analysis and delinquency follow-up. Rather than repeating all general recommendations contained in the conclusions and recommendations section of this report, it should be noted that all of the general recommendations apply to this institution. The only specific recommendations, which should be highlighted, are:

- This institution needs to have two full-time loan officers to manage the 613 active loans. The recent hiring of one loan officer is not sufficient since the current loan officer is expected to become the full-time accountant as soon as he is trained.

- All staff job description and actual work activities should be review. Currently staff members are fulfilling multiple roles within the institutions, on an as needed basis, to fill in for any staff members who were absent, on leave or not yet hired. While this is normal and customary for small institutions, it has lead to some confusion and inefficiency in the operations. It has led to a lack of checks and balances in the internal control system.

- The new pre-numbered cash withdrawal booklets should be used instead of the tiny, un-numbered cash withdrawal slips.

- The institution could improve the coding of its loans to directly identify the loan cycle, simply by adding a dash and 2 digits to the current unique client loan number; i.e., for example, 937-02 would represent the second loan for client number 937.

- The issue of credit-life insurance premium is reviewed with the insurance company, which is thought to be AIG. It appears that the amount deducted from the client accounts is incorrect. It should be 1% of the loan amount for loan terms from 1 to 6 months and 2% of the loan amount for loan terms from 7 to 12 months.

- The cash insurance is purchased for the institution. Currently, there is none, which is a significant risk to the institution, especially since they are located in a major town, Mbarara.

2.2.10 AMFIA

This visit took place on Wednesday, September 14, 2005. During the mentoring visit the following staff members were present:

Executive Secretary	Tumuhairwe Frank
Finance and Administration Manager	Najune Alexander
Administrative Assistant	Irene

The assessment visit focused on four performance areas. First, it reviewed the SWOT[1] analysis that is presented in their 2005-2007 business plan. Second, it reviewed the current services offered and provided to members. Third, it looked at the current accounting system and fourth, it covered the proposed products and services, which it would like to develop.

At this time, the Ankole Microfinance Institutions Association (AMFIA) has 55 members, of which 37 are SACCOs and 18 MFIs. AMFIA is strongly encouraging all of it MFI members to convert to the SACCO legal form to avoid conflict in mobilizing public savings, which is now prohibited by the Bank of Uganda, except for MDIs and SACCOs. AMFIA was registered on 3 September 2003 as a company limited by guarantee. It is actually exploring the procedures to transform into a Union, which would make more sense since eventually all of it members will be SACCOs.

SWOT Analysis

The full SWOT analysis is contained in the 3-year business plan and will not be repeated in detail in this report. Only the essential items will be covered. If more detail is needed, one should refer to their business plan.

<u>Strengths</u>

- Strong support and involvement of members;
- Linkages to other institutions
- Centralized location with respect to their members;
- Clear vision and mission;
- Competent and strongly motivated board of directors; and
- The geographic area covered by the member institutions is agriculturally rich and productive, so disposable income for savings exists.

<u>Weaknesses</u>

- Limited internal capacity (financial and human resources);
- Member institutions are distant and located on bad roads making it time consuming and costly to visit;
- Limited products and services available due to the small number of staff;
- Tier 4 supervision is difficult due to the large number of institutions and lack of transport;
- Lack the equipment needed for training; and Lack of effective SACCO internal controls means a lot of strengthening support is required.

<u>Opportunities</u>

[1] **S**trengths, **W**eaknesses, **O**pportunities and Threats

- Large degree of goodwill between AMFIA and government bodies;
- Government policies provide a good economic environment for private sector initiatives;
- Excellent leadership experience among board members;
- Large un met demand for microfinance services;
- Access to other microfinance support institutions ; and
- Potential funding partners and opportunities.

Threats

- Financial vulnerability to donor conditions;
- Political interference by Ugandan MPs in local institutions, who were founding members and who do not want to relinquish control;
- Lack of a national regulatory body for Tier 4 institutions;
- Previous collapse of the cooperative movement and some commercial banks makes potential members reluctant to use the local institutions; and
- Micro-borrowing has led to too much debt in many areas.

Current Products and Services

The services currently provided by AMFIA to its members are:

- Training on loan tracking, basic bookkeeping, financial analysis using the PMT software, internal audit best practices and procedures, and micro-loan appraisal. These trainings have usually been done by contracting with a consultant. There is normally a 50,000 UShs fee paid per person trained by the institutions out of an estimated average cost of 300,000 UShs per person trained (17%);
- Provision of 30 computers to 30 of the member institutions;
- Collecting monthly financial and performance information from all member institutions. The intention is to prepare peer comparison reports, however, they do not yet have the capacity to produce these reports;
- Mentoring at Annual General Meetings;
- Representation of the member institutions at the national level (advocacy);
- Coordination of the flow of information to and from the member institutions;
- Assist, when requested, member institutions with staff recruitment;
- Monitoring/mentoring of member institutions although no reports of this activity have been produced; and
- Production and distribution of quarterly reports.

Accounting System

The actual accounting system is an Excel spreadsheet, with detailed individual income and expense account information. It is not based on the use an accounting software package. The Finance and Administration Manager was only hired in January 2005 and is still implementing some of the audit recommendations. The manual filing of expense receipts/vouchers is correct but no verification of expenses was done.

The income statement is produced on a quarterly basis instead of monthly. While this may have little effect at this time, due to limited financial resources, it should still be done monthly. The format suggested for the SACCOs would serve the purpose nicely. In addition, the balance sheet is only done yearly, as in the SACCOs, and should be done monthly. Once again the format presented during the training workshop would work well here. Without a good accounting software package, however, it will be difficult for AMFIA to manage large amounts of funding.

Proposed Products and Services

The full range of products and service that AMFIA would like to offer to its members can be found in their business plan. I will only focus on a few that merit particular attention.

- Provision of Advisory and Audit Services

The intention is to train six people coming from the member institutions' supervisory and audit committees to be able to conduct internal audits for the member institutions. These audit teams would be less expense than audit firms and have a greater understanding of how the SACCOs/MFIs should function. The problem is that these people are unlikely to be trained auditors or certified public accountants and thus while the service will be less expensive it may also be less useful. Auditing requires very specific qualifications and capacities. It might be better to train a number of local audit firms on how to do proper SACCO audits and in return for the training to have a lower rate available to members for a limited (1-2 year) period. That way the internal audits would be very professional and useful for management decision making by the boards.

- Mutual Guarantee Fund

This is an excellent idea, although it is not a simple activity. A mutual guarantee scheme requires legal registration, guaranteed linkages to bank funding, involvement of an insurance firm to ensure that all member institution loans include credit-life insurance and significant contributions from member institutions. I would estimate a time frame of 18 – 24 months, with outside consulting assistance, to set up and register this guarantee fund.

- Central Finance Facility

This too is an excellent idea but requires legal registration, often under the banking act, due to the large size of its loans to member institutions. It also requires much better financial management software and systems.

- Member Institution Bail Out Support

I have renamed this activity based on their explanation. In the business plan it is referred to as a liquidity pool. The intention is to provide soft loans to member institutions that have become technically insolvent, for whatever reason, and to bail them out until they can turn around the institutions. This is a central bank role and what is really needed is a deposit insurance scheme to guarantee member savings in case of insolvency. It would not be a good idea to throw good money after bad. Institutions that become insolvent are generally poorly managed and should not continue operations. It would be better to hand over or sell the assets (loan portfolio) at a discounted rate to another nearby and well-performing institution.

Recommendations

While the time spent with AMFIA is too short to make a full and fair assessment of the institution, I was impressed with the vision and optimistic business plan. It appears to have strong member involvement and a desire to increase services to members. They are on the right track to want to convert to a Union but lack the resources to achieve their goals without very significant donor involvement.

Financial management must be improved by using simple accounting software. It might be advisable to have a simple bookkeeper for the accounting operations since the Finance and Administration Manager has many additional tasks in his job description. I realize that this is budget issue, however, more focus must be made to improve the accounting system.

Given the fact that AMFIA was created at the demand of the member institutions, it can serve as an excellent vehicle to deliver training and support services to members. More detailed due diligence will need to be done to determine the extent of their institutional capacity.

3 Conclusions and Recommendations

During both the training and mentoring visits it was clear that the primary challenge for the institutions is managing delinquency. It appears that in most cases the institutions are only aware of the excuses given by the delinquent members and not the causes of the delinquency.

Delinquency Management

- None of the institutions are calculating their portfolio at risk rates. Thus they do not even know how delinquent loans are without looking at each and every loan ledger card.

- Loans are approved based character and collateral. There is no business analysis of cash flows, income statements and balance sheets. While this is acceptable for small loans of less than 1,000,000 UShs, loans above 1,000,000 UShs need progressively more business information before approval can be granted.

- There has not been any recognition that loan delinquency begins the day the loan is disbursed. The institutions react to the excuses given by clients and not on better information to judge how the loan will be and is actually invested in the business.

- Loan loss provisioning is not done monthly. It is not based on the actual portfolio risk. In the past, it has been done only at the end of the financial year, at a flat rate based on the gross loan portfolio and generally ranging from 1.8% to 5% of the gross loan portfolio. There was one exception, Ankole Farmers and Traders Savings and Credit Ltd., which is using a 15% rate.

- Loan loss write-off is not being done as required under the generally accepted accounting principles for loans delinquent more than 12 months. Loan write-off is not done because the institutions believe that writing off a loan equals forgiveness, which is not the case. Loan loss write-offs are simply an accounting procedure to remove the loans from the balance sheet and to transfer them to a “Written-off Loan” register.

- In some cases the loans policies are not adhered to by either the loan officers or the loans committee leading to previously delinquent clients receiving repeat loans and becoming delinquent again.

- The loan policies are not reviewed on a periodic basis. Many are the same as they were when the institutions were created.

- Guarantors are rarely informed of the loan delinquency immediately and do not understand their liability (obligation) to pay if the client is delinquent. Members simply sign the forms without understanding the implications.

- Most loan collateral is land (property), however, it is difficult if not impossible to seize and sell land in rural communities.

- Many loan officers collect delinquent repayments in the field. This is both a risky and a dangerous idea for the institution. Field repayment, even with receipts can lead to embezzlement or being falsely accused of receiving payments, when the client did not give it to him. It also encourages delinquent clients to continue to wait for the loan officer to come to collect the next delinquent payment. It is a costly procedure for the institution.

In light of these weaknesses, it is recommended that:

- **1.** The board and management review the loan polices and procedures at least once a year and if possible every six months. Where the policies are found to be lacking or inappropriate they must be added or changed.

- **2.** The loan officers are evaluated to see if they are correctly applying the policies. If they are not then they should be warned and given a chance to change. If change does not occur within a reasonable time then they should be replaced.

- **3.** The loan committee members are evaluated to see if they are correctly applying the policies. If they are not then they should be warned and given a chance to change. If change does not occur within a reasonable time then they should be replaced.

- **4.** The delinquent loans in the portfolio should aged into the six age categories and the portfolio at risk rates calculated for each age category, for PAR > 1 day and for PAR > 30 days, at the end of each month. This information must be communicated to the board.

- **5.** The loan loss provisioning be done monthly based on the risk percentages.

- **6.** All loans greater than 12 months past due be written off and transferred to a “Written-off Loan” register. The board would then be responsible to follow up on these loans and not the loan officers. While this amount may be too much to do in one month, it can be phased in between now and 31 December 2005. That way the accounting will be correct at the beginning of 2006.

- **7.** Training on business analysis of loans should be conducted to teach loan officers and loan committee members how to properly evaluate business loans. This training should include formats for simple balance sheets, income statements and cash flow statements for the businesses. The amount of information required will be dependent upon the loan amount requested. The larger the amount, the more information required. It is important to increase the expenses by 20% and decrease the income by 20% during the analysis, to take into account that the fact that small businesses, without proper accounting records, generally overestimate income and underestimate expenses. If this change of 40% still gives a positive result, then the loan is likely to be successful. In addition, the monthly installment amount should not exceed 30% of the total unadjusted income. If it is 50% or more, then the business is likely to be delinquent on one or more installment.

- **8.** Higher rates of interest are charged on repeat loans to previously delinquent clients, after a 6-9 month waiting period. Additional collateral or guarantors should be required as well.

- ► **9.** Guarantors are required to come to the office with the client before the loan is disbursed to ensure that they fully understand their liability as a guarantor. In addition, they need to be informed immediately when a loan payment is delinquent and must pledge either one or more shares or savings, which can be seized immediately if the loan becomes delinquent.

- ► **10.** When land is given as collateral, the institutions should require some form of additional guarantee, which will cover one or two installments and which can rapidly be seized and sold if the client is delinquent. This will deliver the message that the institution is serious about collecting the loan and ensure that some money is recovered before the court process to seize and sell the land occurs.

- ► **11.** New delinquent loan collection strategies need to be developed to reduce the number and amount of delinquencies.

- ► **12.** No loan officer should ever collect money from clients, no matter what the reason. If field collection is necessary the manager or the accountant should do the collections.

Self- sufficiency

None of the institutions trained or mentored are using any means of testing for self-sufficiency. It is therefore recommended that:

- ► **13.** Institutions, which currently have “soft” interest rate loans from MSCL or a similar institution, calculate the “Operating Self-sufficiency Ratio” and the “Financial Self-sufficiency Ratio” at the end of each month.

- ► **14.** Institutions, which do not have any outside borrowing, calculate the “Operating Self-sufficiency Ratio” monthly and only do the “Financial Self-sufficiency Ratio, if and when they are seriously considering some form of external borrowing. This will allow them to evaluate if their current interest rate can support the cost of the proposed external funds.

Financial Reporting Format

The current financial reporting in most, if not all institutions, is inadequate and does not follow generally accepted accounting principles. Most institutions are producing monthly income statements, which are cumulative. This does not provide the board with the information that it needs to make decisions on income and expenses. Furthermore, almost all of the institutions are only producing a balance sheet at the end of the financial year. The board therefore has no information to judge the institutions progress until the end of the financial year, which is too late for proper decision making. While it might be advisable to have a standard chart of accounts for the institutions, the priority must be put on the production of proper income statements and balance sheets.

It is therefore recommended that:

- ► **15.** The proposed income statement format is adopted at all of the institutions. It has the advantage of showing the current month’s income and expenses, the previous month's income and expenses and the year-to-date totals at the same time. The adoption of this format will not add additional work time to reporting process. It is simply a matter of changing to the new format. It would be helpful if a model Excel spreadsheet file, with twelve worksheets, could be prepared and given to the institutions, which have computers. This would significantly speed up the adoption process

- ► **16.** The proposed balance sheet format is adopted at all of the institutions. It has the advantage of showing the current month's balance sheet accounts, the previous month's balance sheet accounts and last year-end's balance sheet accounts, at the same time. The adoption of this format will add some additional work time for reporting, since it has not been done on a monthly basis in the past. Once the first month is completed, however, it will not take significant additional work time to prepare the balance sheet each month. As with the income statement, it would be helpful if a model Excel spreadsheet file, with twelve worksheets, is prepared and given to the institutions, which have computers, to speed up the adoption process.

- ► **17.** Once the institutions have used the new formats for approximately six months, then a standard chart of accounts should be introduced. If it was introduced now, the institutions would waste a lot of time trying to defend why their account names are best, instead of focusing on improved reporting. Once the improved reporting is fully understood, the institutions will be open to improvement in their chart of accounts.

Depreciation

In all of the institutions, depreciation is done yearly instead of monthly. There was a serious misunderstanding about the role and purpose of deprecation, which is to account for the use of a fixed asset during the time in which it is used; i.e., each month. There is also some confusion with the definition of a fixed asset. In one institution, a 20,000 UShs wall clock is considered a fixed asset, when its value is too small to be considered one. While this is only one example, it is possible that other institutions have considered similar low cost items as fixed asset. It is therefore recommended that:

- ► **18.** All of the institutions begin depreciating fixed assets on a monthly basis. If the amount is too much for one month, then the amount should be fazed in between now and the end of December 2005.

- ► **19.** That a minimum value is set before an item can be considered a fixed asset. It is recommended that this be set around 150,000 to 200,000 UShs.

Other Financial Management Issues

Financial Year

At this time the majority of the institutions visited use the calendar year as their financial year, however, two have different financial years. While the actual dates for the financial year are not essential to proper financial management, most banks and international lending institutions require financial reporting on a calendar year basis. This will lead to twice the work load in preparing an interim year-end report for December and then a formal year-end report at the end of their actual financial year. It is therefore less cumbersome to change the financial year to follow the calendar year. Thus:

► **20.** For any institutions, which have a financial year that is not the calendar year, those institutions should work with their boards to convince them to change the financial year. Since it is better to have a longer than twelve month financial year as a bridge, rather than a shorter one, it is recommended that the change occur as of 1 January 2007.

Accrual Accounting

Many of the institutions are not accruing expenses and income as required under the generally accepted accounting principles. One institution indicated that they had previously received (sometime in the past) instructions from the Uganda Cooperation Alliance (UCA) to use cash accounting. While this was verified as accurate it is not appropriate to microfinance institutions. It is therefore recommended that:

► **21.** All institutions immediately implement accrual accounting procedures for income and expense items.

Double Entry Accounting

While most institutions are using double entry accounting principles, some are not doing it properly. The training covered everything necessary to implement or improve their double entry accounting systems. It is therefore recommended that:

► **22.** All institutions immediately implement double entry accounting, if they are not currently using it.

Internal "Voucher" Transactions

In all of the institutions visited, multiple internal vouchers are used for double entry transactions and specifically for loan repayments from savings. Instead of having one voucher with both the debit and credit accounts on it, they use one voucher slip per account transaction. This is inefficient and time consuming. From a technical point of view it does not make sense, however, management and staff is most comfortable with a pile of slips to balance against each and every subsidiary ledger card. Although this is certainly not a "first" priority issue, it is recommended that:

► **23.** A model internal voucher book is designed for these transfers. This should be a pre-numbered duplicate booklet form. The Shuuku accountant has a clear idea of what is needed and could be asked to prepare the initial design. This would involve the institutions in the entire process and encourage then to change to a less time consuming system.

Cash Count

While most institutions are doing cash count on a regular basis, improvement is possible. Each institution should ensure that:

- **24.** The cashier(s) and the accountant do a cash count at the end of the day;
- **25.** The manager does a weekly, unannounced cash count and also one on the last working day of the month, which includes counting the cash reserve.
- **26.** The Board (Treasurer) does a cash count at least once monthly;
- **27.** The Supervisory an Audit Committee does at least one unannounced cash count each quarter and more often if possible. They should also be present on the last working day of the financial year for that cash count, too.

Financial Performance

Since none of the institutions are actually analyzing their performance using the PMT ratios, it is difficult to say where they stand. While some are producing PMT software reports, the information is not being used for decision making purposes. It is seen more as a reporting requirement for outside support organizations, such as UCA, ANFIU, AMFIA and Rural SPEED than as a management tool. It is therefore important that:

- **28.** Those institutions, which do not have a computer and PMT software, begin making calculations manually for most of the ratios. These ratios should be compared to the Uganda benchmarks and used by the board to make an institutional growth plan.
- **29.** Those institutions, which have a computer but do not have the PMT software, be given the software and shown how to use it. The board should then be given the reports to compare their ratios to the Uganda benchmarks. This information should then be used by the board to make an institutional growth plan.
- **30.** Those institutions, which have a computer and the PMT software, should begin using the information to compare their ratios to the Uganda benchmarks. This information should then be used by the board to make an institutional growth plan.
- **31.** Gender disaggregated data should be collected and analyzed to determine specific products and services for women members.

Roles and Responsibilities

During the training and site visits, it was observed that the staff and board roles and responsibilities are not always clear. This is not simply a “paper” description issue. It is an application issue. As such:

- ► **32.** Boards should exercise oversight and not micro-management.
- ► **33.** Boards should closely monitor loan repayment rates, portfolio at risk ratios and delinquency.
- ► **34.** They should become involved early on to assist management to collect delinquent loans, instead of being informed once it is too late.
- ► **35.** Managers should communicate fully and transparently to stakeholders.
- ► **36.** The Supervisory and Audit Committee’s role must be clarified and a set of working procedures and documents developed to guide them in their tasks.

Participant Recommendations

In addition, participants at the two workshops have suggested the following recommendations to Rural SPEED:

- ► **37.** To organize a training of loan officers and loan committee members on loan portfolio management.
- ► **38.** To conduct member trainings on loan management and finance.
- ► **39.** To train managers on accounting, financial management and loan portfolio management.
- ► **40.** To train at the local level rather than at the regional center; i.e., to have less SACCOs trained per session and to train more members per SACCO.
- ► **41.** To train on new product development (savings/loans), especially for agriculture loans.
- ► **42.** To collect information on current loan and savings products available in each of the institutions and share the product information among all the institutions.
- ► **43.** To conduct training on “GAP[2] analysis” so that the institutions can better match resource terms to loan terms.

[2] GAP simply means the gap between the term of the mobilized resources (external borrowing, ordinary savings, time deposits) and the loan terms. Resources are matched to the loans to avoid a liquidity crisis whereby savings are withdrawn and there is insufficient cash or near cash available because it is tied up in longer term loans.

In conclusion, the training and mentoring has been very useful in uncovering institutional weaknesses. It has reinforced proper accounting practices and procedures, such as accrual and double entry accounting, improved monthly reporting formats, monthly loan loss provisioning based on portfolio at risk percentages, loan write-offs after 12 months, and monthly depreciation. All of the institution, which participated in the training workshops, can now calculate and interpret a number of key financial performance ratios and use this information to better guide their institutions.

The critical issue is the implementation and use of the improved practices and procedures, which were covered during the workshops and mentoring visits. If these recommended changes are implemented, with a view to having them all in place by the end of December 2005, then management performance should greatly improve over the next year. Information will be available to make proper decisions, instead of using guesswork, which was often done in the past. More training and mentoring type follow-up is still necessary, if the institutions are to achieve the objective of independent and financial self-sufficient SACCOs.

APPENDICES

Appendices were included in the original report are excluded from general distribution because they contain proprietary information. Rural SPEED will provide this information on qualified request.