Appraisal Guide for Microfinance Institutions

Resource Manual

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CGAP
Consultative Group to Assist the Poor

Appraisal Guide for Microfinance Institutions Resource Manual is available for download from the CGAP Web site (http://www.cgap.org/) publications page.

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Jennifer Isern (CGAP) led the development of the revised appraisal guide, resource manual, and accompanying Excel spreadsheet. The principal authors of this appraisal guide are Jennifer Isern and Julie Abrams (Microfinance Analytics). Matthew Brown contributed extensively to an earlier draft while he was research assistant at CGAP in 2004–05. Kim Craig developed appraise.xls, the accompanying Excel spreadsheet to generate summary tables for the appraisal report, and provided useful comments on the appraisal guide.

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Foreword

The Consultative Group to Assist the Poor (CGAP) produced its first guide to appraisal of microfinance institutions (MFIs) in 1996, for internal use in evaluating MFIs who were being considered for grants. Before long, colleagues from other organizations were asking for copies and adapting the document for other purposes. CGAP published a version for general use in 1999.

The present updated version is intended primarily for two types of users: funders who are considering support for, or investment in, MFIs; and MFIs conducting self-evaluations.

The revised MFI Appraisal Guide offers new sections on analysis of savings, social performance, information systems, and risk management. In addition, the Guide includes new indicators and financial statement formats agreed within the microfinance industry from 2003-2005.

Users need to note some important cautions:

- The Guide is not a one-size-fits-all tool. It calls for a lot of detail and analysis because it was designed for use with relatively mature MFIs (generally with more than 3,000 clients and three years' experience) being considered for large investments (often several million dollars). For smaller or newer MFIs, or for smaller investments, a less intense review may be appropriate. It would be unfortunate if indiscriminate use of the format resulted in MFIs being burdened with requirements to produce information that is either unnecessary or unlikely to be used by the donor or investor requesting it. Sample terms of reference for a lighter analysis and a more thorough analysis are included in the Resource Manual that accompanies this Appraisal Guide.
- The Guide assumes the involvement of a highly knowledgeable analyst. It is essentially a checklist of information to be gathered, and the analyst's judgment is critical in deciding which information is worth pursuing and in evaluating the information collected. If the person conducting the appraisal lacks substantial experience with MFIs and good financial analysis skills, the results will not be reliable.

- This revised Guide gives more attention to assessing poverty levels and social performance impact of the MFI's clients. However, a serious poverty analysis may require more resources than are budgeted during a typical appraisal. The Resource Manual references several guides for determining client poverty, including CGAP's Poverty Assessment Tool.

Please send questions or comments on this Guide by email to Jennifer Isern (jisern@worldbank.org) or contact us at the CGAP Operational Team offices (mailing address: CGAP, 1818 H Street NW, Washington, DC 20433, USA; fax 202-522-3744).

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This Manual's Contents and Structure

This Resource Manual can be used to address questions not answered in the Appraisal Guide and support further analysis of select topics. The first part of the manual follows the same structure as the Appraisal Guide, but with more detailed discussions, followed by additional resources and references in the annexes. The annexes cover the following topics:

Annex 1 Sample Terms of Reference
  1a) Short version
  1b) Long version
Annex 2 Management Information System Evaluation Checklist
Annex 3 Social Performance Measures
Annex 4 Appraise.xls Instructions
Annex 5 Financial Statements
Annex 6 Analytical Adjustments to Financial Statements
Annex 7 Financial Risk Management: Asset–Liability Management Analysis
Annex 8 *MicroBanking Bulletin* Definitions for Benchmarking Peer Groups
Annex 9 Calculating Theoretical Interest Yields
Annex 10 References and Resources

Because the information in this resource manual is very detailed, it is *not* intended to be used as a template for an appraisal of a microfinance institution (MFI).

As in the Guide, essential information is starred (★) and appears in bold face. Crucial information is starred (★). Topics of material concern are indicated with this symbol: ⚠

1

Funding Recommendation

Based on the findings of the appraisal and the main report, the funding recommendation should succinctly state whether funding is recommended based on a summary of key factors and any mitigating circumstances. The recommendation should also answer key questions about the MFI relevant to the appraisal's focus:

- If funding is recommended, what is the suggested amount and type, and over what period?
- What are the institution's main strengths and weaknesses? How would the funding strengthen the institution? Especially with large amounts of funding, are there any risks of overwhelming the institution or shifting incentives or operations?
- Is the institution profitable? If not, is it expected to be profitable within a reasonable timeframe? What drives its (current or anticipated) profitability?
- Are there any concerns, contingencies, requirements, or improvements the MFI should address or achieve before funding is approved or disbursed? What areas should the funder monitor over time?
- What are the main internal and external risks facing the MFI? What are the mitigating factors?

The analyst also should discuss any other essential findings in the funding recommendation.

Most funders want to finance MFIs with reasonable portfolio quality, as indicated by measures such as a portfolio at risk greater than 30 days (PAR30) below 10 percent combined with a write-off ratio below 5 percent. If the MFI's performance does not meet this threshold, or if it is operating in an extreme environment (such as an area recently emerging from conflict), the funder may want to consider providing technical assistance grants instead of direct financing.

2

Overview

2.1 Summary institutional data

★ **Are the MFI's performance, management, and governance reasonable, given its time in operation?**

- Briefly describe the MFI's history and evolution. Be sure to include the MFI's legal name, year of incorporation, year operations commenced, and current and planned legal structure. If the MFI is part of a larger organization, describe the structure, strengths, and weaknesses of this arrangement (including the relationship between the organization's microfinance and other activities and whether the organization keeps separate accounts for microfinance activities).
- Does the MFI's legal structure meet its current and long-term needs? If not, can the legal structure be changed? If the MFI plans to adopt a new legal structure, explain how and why the proposed structure was selected, and identify related risks.

Table 2.1 Summary of Key Data

						Currency:	
		Actual				Projected	
		Prior Year 1	Prior Year 2	Current, as of (date)	MBB Peer Group	Projected Year 1	Projected Year 2
Clients and Products							
1	Number of borrowers						
2	Number of active loans						

							Currency:
Table 2.1 Summary of Key Data (continued)		**Actual**				**Projected**	
		Prior Year 1	**Prior Year 2**	**Current, as of (date)**	**MBB Peer Group**	**Projected Year 1**	**Projected Year 2**
Clients and Products							
3	Total gross loan portfolio						
4	Number of voluntary savings clients						
5	Total balance of voluntary savings accounts						
Portfolio Quality							
6	Adjusted PAR30						
7	Adjusted write-off ratio						
8	Adjusted risk coverage ratio						
Efficiency and Productivity							
9	Average loan balance						
10	Average savings balance						
11	Adjusted operating expense ratio						
12	Adjusted cost per active client						
13	Adjusted average outstanding loan size						
Clients and Products							
14	Client turnover						

							Currency:
Table 2.1 Summary of Key Data (continued)		Actual			Projected		
		Prior Year 1	Prior Year 2	Current, as of (date)	MBB Peer Group	Projected Year 1	Projected Year 2
Profitability							
15	Adjusted return on assets (AROA)						
16	Adjusted return on equity (AROE)						
Asset/Liability Management							
17	Yield on gross portfolio						
Macroeconomic Data							
18	Year-end free market exchange rate (local currency/ other currency)						
19	GNI per capita						
Note: MFI can use GNI per capita or GDP per capita, depending on which figure is more readily available.							

2.2 Vision and mission

- ★ **Do the MFI's management and board have the vision, ability, leadership, and experience to lead it, now and in the future?**
- ★ **Does the MFI have a clear mission that is embraced and implemented by its board and staff? Are the MFI's mission and vision consistent with the goals of the commissioning funder?**
- ★ **Include the MFI's mission statement (verbatim), and discuss whether it is embodied in the MFI's daily work.**

★ What are the main strengths and weaknesses of the MFI's mission?
★ Does the MFI have a clear target market it is trying to reach? Does it have a coherent strategy for reaching that market? How successful has it been in reaching it?

⚠ Is the MFI's mission unclear or vague? Does it have a well-defined mission that it is not fulfilling?

2.3 Organizational strengths, weaknesses, and competition

★ **What are the MFI's key strengths and weaknesses?**
★ **What opportunities and threats does it face?**

★ What are the MFI's greatest comparative and competitive advantages and disadvantages?
★ Who are the MFI's main competitors –and potential new entrants--and how are they positioned in the local market as compared with this MFI?

- How does the MFI's competitive environment affect its outreach, growth, operations, effectiveness, and profitability? Briefly describe management's view of the MFI's competitive situation.[1]
- How does the MFI differentiate itself from competitors (e.g., products, service, pricing, a combination, or other factors)?
- To what extent does the MFI take competitors into account when making key decisions regarding operations, products, and interest rate policy?
- How has the MFI handled its growth thus far? Is it prepared to manage (often rapid) growth, in terms of staffing, products, and funding?
- Does the MFI operate in nontransparent ways? For example, are loan files available as needed, can portfolio quality be easily monitored, are there any unusually high interbranch balances, etc.? Did the appraisal unearth any concerns about transparency in terms of reporting, operations, or behavior?

2.4 Macroeconomic and political environment

★ **How does the domestic macroeconomic and political environment affect (positively and negatively) the MFI's operations, including its ability to execute its stated strategy?**

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[1] If the MFI is large or faces serious competition, a more comprehensive competitive analysis may be appropriate. This could include analysis of the number, scale, and market focus of MFIs in the local market (regionally or nationally, depending on the MFI's context). If data are available, provide the market share and competitive advantages of each competitor, including commercial banks and their subsidiaries, consumer lenders, NGOs, cooperatives and credit unions, postal savings banks, and other financial service providers. Based on the potential market, evaluate overall microfinance market penetration and saturation and the implications of the competitive environment for the MFI's current and future market share and profitability. This information should be as quantitative as possible, accompanied by qualitative insights. For further explanation of competitive analyses, refer to *Competitive Strategy* and *Competitive Advantage* by Michael E. Porter, and *Blue Ocean Strategy* by Kim and Mauborgne.

- If the economic, political, or social environment has undergone significant changes that affect microfinance, discuss any positive or negative impacts on the MFI.

2.5 Other external environmental factors

★ **What other external environmental factors bear significantly on the MFI?**

- Identify the impact of any influential local conditions, such as a high incidence of HIV/AIDS, a post-conflict environment, seasonal loan cycles (because of agriculture, for example), or market disruptions because of natural disasters. Indicate how the environment could or does adversely affect the quality of infrastructure (roads, electricity, water), availability of qualified staff, and so on. Specify the potential disruptions and risks they pose to the MFI's operations.

3

The Institution

3.1 Ownership and governance

★ **Does the MFI's board have the experience and commitment needed to provide fiduciary and strategic oversight of the MFI? Is the board capable of enabling the MFI to achieve its mission, guiding its strategic direction, managing and mitigating risks, and ensuring accountability throughout the institution?**

★ **Is the board appropriately qualified, active, and experienced in fields such as banking, law, accounting, and social development?**

3.1.1 Ownership

- What is the MFI's legal structure? (Most MFIs are NGOs, cooperatives, credit unions, nonbank financial institutions, or commercial banks.)
- If the MFI is a bank or nonbank financial institution, complete Table 3.1. (Ownership in Table 3.1 should sum to 100 percent and to the MFI's stated equity book value. If market value is used instead, that should be specified.)
- Indicate any relevant recent change in ownership or significant impact the composition of ownership has on the MFI's mission, strategic direction, and operations. Also note any significant contingencies in ownership, or puts, calls, or buyout options pertaining to the owners. Finally, note whether all allowable capital is subscribed or if there is a significant upcoming increase in the number of shares.

Table 3.1 MFI Ownership Summary

					As of (Date):
	Owner Name	Type (individual), company, bank, NGO, other)	Domestic or International	Amount of Ownership (in Local currency)	Percentage Ownership
1					
2					
3					
Etc.…					

3.1.2 Governance[2]

★ Evaluate if and how the MFI's board practices sound governance in terms of defining and upholding the MFI's mission (and changing it as needed), guiding major strategic decisions, managing risks and maintaining the MFI's health, and ensuring accountability throughout the institution.[3]

★ Does the board have the skills and ability to lead the MFI strategically?

★ Do board members' roles extend beyond governance and into management of the MFI?

★ Do all board members agree on the MFI's mission and strategic direction?

- Indicate the criteria for board membership, including professional experience and education level. Note number of board members and their expertise. How many board members are "independent directors" who have no other ties to the MFI? If there are outside investors in the MFI, how many seats do they hold on the board? [4]
- How often does the board meet? (Base your determination on meeting minutes and discussions with board members. Are the board's committees appropriate, given the MFI's stage of development?[5]
- Does the board have policies stipulating term limits and rotation for its members? Does it follow those guidelines?
- If board is not fulfilling its oversight and strategic role, explain how that evolved, and what practices should be established to provide adequate board oversight.

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[2] Natilson and Bruett 2001.

[3] Adapted from Council of Microfinance Equity Funds 2005.

[4] Equity investors with a 15% or higher ownership position typically seek a seat on the board as a condition of their investment.

[5] A young or small MFI may not have or need a lot of committees. Typical committees in more mature MFIs include an audit and finance committee, executive committee, compensation and personnel committee, risk management and investment committee, committees related to social performance management (client monitoring, market research), and temporary committees for specific, time-limited issues. If an MFI accepts deposits or has reached a scale where asset–liability management is becoming more important, it will likely want to form an asset–liability committee (ALCO) as well.

- Confirm that the MFI has guidelines preventing conflicts of interest among board members. Specifically, do the guidelines prohibit related-party (insider) lending, require full disclosure of all conflicts of interest, and require arm's length business transactions?
- If loans to board members are allowed, are the criteria for eligibility and loan size the same for all borrowers? Are all board members current on their loan repayment? Are loans to board members subject to a periodic review? If a board member is delinquent on a loan or receives preferential loan terms, what are the consequences or sanctions, such as removal from board, etc.?
- For credit unions and other deposit-taking institutions, do board members receive the same deposit rate as other members?
- Does the MFI have any of its invested funds in a financial institution or other company in which a board member has significant ownership?
- Is the board involved in overseeing management, ensuring accountability, and planning management succession?

⚠ Have any events damaged the MFI's reputation and operations?[6]

3.2 Management

★ **Does management have the experience, ability, vision, and leadership to lead the MFI to achieve its mission?**

★ Describe the backgrounds and positions (chief executive officer, chief financial officer, and so on) of the management team. Evaluate top management.

★ Has management handled any particularly challenging internal or external circumstances?

★ Has management been candid with the analyst (and others) about past or current challenges facing the MFI?

★ If the MFI is new, does management include anyone with a track record of achieving sustainable microfinance in another institution or setting? If not, does management have access to intensive support (more than a few weeks a year) from someone with such a track record?

★ How effective is management in representing the MFI externally, responding to crises (cite examples if possible), and advancing the MFI's vision and mission?

- How much time does management spend working with external relationships (such as networks)? How helpful is this to management?
- Is the founder of the MFI its current leader? Does this setup affect the MFI's professionalism or sustainability in any way?

[6] See guideline 5.3 on related-party (insider loans) in Rosenberg, Mwangi, Christen, and Nasr 2003.

- Is there a succession plan? How difficult and lengthy a process would it be to replace some or all of the management team, if needed? What impact would this have on the MFI?

⚠ Would the MFI be able to operate if, for any reason, certain members of the management team were suddenly unable to fulfill their obligations?

3.3 Organizational structure

★ **Does the MFI's organizational structure ensure staff accountability?**

★ **Is the organizational structure designed to optimize the MFI's branch network (if it has one)?**

★ **Does the organizational structure enhance the MFI's efficiency and productivity? Does it lower costs for the MFI and its clients? Do staffing levels meet client demands?**

★ **Does the organizational structure support effective management oversight?**

★ **How do branch structure and management influence the MFI's ability to effectively and efficiently meet clients' needs?**

★ **For cooperatives, is it a member of any national network or federation?[7] In what ways does the cooperative's membership in the network or federation affect its operations? What funding, revenue, costs, expenses, or services does the network or federation provide or incur for the cooperative? What decisions are made at the network or federation level that affect the institution? Is its membership in the network or federation a clear benefit to the cooperative?**

★ Include the MFI's organizational chart as an appendix to the appraisal report. Are key functions represented in the structure?

Evaluate how the organizational structure supports management:

- How are departments or units organized (e.g., cost centers and profit centers)? Does the organizational structure contribute to efficient processes and decision-making? Is it appropriate for the MFI's mission, scale, target client base, geographic dispersion, and local environment?
- Do the number and type of staff in the MFI's headquarters and branches match their levels of responsibility and delegated authority? (The headquarters may be an administrative head office but is often a key branch as well.)
- Are branches treated as cost or profit centers? How effective is this approach? Are head office costs fully and appropriately allocated among the branches?
- How is the branch reporting system organized? What inputs do branch managers have in the annual planning and budgeting process?

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[7] A federation is a group of similar institutions (e.g., credit unions or financial cooperatives) that are tied together through political and financial commitments and are managed through that political process. A network is a group of similar institutions (e.g., independent institutions) that are committed to a common business objective. Within different types of networks, the political, financial, and management links vary widely. See also Isern and Cook 2004.

Table 3.2 Staffing Summary Data

		Prior Year 1	Prior Year 2	MBB Peer Group	Variance (between MFI and MBB Peer group)
1	Total # staff				
2	Total # client officers				
3	Staff turnover				
Staffing Efficiency					
4	Personnel expense/Loan portfolio				
5	Average salary/GNI per capita				
Staffing Productivity					
6	Borrowers/per client officer				
7	Borrowers per staff member				
8	Clients per staff member				
9	Personnel allocation ratio (loan officers/# of personnel)				

Note:
- The analyst can select which (if any) of these indicators is relevant to the analysis of human resources management. Data on *MicroBanking Bulletin* peer groups are available at www.mixmbb.org.
- Loan officers are staff that regularly interact with clients specifically for loan administration.
- Savings officers are client officers who mobilize or handle savings.
- Administrative staff includes management, finance, bookkeeping, internal control, and management information system (MIS) staff; it does not include loan or savings officers, cashiers, and others who spend most of their time dealing with clients.
- Line staff includes loan and savings officers, cashiers, and other staff with direct and continual client contact.
- The term "client officers" refers broadly to all staff that interacts with clients for loan administration, deposits, repayment collections, etc. This broader staff officer definition can be useful for productivity metrics looking at a full range of financial services, including savings and money transfers.

- Are staff functions assigned appropriately? (For example, are too many functions given to one person or is a single function spread inefficiently across too many people?)

3.4 Human resource management

★ **Does the MFI have enough motivated, trained, capable staff to implement its mission?**

Table 3.2 can be used to summarize key human resource information and compare with the MFI's peer group.

★ Evaluate the MFI's human resource management in terms of recruiting, training, compensation (including salary and performance-based incentives), sanctions and promotions, retention and turnover, and termination of staff members. Are these policies and procedures institutionalized? How big a priority are they for mangers?

★ If the MFI has recently experienced a significant increase in staff because of rapid growth, provide information on the increase.

- What proportion of middle or top management was recruited from within the organization?
- What are employees' perceptions of the opportunity for upward mobility and professional advancement within the MFI?
- Analyze whether the MFI's compensation structure and work environment attract, motivate, and retain the needed number and caliber of staff. Is staff turnover an issue, particularly among client officers?[8]
- What are the key aspects of fixed and incentive compensation and the work environment? How strong is staff morale? Do these features effectively motivate staff to achieve the MFI's mission?
- Profile and comment on the effectiveness and productivity of loan officers, savings officers, and other key staff.
- Assess staff recruitment, training, evaluations, and incentives.
- How do staff training and incentives balance social and financial objectives?
- How much does the MFI depend on external domestic or foreign consultants in its daily operations?

3.5 Information and communications technology[9]

★ **Does information and communications technology provide relevant information to the appropriate people at different levels of the MFI?**

★ **Is the information reliable and available in a timely manner?**

★ **How many days does it take for a loan officer, branch manager, and headquarters manager to become aware of a missed payment?**

★ **Does the MFI use the information it produces?**

Functionality and expandability

★ Can the MIS handle the MFI's growth? Or is it a bottleneck to growth?

★ Can the MIS easily incorporate new MFI products or expand to accommodate new reporting needs?

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[8] MFI definitions of "client officer" vary and may include any combination of loan officers, tellers, and front-line staff who work directly with clients. The analyst should specify which employee categories the MFI includes in its client officer designation.

[9] See also Ivatury 2006.

- If there are plans for technology upgrades or MIS staff additions, how realistic are the plans? Identify any MIS shortcomings and their impacts on data quality and control, as well as the MFI's proposed solutions.[10]
- Does the MFI have a comprehensive MIS function that properly tracks and accounts for all products and clients, or is it simply using an Excel spreadsheet or manual ledger?
- Can the MIS track performance on past due loans for individual and aggregate portfolios, including days overdue, collection status, write-offs, and renegotiated loans? What information is available? When is it available? How is it used?
- Can the MIS quickly and accurately generate statistics and detailed analyses on the total portfolio and per product by client, loan officer, branch, and region?
- Does the MIS allow management to analyze revenue and profits by product and branch?
- Can the MIS generate data on individual staff performance, to determine incentive compensation? Can it provide immediate summary data on individual clients, products (such as savings and lending products), and operating units?

Usability

- How do staff members feel about the MIS—particularly its ease of use?
- Does the MIS interact with any applied delivery technologies, such as handheld computers, point-of-service (POS) terminals, or automated teller machines (ATMs)?[11]

Reporting

★ How many days does it take for a loan officer, branch manager, and headquarters manager to become aware of a missed payment?

★ How timely are financial performance data received by managers at various levels?

★ Identify which of the following the MIS provides: supervisor reports (operations, staffing), monitoring reports (compliance, liquidity), management accounts (statistical summaries, cash-flow projections, branch office and loan officer performance

[10] More information about MISs and other technology issues can be found at CGAP's Technology Resource Center (www.microfinancegateway.org/resource_centers/technology), including a helpful checklist from Mainhart 1999. See also Waterfield and Ramsing 1998.

[11] This question is intended not just to assess the MFI's technological savvy but also to determine whether it has used good planning processes, measured results against expectations, effectively managed donor funds for such initiatives, and been innovative in using or willing to experiment with new technologies.

data), analytical systems (such as costing), client interface data, market intelligence, back office data processing, and accounting ledgers.

- Analyze the MIS's ability to provide timely and relevant information where it is needed. Does it monitor and channel market intelligence information to strategic decision makers? Does it produce clearly focused and appropriately detailed loan monitoring information for supervisors? Does it provide timely compliance monitoring information for internal and external regulators? Does it support staff incentive plans with fair and transparent information on staff performance? Does it provide timely performance information for profit-center managers?
- Does the MFI currently, or plan to, provide information to credit bureaus? If so, are the content and format of the MFI's data synchronized with that of the bureaus? Are there any challenges to seamless data transfer?

⚠ Client loan and savings files and resulting data in loan tracking and accounting systems ideally should be identical or, if not, vary by less than 5 percent.

Standards and compliance

Using a small sample, verify that paper or electronic loan files correspond to loan data in the MIS. Confirm that general ledger or accounting records flow correctly into the financial statements. Is the loan portfolio system fully integrated with the accounting system? If not, comment on any quality-control measures used to ensure adequate data transfer.

Administration and support

- Analyze data security and determine whether adequate safeguards are in place for data retrieval, fraud protection, and physical security. Ensure that data backup and physical security are timely and appropriate for the local environment (based on weather conditions, electricity supplies, and the like).

Technical specifications and correctness

- Does management have the capacity to implement technology and make technology decisions that benefit the MFI?

Cost

- What are the costs of purchasing, installing, and operating the MIS? Include hardware, software, training, project management, consulting, staff time, and operating costs. Software costs should include base prices, maintenance agreements, installations, training, and upgrades. (This could be a time-consuming cost analysis and may be useful only if the funder is considering support for the institution's MIS.)

3.5.1 Information quality, availability, and transparency

★ **Is the MFI's information—including internal, MIS, internal and external audit, product, and portfolio data—reliable and readily available to management and staff? Is the MFI able and willing to be transparent with its information?**

★ Is there a willingness to provide information and a consistency of answers across the MFI?

★ Does the MIS support the client and transaction information required for AML/CFT compliance?

⚠ Describe any significant data quality or availability issues encountered during the appraisal and their implications for the report and funding decision.

3.6 Internal controls

★ **Does the MFI have adequate policies and procedures to manage its operational risks?**

★ Does the MFI have an operations manual? Are its contents appropriate? Is it widely accessible to MFI staff? Note whether the MFI has and adheres to written policies and procedures to manage operational risks in the following and other relevant areas:

1. *Financial operations*: credit (applications and approvals, disbursements and collections, refinancing and repeat loans[12]), savings (approvals for opening and closing accounts, deposits and withdrawals), portfolio quality review, provisioning.
2. *Procurement*: purchases (requisitions through payments), payroll (hiring, remuneration, personnel file documentation), fixed assets (budget requests and approvals, purchases, uses, security, depreciation policy, disposition).

[12] Fictitious loans are the most common form of fraud in MFIs.

3. *Treasury*: cash handling, banking (accounting, account opening and closing, deposits, transfers, withdrawals), investments, funding (donations, capital stock, debt), liquidity management.
4. *Financial management:* budget controls, asset safeguarding, production of accurate financial statements, and fulfillment of statutory requirements.

★ How effective is the MFI at detecting fraud or other significant operational risks? Does the MFI have adequate safeguards in its procedures, policies, and practices to prioritize risks, detect fraud, and maintain fair and transparent human resource management?
★ How are interbranch balances monitored and cleared? What are procedures for uncleared interbranch balances?
★ Does the MFI have appropriate and sufficient AML/CFT internal controls in place?[13]

⚠ Ask if there have been any instances of fraud or embezzlement by clients or staff. If so, provide detailed descriptions, including related changes in procedures and safeguards. Has the MFI made the changes needed to avoid future occurrences? Was it sufficiently transparent about the issue?

3.7 Internal audit

Internal audit is an important tool for internal control. Although it is a function of the internal control system, internal audit warrants specialized attention.

★ **Do the MFI's internal audit functions ensure effective use of resources, accurate financial reporting, and ample random spot checks of MFI branches, clients, and staff?**

★ Assess the effectiveness of internal audit functions, staffing, and responsibilities. Does the internal audit manager report to the head of the MFI or to a committee of the board of directors? Is the reporting structure appropriate and effective?

⚠ Include any material irregularities found by internal auditors, recommendations made, the extent and success of their implementation, and any remaining issues to be resolved.

[13] AML: Anti-money laundering; CFT: combating the financing of terrorism. Based on international guidelines by the Financial Action Task Force, four main activities are required for AML/CFT compliance: (1) internal controls; (2) customer due diligence, including "know your customer" requirements; (3) surveillance and record-keeping; and (4) reporting of suspicious activities. For more information on AML/CTF implications for microfinance, see Isern, Porteous, Hernandez-Coss, and Egwuagu 2005 and Isern 2006.

3.8 External audit[14]

★ **Does the MFI have an external auditor? If not, why? What are the MFI's audit plans and requirements?**

★ **Does the external audit accurately reflect the MFI's financial picture? Can the board and management adequately monitor and manage the audit process?**

★ Does the MFI generate an annual audited set of financial statements? Has the auditor issued an unqualified letter supporting the financial statements? If not, summarize the key reasons.

★ Are the financial statements reliable and publicly available?

★ Attach all audit reports from the past two years.

★ Does the MFI adhere to generally accepted accounting standards, such as national standards, International Financial Reporting Standards, or the microfinance-specific *Disclosure Guidelines for Financial Reporting?*

★ Are auditors familiar with the specific risks related to and monitoring required for microfinance, as well as for voluntary savings mobilization?

★ Evaluate the quality of audited financial statements, the composition and qualifications of the external auditors, and the frequency and track record of the MFI's audits. Is the audit opinion clean? How consequential are the reservations, if any? Did the auditors produce a meaningful, useful management letter with specific recommendations emerging from the audit? What follow-up did the MFI do on any findings in the management letter? Did the MFI and its board address and resolve any outstanding issues? Did the MFI implement all material recommendations made by the auditors?

- Analyze the extent to which external audits, ratings, and assessments have increased the MFI's transparency.
- Has the MFI had any independent testing of its portfolio, such as special audit procedures negotiated for this purpose?[15] If not, the analyst may consider evaluating the procedures auditors used to test its portfolio information, especially for delinquency and default. (The risk of inadequate control and reporting of portfolio quality is among the most significant in an appraisal.)
- Do management accounts provide a clear picture of current-period performance and trend

[14] More information on audits for MFIs is available at the Microfinance Audit Information Center, at www.microfinance-gateway.org/audit/index.htm. See also CGAP's *Financial Disclosure Guidelines for Financial Reporting by Microfinance Institutions* (available at www.cgap.org/docs/Guideline_disclosure.pdf) to be used in addition to an MFI's compliance with International Financial Reporting Standards (IFRS) or national accounting standards.

[15] Normal audits and ratings seldom include procedures sufficient to provide reliable assurance that an MFI's portfolio quality reporting is accurate.

analysis? Are published financial statements audited annually? Are they comprehensive and compliant with international disclosure guidelines? Does the MFI's annual report provide sound background on its mission, strategy, and future outlook by its directors?

3.9 Regulation and supervision[16]

★ **If the MFI is regulated, how does the prudential and nonprudential regulatory and supervisory environment affect its ability to charge appropriate interest rates or access commercial funding? Does regulation and supervision affect its operations in other ways?**

★ Do local laws (such as interest rate ceilings) affect the MFI's operations and profitability?
★ If the MFI is a licensed intermediary, is it out of compliance with any regulations? Review and include any reports issued to the MFI by the supervisory authority in the past two years. Note any corrective actions required by supervisors and whether the MFI has implemented them.
★ What are the AML/CFT regulations in the country that affect the MFI?[17] Is it compliant with all relevant regulations?
★ Do any of the MFI's operations clearly function outside the prescripts of the law? For example, is the MFI collecting deposits illegally?

- Is the MFI regulated? If so, by whom? If the institution is a credit union does the formal financial sector regulate it? If not who does?
- Does the regulatory environment provide an appropriate framework for the MFI's current and potential operations and legal status? Does the supervisory agency provide adequate supervision for the MFI?
- If regulation or supervision is inadequate, how does this affect the MFI? Are there benefits or drawbacks to the regulatory framework? (For example, does the regulation provide benefits to the MFI in the short term, but create a disincentive in the longer term—say, for "graduating" from being a tier 1 institution to other tiers?)
- Describe regulatory requirements, including licensing, reporting, and prudential requirements, and fitness standards for owners and managers. What types of onsite and offsite supervision are conducted? What is the relationship and degree of compliance with regulatory and supervisory authorities?

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[16] More information on regulation and supervision can be found at the Microfinance Regulation and Supervision Resource Center, created by CGAP and the University of Maryland's IRIS Center, available at http://microfinancegateway.com/resource_centers/reg_sup. The site contains profiles for selected countries and a comparative database.
[17] This will vary, depending both on the extent and type of AML/CFT regulation in place in the country. For more information, see Isern, Porteous, Hernandez-coss and Egwuagu (2005).

- Note any prudential capital adequacy requirements for the MFI. If relevant for the country, evaluate whether the MFI is familiar with the capital adequacy calculations requirements of Basel I or the planned phase-in requirements of Basel II. Is the MFI is familiar with the ratio of total capital to risk-weighted assets? Is the MFI compliant with the suggested minimum ratio of 8 percent?[18]
- Does regulation or supervision affect NGO-run MFIs?[19]

3.10 Ratings[20]

★ Attach all the MFI's rating reports for the past two to three years. If it is a credit union, has it undergone a PEARLS or other similar rating?

★ Summarize the conclusions and scores of all ratings and any key areas of strength or concern.

★ If there are concerns about the quality of a rating report and such information is available, evaluate the composition and qualifications of the rating team.

3.11 External relationships

★ What are the MFI's most significant external relationship? What impact have they had?

★ What are the MFI's most significant relationships or alliances with donors, domestic or foreign networks (such as microfinance or banking networks), technical assistance providers, and domestic political or commercial institutions?

★ Does the MFI have a formal or informal code of conduct or ethics? Does it have a pro-consumer statement or policy? If so, are these enforced? Is a product's full cost disclosed to clients?[21]

- How have of these relationships affected the MFI's ability to manage or improve its operations? Does the MFI depend on any of these relationships? If so, what would happen to the MFI if the relationship ended?
- If the MFI is a member of a national, regional, or international federation or network, what is the extent of the network's influence on the MFI's strategy and/or operations? What is the role of the network on prudential oversight, financial support or costs, liquidity and cash management, internal controls, training, product mix, branding, and/or marketing?[22]

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[18] Under both Basel I and Basel II, the minimum capital requirement is 8 percent, expressed in terms of the ratio of total capital to risk-weighted assets. Thus riskier assets require a ratio above 8 percent. More information is available at www.microfinancegateway.org/files/26273_file_Basel_II_and_MF_April_2005.doc.

[19] See also Christen, Lyman, and Rosenberg (2003).

[20] More information on ratings and rating agencies is available at the Microfinance Rating and Assessment Fund (www.ratingfund.org).

[21] For more information on product transparency and consumer protection, see McAllisteron (2000), Porteous and Helms (2005); Rhyne (2003), and Acción Network (2004).

[22] For further questions to consider on the role of the MFI's network, see Isern and Brown (2007).

4

Products

- Does the MFI's mix of financial products reflect its mission and strategy?

The extent of possible analysis of an MFI's products depends on its stage of development. If an MFI is young and small, the analyst does not need to spend much time analyzing its products and should mainly assess whether management is focused on making the institution's initial products stable and profitable. In such cases, most of the more detailed questions below can be skipped.

★ **For larger and more advanced MFIs: Does the mix of products adequately meet current and anticipated client demand?[23] Does the MFI have the capacity to meet the evolving demands of its clients and expand its client base? Does the MFI offer a suitable variety of financial products—voluntary savings, loans, transaction accounts (such as checking), insurance, money transfers, leasing, and so on—that reflect client demand and are aligned with its capacity? Does the MFI have effective strategies for product design, marketing, delivery, maintenance, and evaluation?**

Table 4.1 Product Summary

					As of (Date):
		Number of Products	Number of Active Clients	Total Balance or Value	Average Account Balance (Mean or Median)
1	Savings Products				
2	Loan Products				
3	Other Financial Products				
4	Other Nonfinancial Products				

Notes:
1. Analyst can use average or median figures in this table, noting any significant outliers and their implications.
2. Analyst can select number of active clients or number of active accounts, depending on what data are available from MFI.

[23] For more about clients and product choices see the next section on social performance.

- Summarize the MFI's products in Table 4.1, including a brief description and the period covered for each. Provide any useful breakdowns of these products, such as individual relative to group loans or microcredit relative to consumer loans.
- Does the MFI have a formal or informal code of conduct or ethics? Does it have a pro-consumer statement or policy? If so, are these enforced? Is a product's full cost disclosed to clients?[24]
- To what extent does the MFI's mix of financial products reflect its mission and strategy?
- How are products marketed? Comment on the strategy, mix, and appropriateness of lending, voluntary savings, money transfers, insurance, and other financial and nonfinancial products offered.
- Are any products designed specifically for poorer clients?
- Do the MFI's products seem appropriate, given its current and anticipated growth?
- What is the MFI's strategy for market research and development?
- What, if any, mechanisms does the MFI use to generate feedback from clients or potential clients about its products?[25] Evaluate the MFI's overall capacity to deliver quality financial products.
- Comment on the potential use and impact of innovative delivery channels, such as ATMs, retail POS, kiosks, debit cards, and handheld POS devices (used by lending staff), and relationships, such as brokering, client prospecting, and the like.
- Is the MFI optimizing its cross-selling potential or considering additional product lines?
- Do the MFI's product delivery channels adequately factor in the geographic dispersion of clients, availability of reliable infrastructure (transportation, telephones, technology, and so on), client characteristics, competitive practices, and customer expectations?
- Does the MFI have control over its products (for example, if it is brokering another institution's products, or a banking partner's credit committee makes credit decisions)?

⚠ Have there been any material crises related to the MFI's products—involving, for example, mismanagement, repayment, default, or liquidity? If so, what was the impact? What is the current status?

⚠ Are there any significant concerns about the design, marketing, pricing, or delivery of any of the products?

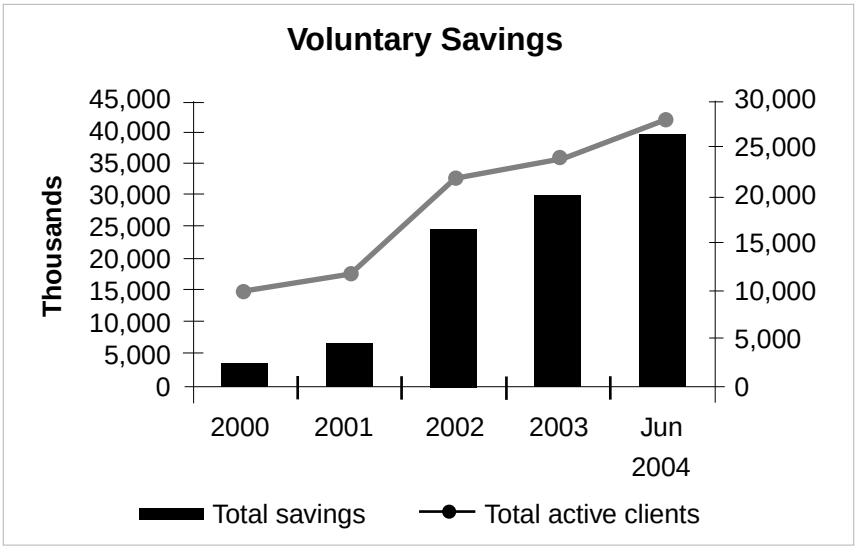
4.1 Voluntary savings[26]

This section addresses voluntary savings only. If an MFI requires clients to save as a

[24] For more information on product transparency and consumer protection, see McAllisteron 2000, Porteous and Helms 2005, Rhyne 2003, and Acción Network 2004.

[25] More information on microfinance product design is available at www.microsave.org.

[26] Additional information on savings can be found at the Savings Information Resource Center (http://www.microfinance-gateway.resource_centers/savings. See also Microfinance Consensus Guidelines: *Developing Deposit Services for the Poor* (2005).



condition of receiving loans (forced savings), see the next section on loans. If the MFI does not offer voluntary savings, do not include this section in the appraisal report. If it plans to establish voluntary savings, comment on whether the plan is credible and realistic.

- ★ **Does the MFI offer, or plan to establish, voluntary savings products? If it offers them, what have been the main outcomes and challenges? What effect have such products had on the MFI's cost of funds and on satisfying client and market demand?**

- ★ Is the MFI legally allowed to collect voluntary savings?
- ★ Is savings a requirement for borrowing? (If so, these are forced or compulsory savings.)
- ★ To what extent do the MFI's savings products reflect its mission and strategy?
- ★ Are voluntary savings used to fund loans? If so, what percentage of the loan portfolio does savings fund?
- ★ Do the lower financing costs of using savings to fund portfolio growth exceed the costs of administering a savings program?[27]
- ★ How does the MFI manage the operational risks (fraud) and the financial risk (liquidity) associated with mobilizing deposits?
- ★ Is the MFI exposed to repricing risk on its deposits?

[27] Many MFIs would not be able to answer this question easily, because many have not done a complete cost allocation for their savings programs. Even if the MFI cannot answer this question, it should be posed to consider the effectiveness of savings as a funding mechanism.

Table 4.2 Voluntary Savings Products Summary

						Currency:
		Actual			Projected	
		Prior Year 1	Prior Year 2	Current, as of (date)	Projected Year 1	Projected Year 2
Savings Product 1						
1	Interest Rate (%) and calculation method					
2	Minimum deposit to open account					
3	Fees to open account					
4	Minimum deposit per transaction					
5	Fees per transaction					
6	Penalty for early withdrawal					
7	Minimum account balance					
8	Withdrawl frequency (average per period)					
9	Deposit Frequency (average per period)					
10	Number of active individual savings accounts					
11	Number of inactive individual accounts					

Table 4.2 Voluntary Savings Products Summary

						Currency:
		Actual			Projected	
		Prior Year 1	Prior Year 2	Current, as of (date)	Projected Year 1	Projected Year 2
Savings Product 1						
12	Total individual account balance, end of period					
13	Individual account balance as percentage of total savings balance					
14	Average individual account balance (mean or median)					
15	Number of active institutional savings accounts					
16	Number of inactive institutional savings accounts					
17	Total institutional account balance, end of period					
18	Institutional account balance as percentage of total savings balance					
19	Average institutional account balance (mean or median)					

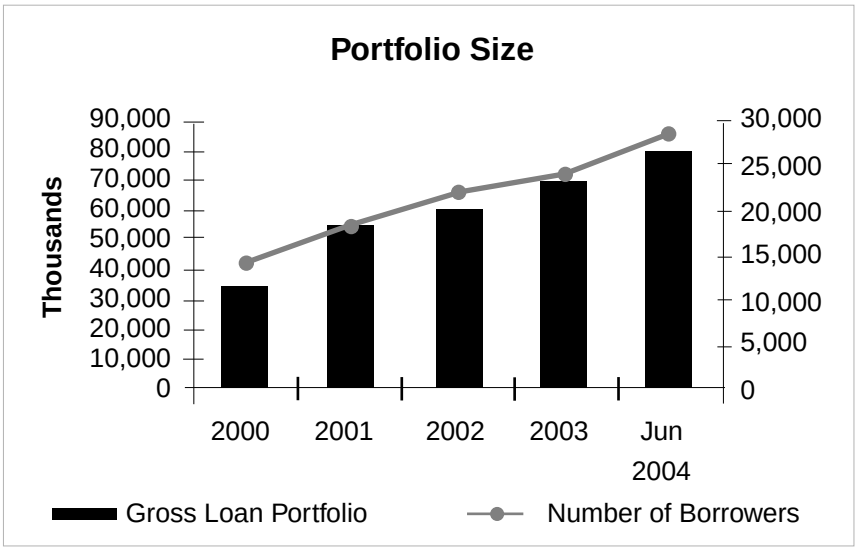
						Currency:
Table 4.2 Voluntary Savings Product Summary (continued)		Actual			Projected	
		Prior Year 1	Prior Year 2	Current, as of (date)	Projected Year 1	Projected Year 2
Savings Product 2						
1	Interest Rate (%) and calculation method					
2	Minimum deposit to open account					
Etc.	Fees to open account					

Notes:
- Analyst has option of using institutional or individual breakdowns or both.
- Analyst can select number of active clients or number of active accounts, depending on what data are available from the MFI.
- The analyst may want to compare savings fees and rates to local financial institutions or bench mark deposit rates against MicroBanking Bulletin.

- How well does the MFI deliver it savings products?
- Has the MFI determined the fully loaded cost of its voluntary savings program? If so, what contribution does it make to overall profitability?
- Can the MFI give a breakdown of savings deposits by size? Is it achieving its desired average deposit size? Is it trying to increase deposits by attracting new clients, increasing balances of existing clients, or a combination?
- If deeper analysis of the MFI's savings products would offer useful insights, assess the products using any of the following features (as needed and if available): individual relative to institutional clients, short-term products relative to long-term products (such as passbook versus time deposits), and client characteristics (such as socioeconomic levels and types of savings products). Evaluate the MFI's market position relative to other local providers of voluntary savings products. Are the MFI's clients primarily individual or institutional savers? If the MFI has both types of clients, do institutional savers typically leave money on deposit longer than individual clients? How frequently or rapidly do balances fluctuate?
- How many dormant or inactive accounts are there (give the MFI's definition of these terms or specify the definition used by the analyst)? What percentage of total accounts and balances do they represent? Are clients using current accounts as transaction accounts?
- Describe the main features of each of the MFI's voluntary savings products and related policies, including fees, minimum deposit levels, penalties for early withdrawal, and links to

other products. Analyze the size distribution of voluntary savings across appropriate ranges based on outstanding balances. How do savings products affect the MFI's cash flow?

- Are the MFI's client demand, institutional capacity, and competitive environment considered in the design (including pricing) of its voluntary savings products? Is the profitability of voluntary savings products considered in their design, or are they cross-subsidized by other products? Does the MFI's management monitor and investigate trends in account closings in its voluntary savings products? Have formal reviews of voluntary savings products led to refinement or discontinuation?
- Does the MFI effectively segment its market for voluntary savings products and consider competition when promoting them? Are the results of voluntary savings campaigns carefully tracked and monitored? Has the MFI effectively branded its savings products?
- Do the delivery channels used by the MFI ensure safe, convenient, and timely delivery of its voluntary savings products while minimizing costs to the MFI? In what ways does the MFI take into consideration the geographic dispersion of clients, availability of reliable infrastructure (transportation, telephones, technology, and so on), client characteristics, competitive practices, and customer expectations in the delivery of voluntary savings products?
- For deposit services, what are the MFI's procedures for internal cash controls and policies for liquidity management (both as driven by the MFI, and as needed by potential withdrawals)? What have been the MFI's liquidity trends? What is the stated strategy for management of administrative costs for small accounts (such as differential rates) and MIS capacity to manage small accounts? What are the capacity implications of these procedures, policies, and trends?



- Does the MFI allocate costs or profits by product? If so, how does the cost of deposit mobilization compare to that of other deposit-taking institutions in the market? How does it compare to inter-bank lending rates? And how do its fees and minimum balance tiers compare in the local market?

4.2 Loans[28]

Loan portfolio quality is addressed in Chapter 6.

★ **What are the main features of the MFI's loan products? What have been the key results and challenges of each? Which of the products are most important to the MFI and its clients?**

★ How well does the MFI deliver its loan products? What do these products contribute to the MFI's profitability and strategic goals?

★ Do the types of loans offered (size, individual versus group, tenor, seasonality) seem to address client needs in that market?

Table 4.3 Loan Products Summary

		Prior Year 1	Prior Year 2	Current, as of (date)
Loan Product 1				
1	Initial amount			
2	Increment / maximum			
3	Term			
4	Repayment frequency			
5	Interest rate			
6	Commissions and fees			
7	Guarantees and collateral			
8	Theoretical interest yield (APR)			
9	Savings requirement (if any)			
10	Number of active loans (clients), end of period			
11	Average principal balance per client			
12	Median principal balance per client			
13	Average principal balance outstanding, over period			
14	Total principal balance outstanding, end of period			
15	Percentage of total loan balance			
16	Total outstanding balance associated with loans that are:			
	On time (and never renegotiated)			

[28] For more information on microfinance loans, see the MicroSave toolkit (www.microsave.org/toolkits.asp?ID=14).

Table 4.3 Loan Product Summary (continued)		Prior Year 1	Prior Year 2	Current, as of (date)
Loan Product 1				
	Overdue 1 to 30 days (and never renegotiated)			
	Overdue 31 to 90 days (and never renegotiated)			
	Overdue 91 to 180 days (and never renegotiated)			
	Overdue 181 to 365 days (and never renegotiated)			
	Overdue over 365 days (and never renegotiated)			
	Renegotiated loans—on time			
	Renegotiated loans—overdue 1 to 30 days			
	Renegotiated loans—overdue 31 to 90 days			
	Renegotiated loans—overdue 91 to 180 days			
	Renegotiated loans—overdue 181 to 365 days			
	Renegotiated loans—overdue over 365 days			
Loan Product 2 …				
1	Initial amount			
2	Increment / Maximum			
Etc.	Term			

Note: Regarding Average Principal Balance per Client, if possible, calculate monthly averages by summing the opening balance and end-month balances, then dividing by the number of months plus one. Or calculate quarterly or annual balances. If the income statement and balance sheet include an inflation adjustment according to generally accepted practice in the MFI's country, leave this section blank. The use of average balances here and in the accompanying spreadsheet is a simplified deviation from standard inflation accounting. If desired, opening balances can be used instead. In this case, a separate adjustment should be calculated if there has been a major change in the balance sheet during the year (such as a large grant), using the inflation accumulated between the time of the grant and the end of the year.

Table 4.4 Classification of Loan Portfolio

					As of (Date):
					Currency:
Loan Size		**Amount of Portfolio**	**% of Portfolio**	**# of Loans**	**% of Loans**
1	0–250				
2	251–500				
3	501–1,000				
4	1,001–5,000				
5	5,001–10,000				
6	>10,000				
Note: Loan size ranges vary by MFI. Analyst should use the ranges already used by the MFI.					

★ What percentage of outstanding loans is accounted for by forced savings? (If it is high, this is a serious drawback from a client's perspective.)

Complete Table 4.3. If possible, distinguish among loan types, such as microcredit, consumer, and mortgage.

★ Does the MFI have a forced savings program?[29] If so, what are its terms? Do clients have to save to receive loans? Under what circumstances can clients access their savings? Is the MFI's real reason for taking members' savings to cover defaults by other members of their lending groups? Does the MFI intermediate (use) the savings, or does it deposit them in a bank? If it deposits the savings in a bank, do the clients earn interest?

- What features of loan products encourage or discourage their use by clients? Have product designs taken into account the MFI's institutional capacity, its competitive environment, and the profitability of each product line? What loan product features—such as compulsory savings components, required loan co-signers, and loan minimums or limits—discourage clients from using the products?
- Has the MFI effectively branded its name and loan products? How do the MFI's products compete in the local market?

[29] Forced (compulsory) savings are savings payments required by loan terms or for membership, usually in a credit union, cooperative, MFI, village bank, or savings group. Compulsory savings often are required in place of collateral. The amount and timing of these deposits, as well as the level of access to them, are determined by the institution, not the client. Compulsory savings policies vary: deposits may be required weekly or monthly, before the loan is disbursed, when the loan is disbursed, or whenever a loan installment is paid. Clients may be allowed to withdraw deposits at the end of the loan term; after a set number of weeks, months, or years; or when they end their memberships.

- Do the MFI's delivery channels ensure safe, convenient, and timely delivery of loan products while minimizing costs to the MFI?
- Does the MFI have sound, written loan origination guidelines and practices, including loan evaluation criteria? Is the current system the most efficient for the scale and type of loans issued? Who is responsible for decision-making, approval, disbursement, and repayment for each of the MFI's loan products? Do loan officers participate in credit decisions, or is this function relegated to a credit committee? Is the methodology appropriate for loan officer capacity? (For example, if individual loans are based on household cash-flow analysis, do loan officers have the skills to conduct such analysis? Simpler methods do not require sophisticated skills.)
- Are the steps and delegation of responsibilities in loan collection guidelines and practices sufficient to maintain high loan portfolio quality? How and how fast is delinquency responded to? Is accountability for tracking and collection of late loans appropriate and effective? Are loan officers held accountable for collection of late payments? At what point, if any, is this function outsourced or given to other MFI staff? How successful is this transfer of responsibility?
- Evaluate the criteria and practice for renegotiated loans, their effect on portfolio quality, and any efforts to mask loan delinquency.[30] Can loan officers independently alter the original terms of a loan—in amount, interest rate, or amortization period—or must alterations receive higher approval? If so, from whom? How are these decisions recorded and authorized in the loan tracking system? How transparent is the treatment of refinanced or rescheduled loans?
- Evaluate the MFI's criteria and practices for increasing loan amounts or average size of payments or for changing loan terms. Does it track, analyze, and factor in total borrowing by individual clients in its lending processes? Are loans given to clients who previously dropped out? Evaluate whether and how new loans are given to clients with prior delinquent loans or outstanding balances. Are substantial increases in loan sizes supported by new cash-flow analysis of client repayment ability? Does the MFI know what percentage of loans are repeat loans and what the dropout rate is? Are these rates consistent with those in MFIs of similar maturity and stage of development?
- Is credit bureau information on clients available to the MFI or its competitors? How does the MFI determine whether clients are taking on too much debt?

[30] Renegotiated loans can take the form of rescheduled or restructured loans, in which loan terms are changed or extended, or refinanced loans, when a problem loan is paid off and a new loan issued.

4.3 Other financial products

★ **Does the MFI offer other financial products, such as checking, insurance,[31] money transfers, remittances, or leasing?[32]**
★ **How useful are these products to the MFI and to its clients?**
★ **What is the institution's capacity to manage other financial products?**

- Many MFIs are beginning to offer services such as money transfers, remittances, and insurance, while fewer currently offer checking or leasing.
- How do other financial products offered by the MFI contribute to client satisfaction and retention? Is each of the other financial products appropriate for the market, well designed, and well managed? Do these products add value to the institution?What are the key components of each of the other financial products in terms of specific product management, branding, and pricing?
- Has each product shown consistent growth in usage and revenues? How many clients are using each additional financial product in the most recent period?
- Does the MFI break down profitability by product line so it can track the product's profitability given fully loaded costs? Verify whether the products enhance the MFI's core loan and deposit services and whether they are tied to those services.

4.4 Nonfinancial products

★ **What nonfinancial products—such as marketing services or financial management training—does the MFI offer?**
★ **How do these contribute to the MFI's overall services and respond to client demand?**

- Summarize all the MFI's nonfinancial products, indicating whether they are tied to financial products (for example, if business training is a loan condition). Are they managed separately from financial products? Doe the accounting system separate income and expenses for financial and nonfinancial products?
- What is the measurable impact of nonfinancial products on clients and the MFI's profitability? [33]

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[31] See Churchill et al. 2003.

[32] Checking and payment accounts are uncommon in many MFIs. For information on money transfers and MFIs, see Isern, Deshpande, and van Doorn 2005 and Isern, Donges, and Smith, 2006. For information on insurance, see the Microinsurance Focus (sponsored by the CGAP Working Group on Microinsurance) at www.microfinancegateway.org/section/resourcecenters/microinsurance. For information on leasing, see www.itcltd.com/microleasing/ and "Leasing in Development: Lessons from Emerging Economies," available at www.ifc.org. See also Westley 2003.

[33] Although most MFIs do not do so, CGAP's Disclosure Guidelines recommend that a separate profit and loss statement be prepared for material nonfinancial products, indicating operational income and expenses (including overhead) associated with each.

- Are these products appropriate for the MFI's business model, and consistent with its mission and vision?
- Are donors encouraging or supporting any specific nonfinancial products? Provide any available information on the extent of subsidization of nonfinancial products.
- Analyze each nonfinancial product in terms of design, marketing, delivery, maintenance, and other relevant characteristics.
- Where information is available, for each additional nonfinancial product, indicate the number of clients using it in the most recent period.

Table 4.5 summarizes all of the MFI's products—savings and loans, financial, and nonfinancial—and client use and revenue contribution analysis of each.

Table 4.5 Analysis of Product Lines

					As of Date: Currency:	
	Product Balance	**% of Total Product Balance**	**# Active Clients**	**% of Total Clients Clients**	**Total Fee Revenue**	**% of Total MFI Fee Revenue**
Savings Products						
Savings Product 1						
Savings Product 2						
Savings Product 3. . .						
Total Savings Products						
Loan Products						
Loan Product 1						
Loan Product 2						
Loan Product 3. . .						
Total Loan Products						

						As of Date: Currency:	
Table 4.5 Analysis of Product Lines (continued)		**Product Balance Product**	**% of Total Clients Balance**	**# Active Clients**	**% of Total Clients**	**Total Fee Revenue**	**% of Total MFI Fee Revenue**
Other Financial Products							
Other Financial Product 1							
Other Financial Product 2							
Other Financial Product 3. . .							
Total Other Financial Products							
Nonfinancial Products							
Nonfinancial Product 1							
Nonfinancial Product 2							
Nonfinancial Product 3. . .							
Total Nonfinancial Products							
Grand Total							
% Loan Products							
% Savings Products							
% Other Financial Products							
% Other Nonfinancial Products							
Note: Total costs should be consistently analyzed as either fully loaded or solely to reflect line of business costs.							

5

Social Performance[34]

★ **Does the MFI have clearly defined social goals—and a strategy for achieving them?**

The commissioning funder will decide whether to include analysis of the MFI's social performance in the appraisal. If so, the funder will need to budget sufficient time and ensure the analyst has the required skills to analyze social performance. An appraisal that includes a more comprehensive assessment of social performance will take longer than the standard one-week onsite visit. The amount of time needed depends on the nature and quality of relevant data available from the MFI. Further guidance on social performance analysis is provided in Annex 3.

Social performance in microfinance reflects how well an institution translates its social goals into practice. This section is designed to help the analyst draw conclusions about the MFI's social performance within the limits of a typical one-week appraisal visit.[35] The focus is on the MFI's systems for pursuing its social goals, breadth and depth of outreach, effectiveness in meeting client needs, and changes in the social and economic lives of its clients. Each area is analyzed using readily available data and interviews with the MFI's staff and clients and measured against the MFI's social mission.[36]

First, does the MFI have specific social performance objectives? Does it have specific indicators for measuring and managing progress toward those objectives? How has it performed on these measures?

Second, is the MFI achieving its goals for breadth and depth of outreach?

- How has the MFI defined its target client base? By income level? Location? Gender?

[34] See also, Social Performance Resource Center: www.microfinancegateway.org/resource_centers/socialperformance.
[35] Micro-Credit Ratings International Ltd (M-CRIL) uses a quick sample survey of recent clients for social rating purposes. For additional reference on social performance, see Sinha 2006. Funders interested in a rigorous analysis of an MFI's depth of outreach may consider applying CGAP's Poverty Assessment Tool (www.cgap.org/publications/technical_tools.html) or a similar framework. An impact assessment would require a separate study.
[36] Imp-ACT (www.imp-act.org) provides guidance on designing social performance management systems and may be a useful reference for analysts. See also the resources available through USAID's Assessing the Impact of Microenterprise Services Project (www.usaidmicro.org/pubs/aims/).

- What is the MFI doing to reach its desired clientele? For example, are human resource policies tailored and staff trained to ensure target clients are reached? Are credit policies and eligibility criteria for various loan products designed to focus on target clients?
- Does the MFI have a credible way to measure whether it reaches its target clients—for example, by quantifying the poverty level of its clients?

Third, is the MFI meeting the needs of its target clients?

- Which needs does the MFI seek to serve?
- What does the MFI do to better meet its target clients' needs? How do the variety, design, and delivery of its products reflect the needs of those clients? How do its institutional policies (on human resources, pricing, delinquency, dropout management, and the like) reflect their needs?
- Does the MFI have an effective system for monitoring its target clients' needs and their use of its services? Does it monitor product use by current and dropout clients? Does it monitor client satisfaction and reasons for dropping out?
- Is the MFI meeting its target clients' needs?

Finally, is the MFI having a measurable impact on improving the social and economic lives of its clients?

- What social and economic impacts does the MFI seek to have on its clients and their communities?
- Does the MFI have an effective system for tracking changes in the social and economic lives of its clients?
- Based on available information, what, if any, measurable improvements has the MFI made in the social and economic lives of its clients?

5.1 Intent and design

★ **Does the MFI have systems that are aligned with its social goals?**

★ To what extent has the MFI adapted its product designs, loan policies, and staff hiring, training, and incentives to ensure it reaches its target clients?

- Does the MFI have adequate monitoring systems and procedures to track welfare changes at the level of client households?
- Are the indicators used to track changes in the social and economic status of clients appropriate? To the extent possible, review the MFI's data and compare with data collected during client interviews. Verify the reliability of both sets of data in terms of their independence and how representative they are of the MFI's clients.

Other topics to consider include the following:

- How are social objectives defined? What social values guide the MFI?
- What areas and clients are targeted?
- What is the MFI's governance policy, in terms of balance between social and financial priorities?
- How does management use systems—such as staff training and incentive systems—to support social performance goals?
- What is the MFI's approach to gender (neutral, supportive, or transformative)?
- How are monitoring and reporting conducted? How is this information used to support social performance outcomes?

5.2 Depth and breadth of outreach

Note: Rather than compiling data for funders, this section is designed to gather information for MFIs to show how they are serving their clients and examine their social performance. (See Annex 3.)

★ **Is the MFI achieving its desired depth and breadth of outreach? If not, does it have credible plans to do so?**

- Depending on available information, summarize the MFI's outreach in Table 5.1. Include historical data if readily available; explain which poverty tool was used. In countries in which absolute poverty assessment tools, such as the Progress Out of Poverty Index (PPI) and/or USAID Poverty Assessment Tool (PAT), are available, they should be used.[37] A relative poverty tool can be used in other countries. The analyst should cite which tool is

[37]A list of countries in which these tools are available may be found at http://www.povertytools.org/USAID_Tools/USAID_Tools.htm and http://www.microfinance.com/#Poverty_Scoring. Additional information on poverty tools maybe found at http://www.microfinancegateway.org/resource_centers/ socialperformance/.

Table 5.1 Outreach Summary

		Prior Year 1	Prior Year 2	% Change
1	Population of region(s) covered			
2	Market size (if available)			
Breadth of Outreach				
3	Total number of active clients end of period			
4	Total number of loan clients			
5	Total number of savings clients (voluntary)			
6	Percentage of clients who are women			
7	Percentage of clients located in rural areas			
Depth of Outreach*				
8a**	Percentage of recent clients living below the national poverty line			
8b	Percentage of clients living on less than PPP adjusted US$1 per day			
9	Mean or median loan balance as % of national poverty line or GNI			
10	Mean or median voluntary savings balance as % of national poverty line or GNI			

** If relative poverty is being measured, specify which relative poverty assessment tool is being used.
** The MFI should define what it means by the term *recent* clients. For example, M-CRIL rating agency defines *recent* as less than two completed years.

being used when presenting the data.[38] Provide any variations on the data in Table 5.1 that the MFI tracks, such as average first loan size. If the MFI targets a group other than women or rural clients, adapt Table 5.1 to reflect the institution's focus.

- Is the MFI reaching its desired target client base, such as by income level, location, or gender?
- Does the MFI have clearly defined depth (poverty) and breadth of outreach objectives (across economic sectors)?
- What key characteristics of the environment affect the MFI's potential (and costs) to achieve its social goals? Comment on locations (urban, periurban, rural, remote rural),

[38] In the absence of credible data, M-CRIL uses a quick sample survey of recent clients for social rating purposes. For a list of relative poverty tools, please see http://ww.microfinancegateway.org/resource_centers/socialperformance/targeting.

level of conflict, population density, infrastructure (roads, electricity, telephone, Internet), social context (gender indicators, women's engagement in economic activities, literacy), and legal and regulatory environment (certain services cannot be performed at all or in a way that reaches the target population). Include data on regional development rankings relative to the national average.

- Compare the MFI's client base with the population and market size for its target region(s). How does the MFI classify its clients—for example, by economic activity (commerce, manufacturing, services, agricultural production and processing), gender, geographic location (rural, urban)?
- Does the MFI have evidence that it is meeting its outreach objectives? Does it have credible information about outreach to target groups and the socioeconomic levels of clients when they join the program? (Relate this to the poverty line, if possible.)
- In areas with several microfinance providers, does the MFI have information on whether its clients are also clients of other MFIs or microfinance programs?

5.3 Changes in the social and economic lives of clients and their households

This section applies only if the MFI is explicitly trying to improve the social and economic lives of its clients.

★ **Have the social and economic lives of the MFI's clients improved since they became clients?**

- If needed, open-ended questions can be posed to clients (and savings and loan officers) about their perceptions of the MFI, such as what they like and do not like about its products.
- If further information is required, the analyst can consider incorporating additional market research, adding time to the appraisal to do so.
- Does the MFI have a credible way to measure whether it reaches its target clients—for example, by quantifying their poverty level? Is it achieving its intended breadth and depth of outreach objectives? Is it having a measurable impact on the social and economic lives of its clients? Does it have an effective system to track changes in the social and economic lives of its clients?

- Review any available and reliable data, monitoring reports, or impact assessments (including external reports). Based on such information, have there been improvements in the social and economic lives of clients? Socially, has program participation increased clients' confidence and empowerment and improved their status in the household or community? Economically, are clients better off, less vulnerable, or better able to cope with crisis and lean periods? Have there been any negative effects? Relate findings to the MFI's target clients and services.

6

Loan Portfolio Quality [39]

★ **Is the MFI effectively measuring, monitoring, and managing portfolio risk to maintain its viability?**

Table 6.1 Loan Portfolio report

						Currency:
		Prior Year 1 (Amount)	Prior Year 2 (Amount)	% of Average Gross Loan Portfolio	Current, as of (Date) (Amount)	% of Average Gross Loan Portfolio
1	Number of overdue loans					
2	Loans at Risk					
3	Loan Loss					
4	(amount) Loan losses written off over the period					
5	Increase in Impairment Allowance over the period					
6	Principal Loan Balance for Loans that have never been renegotiated: Current 1–30 days overdue 31–90 days overdue					

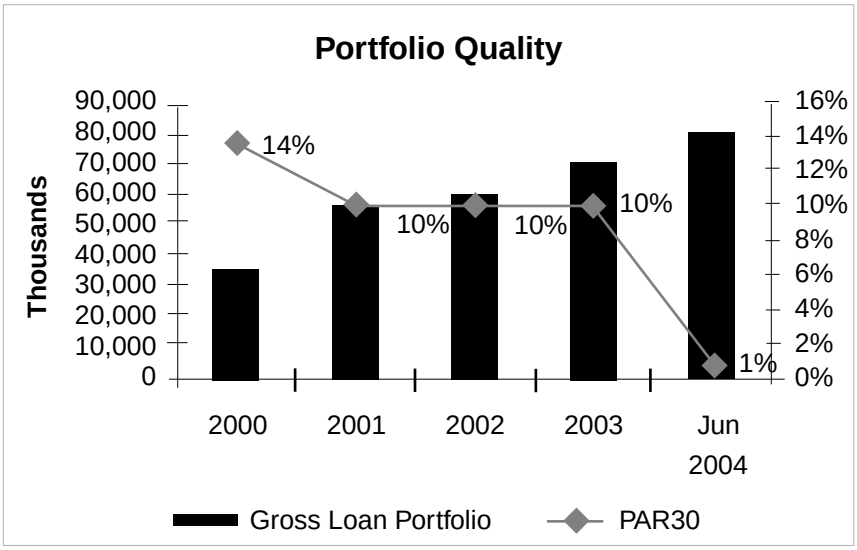
[39] For additional guidance on how to test a loan portfolio, see Christen 2005 and MicroSave, *Loan Portfolio Audit Toolkit,* at http://www.microsave.org/relateddownloads.asp?id=14&cat_id=313&title=Loan+Portfolio+Audit+Toolkit.

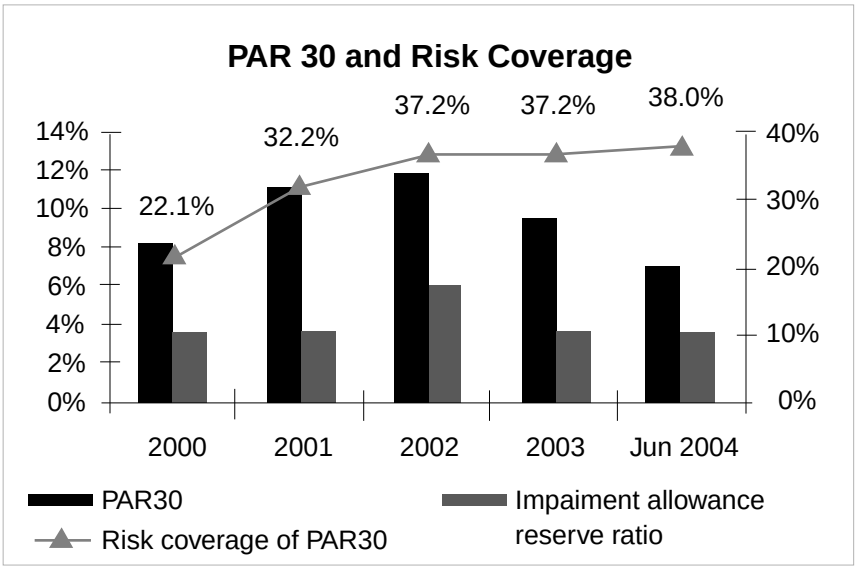
						Currency:
	Table 6.1 Loan Portfolio Report (continued)	**Prior Year 1 (Amount)**	**Prior Year 2 (Amount)**	**% of Average Gross Loan Portfolio**	**Current as of (Date Amount)**	**% of Average Gross Loan Portfolio**
	91–180 days overdue 181–365 days overdue > 365 days overdue					
7	Principal Loan Balance for Renegotiated Loans Current 1–30 days overdue 31–90 days overdue 91–180 days overdue 181–365 days overdue > 365 days overdue					
8	Total gross loan portfolio					

Note: If the MFI does not have systems in place to calculate portfolio at risk (PAR), it can manually calculate loans at risk instead. In addition, the analyst can calculate the current recovery rate, even from a sample of loans. (See also Rosenberg 1999.)

Prepare an aging of the loan portfolio in Table 6.1, including a breakdown based on whether loans have been renegotiated.

- ★ What method does the MFI use to determine portfolio quality? Does this method hide risk?
- ★ What is the trend in portfolio quality? Is portfolio quality affected by seasonal factors?
- ★ Provide a two-year summary of the portfolio, including allowance for impairments (formerly called loan loss allowances), loan loss rates, and write-offs, noting trends in the combined story of these variables. (This can possibly integrate findings from Table


Portfolio Quality
Thousands
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
16%
14%
12%
10%
8%
6%
4%
2%
0%
14%
10%
10%
10%
1%
2000
2001
2002
2003
Jun 2004
Gross Loan Portfolio
PAR30


PAR 30 and Risk Coverage
14%
12%
10%
8%
6%
4%
2%
0%
40%
30%
20%
10%
0%
22.1%
32.2%
37.2%
37.2%
38.0%
2000
2001
2002
2003
Jun 2004
PAR30
Impaiment allowance reserve ratio
Risk coverage of PAR30

4.3 and Table 6.1.) Is the MFI's loan loss provisioning policy adequate and in compliance with any legal requirements?[40] Evaluate whether the MFI's allowance for impairments is adequate, given its historical portfolio quality and write-offs.

- ★ What is the write-off policy? Is it prudent, given the MFI's history and operations?
- ★ What is the MFI's policy and practice for restructuring loans?
- ★ What percentage of the portfolio of renegotiated loans is more than 30 days past due?[41]
- ★ Does the MIS provide a clear idea of the MFI's PAR by product, branch, or loan officer? If so, is risk concentrated in a certain product, branch, loan officer, or other identifiable area?
- ★ How easy is it to track loans from disbursement to final payment? Are in-kind, delinquent, and refinanced loans tracked separately in the MIS?
- ★ What do the MFI's board and management consider acceptable levels of delinquency?
- ★ Has the MFI experienced any delinquency crises in the past five years? (How does the MFI define crisis?) If so, what did it do about them? What was the result?
- ★ Discuss whether the MFI's collections policy is sufficiently aggressive and effective.
- ★ What is the extent of loans to the MFI board and staff? Does the MFI board or staff receive preferential interest rates on loans or preferential treatment for loan disbursement or collection?
- ★ Has the MFI had any independent testing of its portfolio, such as special audit procedures arranged for that purpose?[42] If not, the analyst may consider evaluating the procedures auditors used to test the MFI's portfolio information, especially for delinquency and default. (The risk of inadequate control and reporting of portfolio quality is among the most significant in an appraisal.)
- ★ The analyst should conduct a spot check on 20–50 of the MFI's largest loans. (This may include detailed scrutiny of loan files, payment vouchers, and electronic data in the local accounting system and spot checks on a random sample of customers.)

⚠ When reviewing trends in loan portfolio quality, pay close attention to both absolute amounts of the past due portfolio and indicators of the past due portfolio relative to the total portfolio, because rapid growth in the portfolio can mask increases in delinquency and so dilute measures of PAR.

⚠ Does the MFI have a PAR greater than 30 days (PAR30) of more than 10 percent, a write-off ratio of more than 5 percent, or a large number or percentage of renegotiated loans? If so, is management aware of such concerns—and taking realistic, sufficient steps to strengthen the portfolio?

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[40] Legal requirements are often less stringent than needed for MFIs because they are based on collateral-based lending.

[41] If the MFI has significant overdue loans in the renegotiated loan portfolio, it may be on the verge of collapse and should be examined carefully.

[42] Normal audits and ratings seldom include procedures sufficient to provide reliable assurance that an MFI's portfolio quality reporting is accurate.

7

Financial Performance and Risk Management

- ★ **Is the MFI efficient and profitable? If not, does it have a credible plan to become profitable in a reasonable time? What is management's attitude toward profitability?**
- ★ **Do the MFI's financial statements and performance reflect a sound financial institution, as shown by strong portfolio quality, profitability and sustainability, asset–liability management, and efficiency and productivity ratios—relative to other MFIs in the country and relevant international benchmarks?**
- ★ **Does the MFI use sound financial risk management to protect against losses, attract capital, and instill confidence? Does the MFI adequately monitor, manage, and mitigate its main financial risks?**
- ★ **Can the MFI manage the financial implications of its growth—for example, by attracting new funding, increasing savings, improving cash and liquidity management, and strengthening its portfolio?**

- Financial performance is best evaluated in light of the institution's context and stage of development. Note where the MFI's key strategic moves may have adverse short-term financial consequences but positive long-term effects.
- Before completing this section, the analyst may first want to input and adjust the MFI's income, balance sheet, and cash flow data in appraise.xls (the accompanying spreadsheet). Annex 5 describes each of the line items needed for the income statement, balance sheet, and cash-flow statement. Appraise.xls then requires inputs to make analytical adjustments to the financial statements and calculate information that can be benchmarked against the MFI's peer group, as defined in the *MicroBanking Bulletin* (see www.mixmbb.org and Annex 8). Annex 6 describes these adjustments. Table 7.6 summarizes the macroeconomic data inputs; Table 7.9 shows the analytical adjustments. The analyst should provide explanatory notes for all appropriate items—especially for any adjustments derived using methods that differ from the instructions.

7.1 Financial statement analysis

★ **Do the MFI's financial statements and performance reflect a sound financial institution?**

Include the MFI's income statement and balance sheet in the final appraisal report. If a cash-flow statement is available and/or required by the funder, it should be included in the appraisal.[43]

Table 7.1 Income Statement

				Currency:
		Prior Year 1	**Prior Year 2**	**Current, as of (date)**
1	**Financial Revenue**			
2	Financial Revenue from Loan Portfolio			
3	Interest on Loan Portfolio			
4	Fees and Commissions on Loan Portfolio			
5	Financial Revenue from Investments			
6	Other Operating Revenue			
7	**Financial Expense**			
8	Financial Expense on Funding Liabilities			
9	Interest and Fee Expense on Deposits			
10	Interest and Fee Expense on Borrowings			
11	Other Financial Expense			
12	**Net Financial Income**			
13	Loans Impairment			
14	Provision for Loan Impairment			
15	Value of Loans Recovered			
16	**Operating Expense**			
17	Personnel Expense			

[43] If needed, the cash flow statement can be created in Appraise.xls. It does not need to be created unless specifically requested by the funder. More and more funders require current cash flow statement and one to two years of historical cash flow statements. For example, a cash flow statement is one of the criteria for the CGAP Financial Transparency Award and is a requirement for compliance with International Financial Reporting Standards. Some country regulations also require cash flow statements for an MFI.

				Currency:
Table 7.1 Income Statement (continued)		**Prior Year 1**	**Prior Year 2**	**Current, as of (date)**
18	Administrative Expense			
19	Depreciation Expense			
20	Other Administrative Expense			
21	**Net Operating Income**			
22	**Net Nonoperating Income/(Expense)**			
23	Nonoperating Revenue			
24	Nonoperating Expense			
25	**Net Income (Before Taxes and Donations)**			
26	Taxes			
27	**Net Income (After Taxes and Before Donations)**			
28	**Donations**			
29	Donations for Loan Capital			
30	Donations for Operating Expense			
31	**Net Income (After Taxes and Donations)**			

Table 7.2 Balance Sheet

				Currency:
		Prior Year 1	**Prior Year 2**	**Current, as of (date)**
Assets				
1	Cash and Due from Banks			
2	Trade Investments			
3	**Net Loan Portfolio**			
4	Gross Loan Portfolio			

				Currency:
Table 7.2 Balance Sheet (continued)		**Prior Year 1**	**Prior Year 2**	**Current, as of (date)**
Assets				
5	Allowance for Impairment			
6	Interest Receivable on Loan Portfolio			
7	Accounts Receivable and Other Assets			
8	Other Investments			
9	**Net Fixed Assets**			
10	Fixed Assets			
11	Accumulated Depreciation and Amortization			
12	**Total Assets**			
Liabilities				
13	Demand Deposits: Voluntary Savings			
14	Demand Deposits: Forced Savings			
15	Short-Term Time Deposits			
16	Short-Term Borrowings			
17	Interest Payable on Funding Liabilities			
18	Accounts Payable and Other Short-Term Liabilities			
19	Long-Term Time Deposits			
20	Long-Term Borrowings			
21	Other Long-Term Liabilities			
22	**Total Liabilities**			

				Currency:
Table 7.2 Balance Sheet				
(continued)		**Prior Year 1**	**Prior Year 2**	**Current, as of (date)**
Equity				
23	Paid-In Capital			
24	Donated Equity			
25	Prior Years			
26	Current Year			
27	Retained Earnings			
28	Prior Years			
29	Current Year			
30	Reserves			
31	Other Equity Accounts			
32	**Adjustments to Equity**			
33	**Total Equity**			
Note: Demand deposits are broken out between voluntary and forced savings (rows 13–14), which differs from the SEEP FRAME tool.				

Table 7.3 Cash Flow Statement

				Currency:
		Prior Year 1	**Prior Year 2**	**Current, as of (date)**
Cash Flows from Operating Activities				
1	Cash Received from Interest, Fees, and Commissions on Loan Portfolio			
2	Cash Received from Interest on Investments			
3	Cash Received as Other Operating Revenue			
4	Value of Loans Repaid			
5	(Cash Paid for Financial Expenses on Funding Liabilities)			

				Currency:
Table 7.3 Cash Flow Statement (continued)		**Prior Year 1**	**Prior Year 2**	**Current, as of (date)**
Cash Flows from Operating Activities				
6	(Cash Paid for Other Financial Expenses)			
7	(Cash Paid for Operating Expenses)			
8	(Cash Paid for Taxes)			
9	(Value of Loans Disbursed)			
10	Net (Purchase)/Sale of Trade Investments			
11	Deposits/(Withdrawals) from Clients			
12	Cash Received/(Paid) for Other Operating Assets and Liabilities			
13	**Net Cash from Operating Activities**			
Cash Flows from Investing Activities				
14	Net (Purchase)/Sale of Other Investments			
15	Net (Purchase)/Sale of Fixed Assets			
16	**Net Cash from Investing Activities**			
Cash Flows from Financing Activities				
17	Net Cash Received /(Repaid) for Short- and Long-Term Borrowings			
18	Issuance/(Repurchase) of Paid-In Capital			

				Currency:
Table 7.3 Cash Flow Statement (continued)		**Prior Year 1**	**Prior Year 2**	**Current, as of (date)**
Cash Flows from Financing Activities				
19	(Dividends Paid)			
20	Donated Equity			
21	**Net Cash from Financing Activities**			
22	**Net Cash Received/(Paid) for Nonoperating Activities**			
23	**Net Change in Cash and Due from Banks**			
24	**Cash and Due from Banks at the Beginning of the Period**			
25	Exchange Rate Gains/(Losses) on Cash and Cash Equivalents			
26	**Cash and Due from Banks at the End of Period**			

★ Analyze the main components of the financial statements, adapting the guidelines below as needed.[44]

- What are the MFI's key accounting policies? Does it use cash or accrual accounting? How does it account for interest on delinquent loans? Does it unduly capitalize expenditures, such as for group formation? Does it have a policy on accounting for foreign exchange gains (or losses)?

Income statement analysis

Income

★ Evaluate income growth over the past two to three years.

★ Has income growth kept pace with portfolio growth?

[44] See section 3.8 External Audit for more information regarding the MFI's audited financial statements.

- ★ Have there been any significant changes in the composition of income (interest versus fees)?
- ★ How have changes in product composition affected income?
- ★ How has asset allocation affected income?
- ★ How have profit margins evolved (net operating income as a share of total operating revenue)?

Expenses

- ★ Have expenses grown faster or slower than income?
- ★ What are the largest components of expenses? How have these evolved?
- ★ What (if any) measures is the MFI taking to contain expenses?
- ★ How do the MFI's expense ratios compare to peer benchmarks?
- ★ Are there any unusual one-time expenses, such as a large foreign exchange or inflation adjustment loss?

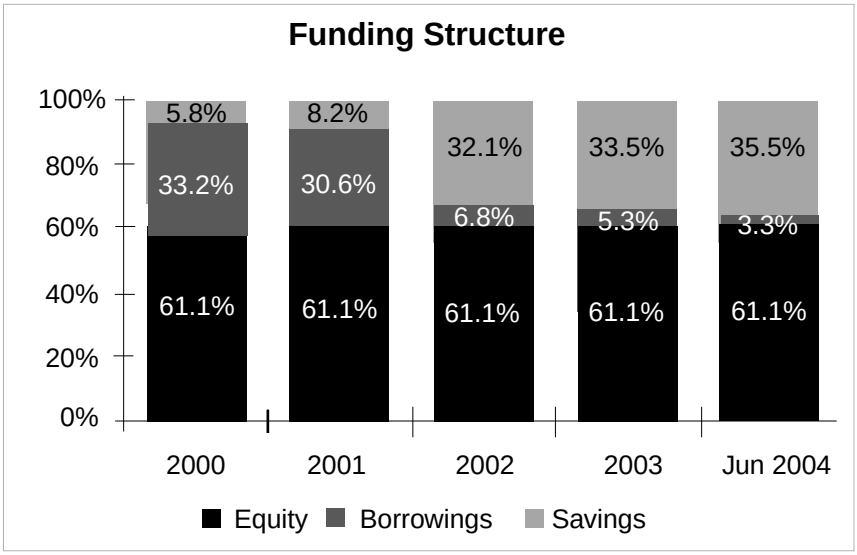
NET INCOME

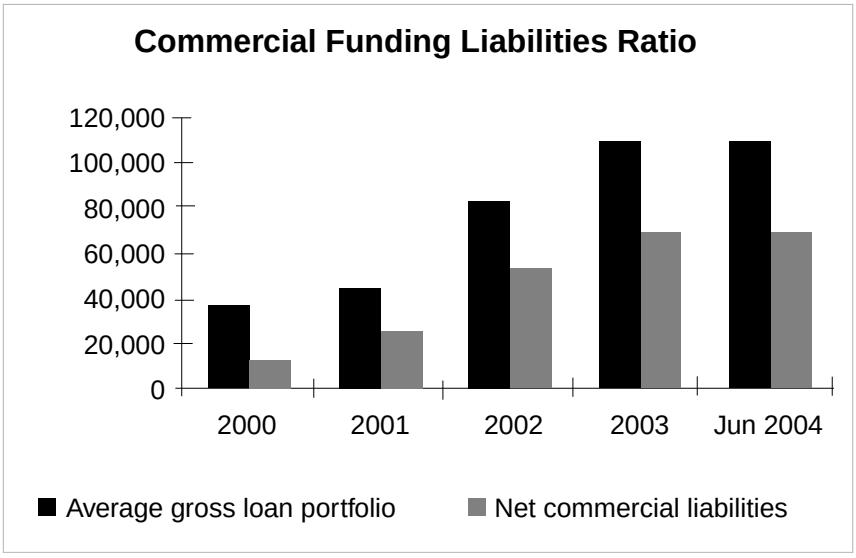
- ★ How have profit margins evolved (net operating income as a share of total operating revenue)?
- ★ Have absolute profit levels increased proportionate to growth in portfolio, number of clients, or other drivers?

Balance sheet analysis

Assets

- Describe the MFI's main assets and calculate the loan portfolio as a percentage of total assets.
- Does the MFI maximize asset returns through appropriate asset allocation?
- Have assets grown significantly over the past three years? Has portfolio growth kept pace? Does the MFI maintain sufficient liquid assets for its liquidity needs? If the MFI's assets are highly liquid, is there a prudent financial reason? Are any assets restricted, such as mandatory reserves placed in a central bank? Are there any significant issues with large fixed assets (such as if the MFI buys a building)?
- Are assets primarily funded by debt or equity?
- Are assets used productively, with a majority funding the portfolio?
- How well does the MFI manage its funds?





LIABILITIES

- Are the MFI's funding liabilities by source, product, and pricing competitive (in pricing and terms), given its age and size? How stable and assured are the MFI's sources of funding liabilities now and in the short term?
- What percentage of the loan portfolio do voluntary savings fund? How has this affected the MFI's cost of funds?

- What percentage of the portfolio do funding liabilities finance? Has the MFI accessed commercial funds? If so, what has been its experience? Describe the sources, terms, and track record (credit history, repayment experience, and so on).
- If known, what have been the historical trends in the MFI's funding liabilities, in terms of commercial versus noncommercial, domestic versus international, and short term versus medium and long term?
- Are the MFI's assets and liabilities in different currencies? Is so, is there a significant mismatch? Does it expose the MFI to foreign exchange risk?
- Using data from Table 7.4, summarize trends in funding liabilities based on their type, range, and average tenor and cost. What is the MFI's weighted average cost of funds?
- If the institution is a cooperative or credit union, does it classify member shares as liabilities or as equity?[45] What are the implications of how member shares are classified on its balance sheet?
- For cooperatives or credit unions and, if relevant, for other share-capital companies, if member shares are considered liabilities, how are the shares distributed, and what is the structure for distribution of profits and dividends?

Concentration risk

⚠ Are the MFI's assets, liabilities, or both heavily concentrated in one or two financial institutions? How strong are those institutions? What are the implications of their potential failure?

⚠ In the case of a deposit-taking MFI, are liabilities concentrated among a few individuals or nonfinancial institutions with large deposits? How would the MFI be affected by a run on deposits or a sudden significant withdrawal of funds?

Table 7.4 Composition of Funding Liabilities

		As of (Date):
		Currency:
Liability 1		
1	Creditor (specify if domestic or international)	
2	Commercial or noncommercial liability (note method of calculation if needed)	
3	Tenor (Term)	
4	Original principal balance	
5	Balance outstanding	
6	Currency in which repayment is due	
7	Interest rate	

[45] See IASB 32 Financial Instruments: Disclosure and Presentation, and IFRIC Interpretation 2: Member Shares in Co-operative Entities and Similar Instruments. The World Council of Credit Unions advocates classifying member shares as liabilities because they can be withdrawn.

		As of (Date):
		Currency:
Table 7.4 Composition of Funding Liabilities (continued)		
Liability 1		
8	Amortization schedule	
9	Details of external guarantee backing the credit extended to the MFI, if any	
10	Other relevant information	
Liability 2 …		
Note: The risk-free interest rate is the basis to determine whether liabilities are priced at commercial or noncommercial rates (and so track the degree of subsidy). Note that this table excludes deposits, accounts payable, and other nonfunding obligations.		

Equity

★ What are the MFI's main sources of equity?

★ How much of the MFI's equity is donated or subsidized, as opposed to derived from retained earnings? If a lot of its equity and funding is donated, does the MFI have a realistic plan for mobilizing commercial funds and/or raising net income to increase retained earnings?

★ Does the MFI have any current or anticipated funding shortfalls?

★ Do sources of equity capital (current or original investors, donors, or shareholders) exercise ownership of the MFI? Is the MFI appropriately leveraged?

- Analyze cumulative gains and losses from operations.
- Does the MFI meet voluntary (for an NGO) or mandatory (for a regulated MFI) prudential capital requirements?
- Are there any plans, in the short or long term, for employee ownership?
- For cooperatives or credit unions and, if relevant, for other share-capital companies, analyze the MFI's net capital[46] position. What have been the trends in net capital over time? If it has declined, was it because of losses in loans, failure to provision, operating losses, or deposits growing faster than capital reserves? If there was a large drop in net capital, what was the shock that caused the drop, and how is the institution rebuilding its net capital base?

[46] Net capital in a credit union is defined as tier one capital less any losses.

Table 7.5 External Grants and Subsidies

				As of (Date):
Source, Date, Terms		**Amount**	**Currency**	**Funding Status**
Grants				
1				
2				
3				
Etc.…				
Significant In-kind Subsidies				
1				
2				
3				
Etc.…				
Note: Include in-kind subsidies and an estimate of their value.				

More broadly, what does current net capital reveal about the institution's history of retained earnings, business and social philosophy (based on extent of reinvested retained earnings), asset quality, provisioning, pricing, and cost management?

⚠ Using data from Table 7.5, calculate the MFI's accumulated losses—including a break-out between grants plus subsidies and operating results—since its inception.[47]

Cash flow statement analysis

Include this only if the MFI calculates a cash flow or the analyst feels that such analysis is needed.

- ★ Has the MFI had a positive cash flow for the past two years?
- ★ Note any significant trends in cash flow.

Asset–liability management

- ★ **Is the mix of the MFI's assets and liabilities appropriate for the scale and maturity of its operations?**
- ★ Is the MFI matching the rates and tenors of its assets and liabilities?

[47] Refers to historical and current grants for equity and concessional liabilities. There are several accounting methods for booking donor grants to an MFI. The important point is that all grants for current and previous years should appear separately from retained earnings and other items in the equity section of the balance sheet. Material in-kind subsidies should be included as well.

★ How leveraged is the MFI when compared to peers with similar legal structures?[48]
★ How does the MFI's cost of funds affect its profitability?
★ Does the MFI have a credible strategy for lowering its cost of funds?
★ Does the MFI have any significant asset–liability risks that should be further investigated? (For example, to what degree is it exposed to repricing risk on its deposits or other liabilities?)

- If the MFI is mature and has sophisticated systems, the analyst can review the effectiveness of the stated asset–liability management policies, the functioning of any risk management committee(s) the MFI convenes, and the abilities of staff or Board involved in asset–liability management.
- Have there been any significant changes in asset and liability risk levels or risk tolerance?
- If the analyst has cause for concern that asset–liability mismatches—such as those driven by interest rates, the tenor of assets versus liabilities, concentration of savings deposits or large foreign exchange risks—may cause significant damage to the MFI's financial position, further analysis is available in Annex 7. The typical MFI being appraised will not need this in-depth analysis; it should be used only if there is a serious concern.

7.2 Analytical adjustments

Key financial rates are required to calculate the analytical adjustments to the MFI's financial statements.[49] Shadow prices from a standard source, such as the International Monetary Fund (IMF),[50] are recommended to create a data set comparable with those in the *MicroBanking Bulletin*. Several different rates can be used as shadow prices, including the following:

- Inflation rate or GDP deflator
- Rate commercial banks charge conventional, medium-grade customers or, if the MFI already borrows commercial funds, the marginal rate charged to the MFI for any additional loan
- 90-day deposit rate (if using a deposit rate lower than the rate for 90-day certificates of deposit, an appropriate amount should be added to reflect the MFI's likely cost of managing such deposits)
- Overdraft lending rate from the central bank[51]

[48] The *MicroBanking Bulletin* (www.mixmbb.org) can be used to benchmark the MFI's leverage against peer institutions.
[49] More details on analytical adjustments are available in SEEP Network 2005, pp. 39–64.
[50] Regularly updated IMF statistics are available on a country-by-country basis at www.mixmarket.org/en/environment/environment.search.asp.
[51] The overdraft lending rate is the minimum interest rate at which banks can access funding.

The selected shadow prices and exchange rates should be shown in Table 7.6.[52] In all cases, indicate what kind of rate has been selected and the source for determining it. Note the adjustment amounts for the past two years and current period and use them to calculate the adjusted line items for the income statement and balance sheet in Table 7.9.[53] These adjustments are used to calculate adjusted financial ratios.

These adjustments can be calculated easily using the accompanying spreadsheet (appraise.xls). The results flow into Table 7.9, on analytical adjustments, and into the financial statements and performance ratios.

Table 7.6 Macroeconomic Data

		Prior Year 1	Prior Year 2	Current, as of (date)
1	Inflation rate			
2	GDP deflator			
3	Market rate for borrowings (IMF statistics)			
4	90-day certificate of deposit rate			
5	Prime rate paid by commercial bank borrowers			
6	Marginal commercial rate available to the MFI			
7	Per capita GDP			
8	Per capita GNI			
9	Exchange rate (local currency/ other currency)			
10	National poverty line			
Note: Analyst should pick either GDP or GNI as basis for calculations, depending on which figure is more readily available.				

[52] For interest rates, use annual percentage rates (APRs) when available. To calculate APRs starting with the effective rate for one period, annualize the rate by multiplying it by the number of periods in a year. Indicate when rates are not APRs. Average inflation and exchange rates over a period should be used to adjust flows (income statement items); end-of-period figures should be used to adjust stocks (balance sheet items).

[53] Analysts may use opening balances instead; in this case a separate adjustment should be calculated if there has been a major change in the balance sheet during the year (for example, a large grant), using the accumulated inflation between the time of the grant and the end of the year.

For the calculations in Table 7.7 and 7.8, if possible, calculate monthly averages by summing the opening balance and the end-of-month balances and then dividing by the number of months plus one. As an alternative, use quarterly or annual balances.

7.3 Financial performance ratios analysis

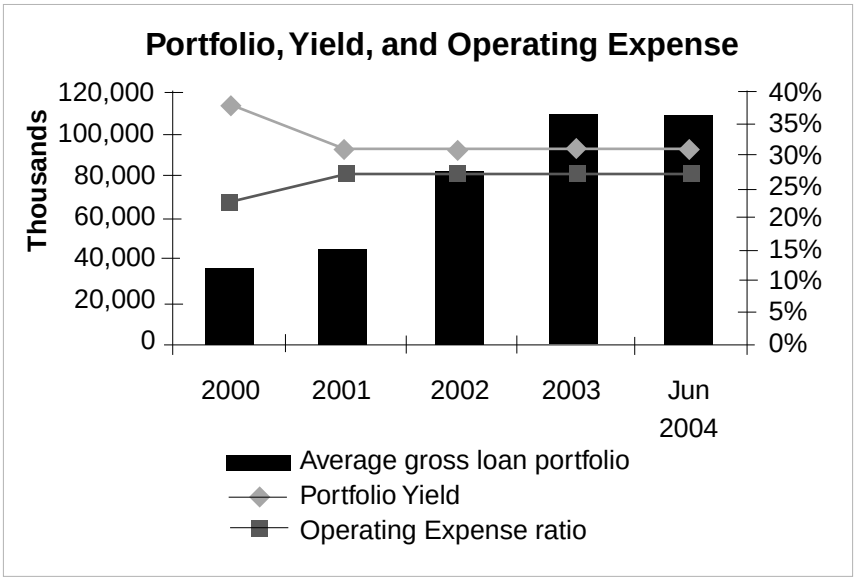
★ **Does the MFI's financial performance reflect a sound financial institution as demonstrated by strong portfolio quality, profitability and sustainability, asset–liability management, and efficiency and productivity ratios, relative to other MFIs in the country and relevant international benchmarks?**

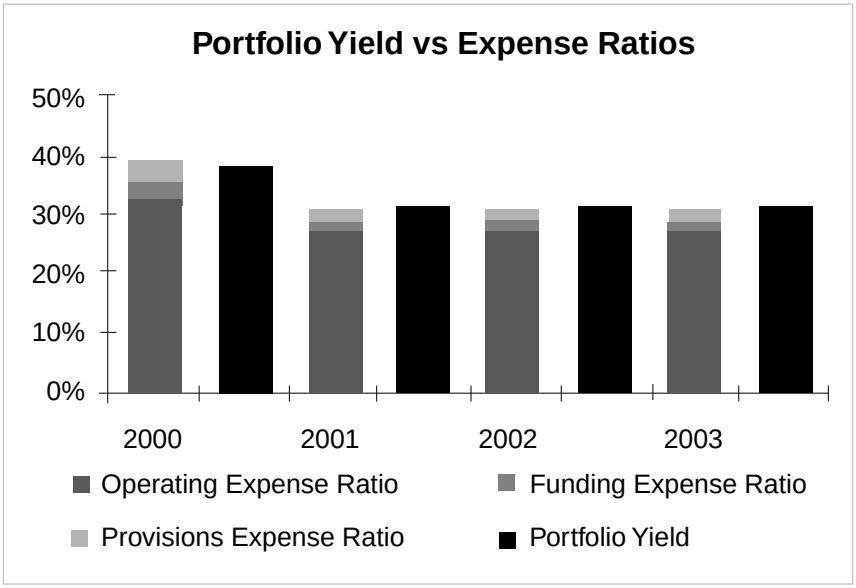
Table 7.9 Analytical Adjustments

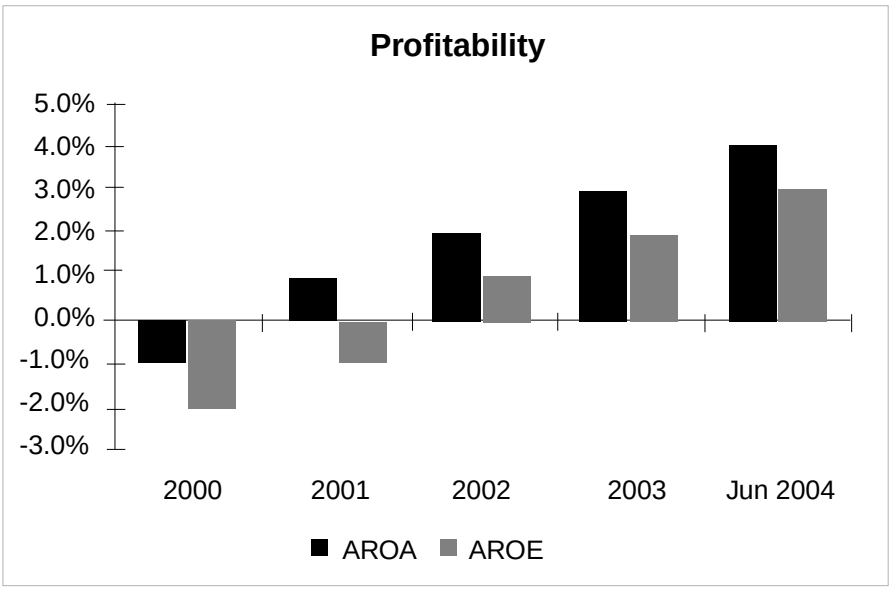
		Prior Year 1	Prior Year 2	Current, as of (date)
1	Subsidized cost of funds adjustment			
2	In-kind subsidy adjustment			
3	Inflation adjustment (3a minus 3b)			
3a	*Equity accounts portion*			
3b	*Net fixed assets portion*			
4	Write-off adjustment			
4a	Portfolio at risk > 180 days			
4b	Number of loans > 180 days			
5	Allowance for impairment adjustment			
BS and IS line items				
6	Unadjusted financial expense			
7	Unadjusted net impairment expense			
8	Unadjusted operating expense			
9	Unadjusted net operating income			
10	Unadjusted assets			
11	Unadjusted equity			
12	Unadjusted gross loan portfolio			
13	Unadjusted number of loans outstanding			
Adjusted BS and IS line items				
14	Adjusted financial expense			
15	Adjusted net impairment expense			
16	Adjusted operating expense			
17	Adjusted net operating income			
18	Adjusted assets			
19	Adjusted equity			
20	Adjusted gross loan portfolio			
21	Adjusted number of loans outstanding			

Multiple indicators, when evaluated and together, tell a story about the MFI's performance. This Resource Manual examines 18 key financial ratios recommended by SEEP (R1–R18 in Table 7.7) that address four areas of financial performance: portfolio quality, profitability and sustainability, asset–liability management, and efficiency and productivity (SEEP Network 2005). Table 7.7 presents these ratios and other selected performance indicators. Analyze the MFI's financial performance over time, noting trends and possible explanations.

Benchmarking allows MFI management and board members to understand their performance relative to that of other MFIs that are similar in terms of age, legal structure (NGO, non-







bank financial institution, etc.), lending methodology (individual versus group lending), outreach (number of borrowers), region, and scale (size of loan portfolio). Appraise.xls indicators can be used for benchmarking against MicroBanking Bulletin data. Details on MBB peer groups are provided in Annex 8. Benchmark the most recent available full-year results for the MFI to appropriate peer institutions using the MBB benchmark definitions and data.[54] If information is available and the analysis is useful, consider benchmarking the MFI's most mature branch to the appropriate MBB peer group.[55] Credit union financial performance can be evaluated using appraise.xls and PEARLS[56] or a similar rating system, and benchmarked against both MicroBanking Bulletin data and the International Credit Union Safety and Soundness Principles developed by the World Council of Credit Unions.[57]

Profitability and sustainability

- ★ What are the MFI board and management's attitudes toward profitability? Is it considered a desirable and attainable goal? A pipe dream? Or is it viewed with suspicion?
- ★ Is management aware of the factors impeding profitability? If so, how is it addressing them (for example, by repricing products, managing expenses more stringently, lowering the cost of funds)?

[54] Details on MBB peer groups can be found in Annex 8 and at http://www.mixmbb.org/Templates/Methodology.aspx
[55] In a rapidly growing MFI, most clients, staff, and branches are new, so today's performance may not indicate the performance likely in the future as growth slows and clients, staff, and branches mature. Benchmarking against mature branches and institutional peers helps explain the MFI's performance and trends.
[56] Further information on PEARLS can be found at: http://www.woccu.org/bestpractices/pearls/aboutpearls
[57] http://www.woccu.org/functions/view_documents.php?id=SafetyOperGovPrinciples

- How do trends in portfolio quality, pricing, and efficiency affect the MFI's profitability?
- How do the MFI's leverage and cost of funds affect its return on equity?
- How does the MFI set interest rates?
- Does the MFI have control over its product pricing, to ensure profitability?
- Do competitive pressures, usury limits, or other factors affect pricing?
- Does the MFI rely on a single financial product to drive profitability?
- How do trends in the distribution of the MFI's assets, liabilities, and equity affect profitability?

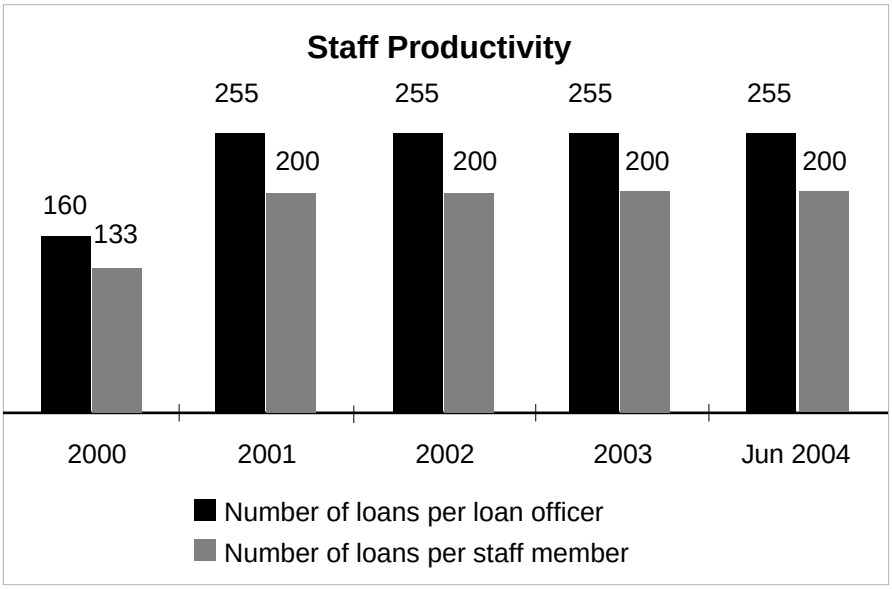
Efficiency and productivity

★ **Is the MFI efficient and productive relative to peer institutions and good practices?**[58]

★ What are key drivers of trends in efficiency?

★ Is the MFI operating at optimal efficiency and productivity levels? To answer this question, compare its performance to similar MFIs using MBB data, and evaluate management's plans to increase efficiency—including the measures and timeframe.

★ For a snapshot look at the MFI's efficiency, consider in tandem its average outstanding loan size (R17), borrowers per loan officer (R14), both from Table 7.7, and staff salary as a percentage of gross national income (GNI) per capita (the latter can be found in row 8 of Table 7.6).



[58] Benchmarks can be found at http://www.mixmbb.org/Templates/BenchmarksTrendLines.aspx. An explanation of the benchmarking process is found in Annex 8.

Table 7.7 Performance Ratios and Peer Group Benchmarking

		Prior Year 2	Current, as of (date)	MBB Peer Group [1]	Mature Branch
Profitability & Sustainability					
R1	Operational Self-sufficiency (OSS)				
R1	Financial Self-sufficiency (FSS)				
R2	Return on Assets (ROA)				
R2	Adjusted Return on Assets (AROA)				
R3	Return on Equity (ROE)				
R3	Adjusted Return on Equity (AROE)				
Asset/Liability Management					
R4	Yield on Gross Portfolio				
R5	Portfolio to Assets				
R6	Cost of Funds Ratio				
R6	Adjusted Cost of Funds				
R7	Debt to Equity				
R7	Adjusted Debt to Equity				
R8	Liquid Ratio				
Portfolio Quality					
R9	Portfolio-at-risk Ratio (PAR)30				
R9	Adjusted PAR Ratio				
R10	Write-off Ratio				
R10	Adjusted Write-off Ratio				
R11	Risk Coverage Ratio				
R11	Adjusted Risk Coverage Ratio				
Efficiency & Productivity					
R12	Operating Expense Ratio				
R12	Adjusted Operating Expense Ratio				
R13	Cost per Active Client				
R13	Adjusted Cost per Active Client				
R14	Borrowers per Loan Officer				
R15	Active Clients per Staff Member				
R16	Client Turnover				
R17	Average Outstanding Loan Size				
R17	Adjusted Average Outstanding Loan Size				
R18	Average Loan Disbursed				
Note: Appraise.xls can be used to provide additional performance indicators.					

7.4 Risk management[59]

This section is relevant only to large or mature MFIs. More information on financial risk management is available in Annex 7.

★ **Does the MFI understand the concept of risk management?**
★ **Is the MFI adequately measuring, monitoring, and managing its financial and operational risks?**

- Evaluate any financial risk management policies and practices. If the MFI is not familiar with financial risk management, discuss any training and steps being taken to better understand and address this topic.
- Does the MFI perform scenario or sensitivity analyses? If so, discuss the findings and how this information has been used.
- How complex is the MFI's balance sheet? Do the tenors of its liabilities and portfolio require active financial management? Mature MFIs usually form an asset–liability committee that meets regularly (weekly, monthly, or less desirably, quarterly).

7.5 Liquidity risk management[60]

★ **Does the MFI adequately monitor and manage its liquidity?**

★ Has the MFI set guidelines for how many months of operating cash it wants to maintain? If so, is it a realistic goal? Is it being achieved?
★ What liquidity management measures does the MFI have in place?
★ What plans does the MFI have to address liquidity shocks? How efficient are these plans?
★ Does the MFI have cash-flow projections? If so, have earlier projections been close to actual results?
★ Does the MFI adequately match assets and liabilities to reduce liquidity risk?
★ Does the MFI have an overdraft line of credit with a local bank? If the MFI takes deposits, does it adequately balance savings and liquidity requirements?
★ Does MFI management actively monitor liquidity management? (If so, note accountability, liquidity trends, ratios used, etc.)

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[59] More information on risk management in microfinance can be found at www.microsave.org/relateddownloads.asp?id=14&cat_id=59&title=Institutional+and+Product+Risk+%20Management.
[60] For more information on liquidity and cash management policies, see Women's World Banking 2005, pp. 24–30.

⚠ Has the MFI experienced any liquidity crises? If so, how were they handled? Did they affect loan disbursement or repayment of loans to the MFI or its ability to honor savings withdrawal requests from clients?

7.6 Interest rate analysis

★ **Given the local market, has the MFI set appropriate interest rates that will allow it to be profitable?**

★ How big is the gap between the weighted theoretical interest yield and the actual yield on portfolio? If it is more than 10 percent, explain possible reasons.

- How does the MFI establish and update loan (and deposit) interest rates?
- Are the MFI's interest rates appropriate and responsive both to its financial requirements and to external factors, such as inflation?
- Do external factors affecting interest rates—such as price competition and legal constraints—limit the interest rates the MFI can charge on loans?

Calculate the effective interest yields for single periods using a financial calculator or the model in appraise.xls, using the methodology outlined in Annex 9. Note these amounts in Table 7.8. Evaluate the gap between the weighted theoretical interest yield and the actual yield on portfolio (lines 4 and 5 of Table 7.8, per product). If the actual yield is less than 95 percent of expected yield, find out why.

Table 7.8 Comparison of Actual and Theoretical Yield

		Prior Year 1	Prior Year 2	Current as of (date)
Loan Product 1				
1	Theoretical interest yield (APR)			
2	Monthly average of outstanding balance on this loan product for the year (opening balance plus 12 month-end balance divided by 13).			
3	Line 1 times line 2			
Loan Product 2				
1	Theoretical interest yield (APR)			
2	Monthly average of outstanding balance on this loan product for the year (opening balance plus 12 month-end balance divided by 13).			
3	Line 1 times line 2			
Loan Product 3 …				
4	Weighted theoretical interest yield (sum of line 3 for all loan products)			
5	Actual yield on portfolio			
6	Yield gap ratio (line 5 as a percentage of line 4)			

8

Business Planning

★ **Does the MFI have a credible three- to five-year business plan and realistic financial projections to achieve or maintain profitability, given its current institutional capacity?**

★ How have the MFI's vision and mission changed over time?
★ Where does the MFI want to strategically position itself in the local market?
★ Does the MFI's business planning process support its direction and goals?
★ If the MFI is not yet profitable, describe its plan and timeframe for becoming profitable, and assess the plan's credibility. What are the potential threats to achieving the plan, including institutional risks (such as changes in target clients, limits in institutional capacity, labor disputes, and continued donor dependency) and external risks (regulatory, competitive, demographic, macroeconomic, political, and so on)?

- Does the MFI use short-term planning tools, such as budgeting and variance analysis?
- Does its management or board check variance analyses regularly during the year? If so, what are the findings? How is the information used?
- Does the MFI have a strategic or business planning process? If so, describe it: What and whom does it involve? Do staff members have an opportunity to provide input? Do the method and results appear sound? If the MFI has plans for any proactive or reactive shifts in strategy, comment on their feasibility.
- Evaluate the MFI's long-term goals in terms of range of financial products, profitability, social performance, legal structure, staffing, organizational structure, and financing.

8.1 Financial projections

★ **Has the MFI developed realistic financial projections?**

- How does the MFI create its projections? What planning software, if any, does it use?
- Are the underlying assumptions and growth expectations plausible, given the MFI's local environment and past performance (including costs, productivity, loan demand, and growth trajectory of mature branches and loan officers), as well as industry bench-

marks (such as those produced by MBB) for similar MFIs? Note any key significant assumptions.

- Include three years of projections for the indicators in Table 8.1, if such information is available. Comment on whether the projections are technically coherent. If the MFI does not have projections for the indicators in the table, provide any prospective financial planning data it has available.

Do not prepare financial projections for the MFI. Such projections should be prepared by the MFI (with external assistance if necessary), in a process that usually takes several months. Business plans prepared by consultants in response to external requirements, with input from the client organization, typically are not useful.

Table 8.1 Projected Performance

		Currency:	
		Projected Year 1	**Projected Year 2**
1	Total number of clients		
2	Total gross loan portfolio		
3	Number of active loans		
4	Total balance of voluntary savings accounts		
5	Number of voluntary savings clients		
6	Number of staff		
7	Number of branch offices		
8	Return on assets (ROA)		
9	Return on equity (ROE)		
Note: Use clients rather than accounts whenever possible. Add projections for other financial products as relevant.			

8.2 Funding strategy

★ **Does the MFI have a well-designed strategy to finance its anticipated growth?**

- Is the MFI's funding plan credible given current funding relationships, amounts, and interest rates?
- Is funding the MFI's primary constraint to growth, or are there more significant factors (such as institutional capacity or local competition)?
- Evaluate trends in the MFI's cost of funds and sources of liabilities and equity relative to its projections for future growth. How does the MFI plan to diversify funding risk?

Annex 1A. Sample Terms of Reference (short version)

The following is a sample terms of reference (TOR) for a short (2–3 day) appraisal of an MFI. This less detailed appraisal would be useful for a younger institution or a smaller potential amount of grant funding.

It would be appropriate to apply the complete appraisal format only in rare cases of a major funding proposal. When designing an appraisal, the funder should request analysis that is relevant and feasible for the MFI being analyzed—based on the purpose of the appraisal, type of funding being proposed, and other characteristics of the MFI gleaned from a rating agency or other informed source. This sample TOR should be adapted as appropriate.

Terms of Reference for
the Appraisal of
<MICROFINANCE INSTITUTION> (<MFI>)
<City, Country>

<MM/DD/YYYY>

Background

<Insert basic information about the MFI, including its history, legal status, main funders, basic financial data, medium-term plans, and other useful information.> This appraisal is <funder>'s due diligence to determine whether to fund <MFI> and, if so, under what conditions.

This assessment will be based on CGAP's Format for Appraisal of Microfinance Institutions. The final analysis will be based on the experience and judgment of the analyst, incorporating input and feedback from <MFI> staff. A request for key financial and management information will be submitted to <MFI> before the appraisal site visit on <date>. Where there are gaps in what the institution can provide, the analyst will use his or her best judgment, given available time and information.

Potential funding

Potential funding from <funder> would be a <grant, loan, etc.> for <purpose, or another targeted initiative based on recommendations from the appraisal team>.

Appraisal analyst

The analyst for the appraisal will be <name>.

The appraisal

The analyst will visit <MFI> in <country> on <dates>. The visit will include meetings with <MFI>'s board of directors, management, staff, and clients at headquarters (and branch offices, if appropriate), as well as government or regulatory officials, as needed. In collaboration with <MFI> staff, the analyst will work at <MFI>'s headquarters. During this time, the analyst will verify information presented by <MFI>, conduct selected analyses of issues suggested in CGAP's appraisal format, and discuss the meetings held with board members, management, staff, clients, and other stakeholders. The analyses and discussions will be conducted jointly with <MFI> management to promote confidence and build relationships that could eventually lead to a funding agreement.

The appraisal report will use CGAP's appraisal format as a starting point, with the appraisal team selecting the topics of focus. The following areas are suggested for a short appraisal of approximately three days:

- Executive summary and funding recommendation
- Institutional factors
    - Stage of development of the institution, potential market size, and competition
    - Governance and leadership
    - Management
    - Products
    - Organizational structure and systems
    - Social performance, if requested by funder
- Financial performance
    - Portfolio quality

  - Managed growth of portfolio and number of clients
  - Efficiency
  - Client retention
  - Profitability
  - Access to funding (grants, loans, guarantees, and equity from local and foreign sources)
- Business plan (projections and strategy)

Once the basic structure of the appraisal has been decided, it can be adapted, as needed, based on the specifications of <funder>.

Appraisal schedule

The complete appraisal is expected to take <number> days, including <number> days in the country. [The number of days should be based on the level of effort required and the expected length and detail of the appraisal report.] <Name> from <funder> will coordinate the contract. The tentative schedule for the appraisal is as follows:

Date	**Activity**
<Date>	Conference call between <funder> and analyst to discuss TOR
<Date>	Analyst contacts <name of general manager of MFI> to discuss the appraisal and request the information listed below, including recent financial data
<Day 0>	Analyst arrives in <location, country>
<Day 1>	Analyst meets with <MFI> management and board
<Day 1–3>	Analyst conducts field work, meeting with selected <MFI> staff, clients, auditors, and other essential stakeholders as needed; completes briefing memo of draft findings, if time allows
<Day 3>	Analyst has final meetings with <MFI> management and board; departs
<Date>	Analyst provides draft appraisal report to <funder> and <MFI> for comments and discussion
<Date>	Analyst provides final appraisal report

Documents to request from MFI before site visit

(**A smaller or less mature MFI may not have these documents available. The analyst will need to adapt this list to the context.**)

External reports about the MFI from the previous two years, such as ratings, assessments, evaluations, and impact studies
Audited financial statements for the previous two years
Unaudited financial statements for the year to date[61]
Documentation of funding liabilities
Organizational chart
List of board of directors, including curriculum vitaes, if possible
Minutes from past three board meetings[62]
Description of financial and nonfinancial services
Operations manual
Loan loss provisioning, write-off, and recovery policies (if not in credit manual)
Relevant microfinance regulations from national regulator
Relevant regulatory interest rate ceiling policies

[61] When possible, internal financial data should be sent as Excel files.
[62] The minutes can help determine if there is continuity and follow-up between board meetings.

Annex 1B. Sample Terms of Reference (long version)

The following is a sample terms of reference (TOR) for an appraisal of an MFI. It would be appropriate to apply the complete appraisal format only in rare cases of a major funding proposal.

The funder should request analysis that is relevant and feasible for the MFI being analyzed—based on the purpose of the appraisal, type of funding being proposed, and other characteristics of the MFI gleaned from a rating agency or other informed source. This sample TOR should be adapted, as appropriate.

Terms of Reference for
the Appraisal of
<MICROFINANCE INSTITUTION> (<MFI>)
<City, Country>

<MM/DD/YYYY>

Background

<Insert basic information about the MFI, including its history, legal status, main funders, basic financial data, medium-term plans, and other useful information.> This appraisal is <funder>'s due diligence to determine whether to fund <MFI> and, if so, under what conditions.

This assessment will be based on CGAP's Format for Appraisal of Microfinance Institutions. The final analysis will be based on the experience and judgment of the analyst, incorporating input and feedback from <MFI> staff. A request for key financial and management information will be submitted to <MFI> before the appraisal site visit on <date>. Where there are gaps in what the institution can provide, the analyst will use his or her best judgment given available time and information.

Potential funding

Potential funding from <funder> would be a <grant, loan, etc.> for <purpose, or another targeted initiative based on recommendations from the appraisal team>.

Appraisal analyst

The analyst for the appraisal will be <name>.

The appraisal

The analyst will visit <MFI> in <country> on <dates>. The visit will include meetings with <MFI>'s board of directors, management, staff, and clients at headquarters (and branch offices, if appropriate), as well as government or regulatory officials, as needed. In collaboration with <MFI> staff, the analyst will work at <MFI>'s headquarters. During this time, the analyst will verify information presented by <MFI>, conduct selected analyses of issues suggested in CGAP's appraisal format, and discuss the meetings held with board members, management, staff, clients, and other stakeholders. The analyses and discussions will be conducted jointly with <MFI> management to promote confidence and build relationships that could lead to a funding agreement.

The appraisal report will use CGAP's appraisal format as a starting point, with the appraisal team selecting which of the following topics to focus on:

1. **Funding Recommendation**
2. **Overview**
   - Summary institutional data
   - Vision and mission
   - Organizational strengths and weaknesses
   - Macroeconomic and political environment
   - Other external environmental factors
3. **The Institution**
   - Ownership and governance
   - Management
   - Organizational structure
   - Human resource management
   - Information and communications technology
   - Information quality, availability, and transparency
   - Internal controls

- Internal audit
- External audit
- Regulation and supervision
- Ratings
- External relationships

4. Products

- Voluntary savings
- Loans
- Other financial products
- Nonfinancial products

5. Social Performance

- Intent and design
- Depth and breadth of outreach
- Changes in the social and economic lives of clients and their households

6. Loan Portfolio Quality

7. Financial Performance and Risk Management

- Financial statement analysis
- Asset–liability management
- Analytical adjustments
- Financial performance ratios analysis
- Risk management
- Liquidity risk management
- Interest rate analysis

8. Business Planning

- Financial projections
- Funding strategy

Once the basic structure of the appraisal has been decided, it can be adapted, as needed, based on the specifications of <funder>.

Appraisal schedule

The complete appraisal is expected to take <number> days, including <number> days in the country. [The number of days should be based on the level of effort required and the

expected length and detail of the appraisal report.] <Name> from <funder> will coordinate the contract. The tentative schedule for the appraisal is as follows:

Date	Activity
<Date>	Conference call between <funder> and analyst to discuss TOR
<Date>	Analyst contacts <name of general manager of MFI> to discuss the appraisal and request the information listed below, including recent financial data
<Day 1>	Analyst arrives in <location, country> and meets with <MFI> internal analyst(s)
<Day 2>	Analyst meets with <MFI> management and board
<Day 3–6>	Analyst conducts field work, meeting with <MFI> staff, clients, auditors, regulators (if relevant), and other stakeholders, as needed; completes briefing memo of draft findings
<Day 7>	Analyst has final meetings with <MFI> management and board; departs
<Date>	Analyst provides draft appraisal report to <funder> and <MFI> for comments and discussion
<Date>	Analyst provides final appraisal report

Documents to request from MFI before site visit

- External reports about the MFI from the previous two years, such as ratings, assessments, evaluations, and impact studies
- Audited financial statements for the previous two years
- Unaudited financial statements for the year to date[63]
- Complete chart of accounts for the year to date
- Complete set of summary reports from the loan tracking system
- Documentation of funding liabilities
- Organizational chart
- List of board of directors, including curriculum vitas, if possible
- List of committee memberships of board of directors (if board has committees)
- Minutes from past three meetings of board of directors[64]
- Description of financial and nonfinancial services
- Personnel manual

[63] When possible, internal financial data should be sent as Excel files.
[64] The minutes can help determine if there is continuity and follow-up between board meetings.

- Credit manual
- Loan loss provisioning, write-off, and recovery policies (if not in credit manual)
- Savings manual
- Internal controls manual
- Internal audit policies and manual
- Risk management policies
- Relevant microfinance regulations from national regulator
- Relevant regulatory interest rate ceiling policies

Internal reports monitoring clients at entry, dropouts, market assessments, and other research.

Annex 2. Management Information System Evaluation Checklist

Functionality and expandability
Functional completeness, appropriateness, and integration
• Accounting package
• Portfolio tracking
• Deposit monitoring
• Customer information system
Expandability and institutional growth
Flexibility
• Customer-centric vs. account-centric
• Institutional types
• Lending methodologies
• Loan interest types
• Savings and deposit account types
• Deposit interest types
• Payment types
• Payment frequencies
• Multiple branches or regions
• Multiple languages
• Multiple currencies
Usability
Ease of use and user friendliness
User interface
Reporting
Reports
Report generation
Standards and compliance
Accounting soundness and standards
Governmental and supervisory adherence

Administration and support
Security
Backup and recovery
Fault tolerance
End-of-period processing
Support infrastructure and maintenance
Version control and upgrade strategy
Technical specifications and correctness
Technology and architecture
Performance
Number and date handling
Cost
Pricing and costs

Annex 3. Social Performance Measures

The Appraisal Guide and this manual offer guidelines for measuring an MFI's social performance within the context of an institutional appraisal. In the absence of available and robust client data, a funder may decide to invest in collecting such data to obtain a statistically rigorous analysis of an MFI's depth of outreach, social impact, or both. The Social Rating tool developed by Micro-Credit Ratings International Ltd (M-CRIL) provides a relatively low-cost, quick way to assess depth of outreach and predict social impact based on a sample of 130 recent clients.[65] A more extensive study, such as application of CGAP's Poverty Assessment Tool, requires considerable additional funding. Aimed at MFIs and others concerned about their social performance, this annex describes various approaches that have been used, and recommended indicators for analyzing an MFI's depth of outreach and social effects. It concludes with a section on assessing social performance more broadly.

Interviews with clients and staff

During the appraisal, interviews with MFI clients and staff help determine, qualitatively, the relative poverty levels of the MFI's clients; the relevance of the MFI's products, particularly for poorer clients; and the ways the lives of the MFI's clients have changed since their initial contact with the MFI.

In countries in which absolute poverty assessment tools that measure absolute poverty are available, such as the Progress Out of Poverty Index (PPI) and/or USAID Poverty Assessment Tool (PAT) are available, they should be used.[66] In countries in which these tools are not available, a relative poverty tool can be used. The analyst should cite which tool is being used with the data.[67]

[65] This sample size, derived from the binomial theorem, provides 95 percent confidence, at 10 percent precision. Microfinance Rating and Planet Rating also conduct social ratings. Rating company web site links can be found in Annex 10.

[66] A list of countries in which these tools are available many be found at: 1) http://www.povertytools.org/USAID_Tools/USAID_Tools.html and 2) http://www.microfinance.com/#Poverty_Scoring. 3) Additional information on poverty tools may be found at http://www.microfinancegateway.org/resource_centers/socialperformance/.

[67] In the absence of credible data, M-CRIL uses a quick sample survey of recent clients for social rating purposes. For a list of relative poverty tools, please see http://www.microfinancegateway.org/resource_centers/socialperformance/targeting.

Products and delivery. Discussions with MFI clients and staff should probe issues related to the MFI's products and program rules and their appropriateness for target clients. Such issues include the following:

- Purpose of products versus their actual use
- Economic activities MFI loans support
- Ways clients manage repayment (especially during seasonal lean periods)
- Financial products and options that exist for emergencies
- MFI's policy on repeat loan increases and whether clients are compelled to take larger loans or inappropriate debt levels
- MFI's policy on dealing with delinquent clients
- MFI's staff incentives, and the behavior they promote in serving clients
- Marketing of products
- Interaction between MFI staff and clients

Effects. During client and staff interviews, the analyst should ask the following questions:

- Have clients' income sources diversified?
- Have clients' income levels increased?
- Has clients' consumption increased?
- Are clients better able to cope with emergencies?
- Have clients' household assets increased?
- Has clients' housing improved?
- Has clients' ownership changed?
- Has clients' use of moneylenders changed?
- Have the terms offered by moneylenders changed?
- Do clients feel more empowered?
- What factors (other than microfinance) have contributed to such changes?
- Who has benefited the most from the financial and nonfinancial services? Why?
- Who has benefited the least? Why?

Details on interview techniques and questions can be found in CGAP's *Poverty Audit: Guidelines for Determining the Depth of Outreach and Poverty Impact of Microfinance Institutions* (www.cgap.org/docs/poverty_audit.pdf).

Measuring depth of outreach

The most precise, statistically rigorous methods for measuring an MFI's depth of outreach are extremely expensive. In most cases, these methods are worthwhile only if the funder intends to invest more than $500,000 or is mandated to provide funding to MFIs reaching the very poor (as with the U.S. Agency for International Development). CGAP's Poverty Assessment Tool is appropriate for such cases (www.cgap.org/docs/poverty_audit.pdf).

But in most cases, such a precise, expensive tool does not make sense. There are other less expensive, less time-consuming ways to measure an MFI's depth of outreach, including the methods highlighted below. These methods take different approaches to assessing poverty. Whatever the approach, the analyst will have to decide on the sample size.

Absolute Poverty Assessment Tools

Progress out of Poverty Index. The Progress out of Poverty Index (PPI) is a method to construct country-level "poverty scorecards" using techniques similar to those used in credit scoring. The scorecards are based on statistical analysis of national household expenditure surveys. They use a small set of simple, easily observable indicators to estimate the share of clients who are below an established poverty line. The tool (sponsored by CGAP, Grameen, and the Ford Foundation) can be used over time to determine improvements in client economic levels and their ultimate graduation out of poverty.

For more information, see Microfinance Gateway Social Performance Resource Center, http://www.microfinancegateway.org/resource_centers/socialperformance/ and poverty scoring tools at http://www.microfinance.com/#Poverty_Scoring.

USAID/IRIS Poverty Assessment Tool. The poverty assessment tools are designed to measure the percentage of respondents who are below the "very poor" poverty line (as defined by U.S. legislation $1/day PPP or the lower 50 percent of those below national poverty line).

USAID Poverty Assessment Tools (PATs) are accurate, cost-efficient, country-specific surveys developed to predict the incidence of extreme poverty within a group of people (the percentage of respondents that are "very poor" or "not very poor"). A household is considered to be very poor if its per capita income lies in the bottom 50 percent of those below a country's national poverty line or lies below the International "Extreme" Poverty Line (PPP$1/day), whichever is more inclusive in a particular country. Poverty levels are categorized by responses to approximately 15 to 30 poverty indicators in each survey, which are based on comparisons to much lengthier, more detailed, national household

surveys. The tools make poverty calculations based on an aggregate group of people and are much less accurate (and not designed) for measuring poverty on an individual basis.

PATs include short, country-specific surveys that gather household data on indicators that have been identified as the best predictors of whether a given set of households is very poor, according to the legislative definition of extreme poverty applicable to the country in question. The data gathered through these surveys are entered into a template, allowing a software package (Epi Info) to estimate the share of households living below the applicable poverty line. The tools greatly simplify the lengthy and time-consuming household budget surveys or composite surveys, which request information on hundreds of potential indicators of income and consumption, focusing instead on a small number of indicators that match the results obtained by these longer surveys. Each tool is meant to be administered in 20 minutes or less and to produce data that can be easily used by partner organizations to determine generally what percentage of clients fall into the definition of very poor according to the legislation.

PPI is designed to facilitate its use as a poverty targeting tool and thus has more potential for bias because the potential client is interviewed before knowing whether he or she will get a loan. PATs are only applied once the person becomes a client of the program and only on an aggregate basis to balance potential errors and increase accuracy. PPI has 10 questions, while PATs can have up 25 questions to increase accuracy.

Link to the manual, tools, and data entry for each country where tool is available for PATs at http://www.povertytools.org/USAID_Tools/USAID_Tools.htm.

Relative Poverty Assessment Tools

In countries in which neither PPI nor PAT is available, a relative poverty tool can be used, citing which tool is being used when presenting the data.[68]

Housing index

The housing index uses visual indicators to determine a household's poverty level. The analyst should work with community members to determine a rough matrix of what housing characteristics determine relative wealth. Examples include roofing materials, wall height and type, flooring type, presence of running water and bathroom facilities, and house or compound size. A point system can be assigned to this matrix. Then the analyst can conduct a

[68] For a list of relative poverty tools, go to http://www.microfinancegateway.org/resource_centers/socialperformance/targeting

mapping exercise in several of the cities, towns, and villages visited during the appraisal to determine the relative poverty of the MFI's clients, based on their housing.

Participatory wealth ranking

This approach uses a community's own sense of relative poverty. First, a mapping exercise is conducted of each house in the community, and a household list is generated. Then three reference groups are formed from community volunteers. Each group ranks households according to their relative level of poverty, placing the name of each household into a corresponding pile. The number of piles used depends on the reference group, but there should be at least four. Finally, a point system is tallied. The analyst must decide the cutoff point for the "poorest" category.[69]

Means testing

Some MFIs measure their clients' poverty levels by developing a checklist of indicators that serve as poverty proxies. These indicators can include information on income, expenditure, land, other assets, health, education, and access to basic services. Visual indicators are also used, such as those in the housing index. Usually these indicators are chosen based on an understanding of the national (or regional) poverty context; sometimes the community is involved in choosing them. The MFI may weight some indicators differently. The scores are then added together to produce an approximation of each client's poverty level.

Participatory approaches

When measuring relative depth of outreach in a participatory manner, an MFI uses input from field staff and community members to identify different dimensions of poverty. Though less rigorous than other methods, this approach enables clients to describe their sense of well being and how that can be measured. For example, for housing an indicator of "hardcore poor" might be a house made of mud with walls lower than four feet. An indicator for "poor" might include a thatched roof. An indicator for "well off" might include concrete flooring or corrugated roofing. Other indicators can be determined using community input for categories such as sources and levels of income, food consumption, land ownership, assets, or empowerment. The community or the MFI can then rank each household based on these indicators.

[69] More information and links to other resources about the housing index and participatory wealth ranking can be found at the Microfinance Gateway's Client Target Centre (www.microfinancegateway.org/poverty/index.htm).

Assessing Social Performance

This section explains how social performance can be assessed beyond depth of outreach.

Social performance is the effective translation of an institution's mission into practice in line with accepted social goals. These include sustainably serving increasing numbers of poor and excluded people, improving the quality and appropriateness of financial services, improving the economic and social conditions of clients, and ensuring social responsibility to clients, employees, and the community they serve.

Traditional evaluation has focused on end results and impact. However, impact (which refers to changes in client or community conditions that can be directly attributed to programs) is just one element of social performance. Social performance looks at the entire process by which impact is created.

Figure A3.1. Dimensions of Social Performance

INTENT AND DESIGN
What is the mission of the institution?
Does it have clear social objectives?

INTERNAL SYSTEMS & ACTIVITIES
What activities will the institution undertake to achieve its social mission?
Are systems designed and in place to achieve those objectives?

OUTPUT
Does the institution serve poor and very poor people?
Are the products designed to meet their needs?

OUTCOME
Have clients experienced social and economic improvements?

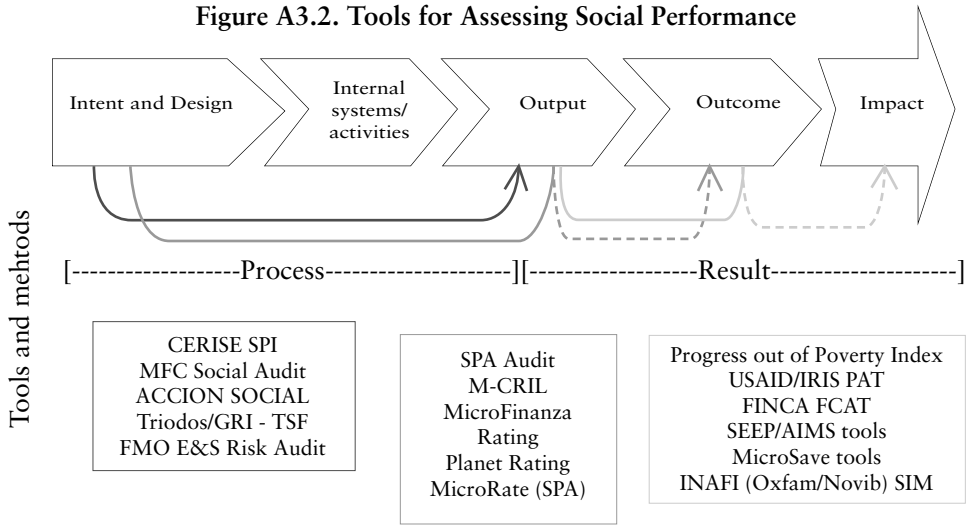
IMPACT
Can these improvements be attributed to institutional activities?

Figure A3.1 identifies the different steps in this process. It starts with analysis of the declared social objectives of institutions (intent and design). It asks whether institutions have a social mission and, whatever these social missions may be, whether their goals are clearly defined and articulated to conform to the social mission. Social performance includes assessment of internal systems and activities. Are institutional activities linked to achievement of their social goals? Are appropriate systems in place to meet these objectives? Is progress along these goals routinely tracked? Social performance is about outputs. Is the institution sustainably reaching large numbers of very poor households? Are products designed to meet the flexible financial need of the poor? Social performance is also about outcomes—are clients improving their social and economic conditions? And finally, social performance is indeed about impact, establishing rigorous causality between program participation and improvements in client conditions.

Social Performance Assessment Tools

Different social performance tools focus on different steps in this process. For instance, CERISE focuses on the institutional process and internal systems through assessing intent, activities, and output. CGAP, Grameen, and the Ford Foundation assess social performance at the client level through looking at outputs and outcomes. The rating and auditing tools focus on intent and design, internal systems, and outputs, but can also review/verify the quality of data an organization has on measuring outcomes. The dotted line in Figure A3.2 signifies that this is not the emphasis of the tool.

Figure A3.2. Tools for Assessing Social Performance



Selected highlights of some of the tools that are referenced in Figure A3.2 are described below.

CERISE Social Performance Indicators Initiative

The CERISE Social Performance Indicators (SPI) assesses the social performance of institutions by evaluating their intentions and actions. An analysis of internal systems and organizational processes determines whether institutions have the means to attain their social objectives. The questionnaire can be self-administered by the MFI or used with an external reviewer.

SPI uses a questionnaire and guide to examine the following:

1. Outreach to the poor and excluded populations
2. Adaptation of products and services for target clients
3. Improvement in social and political capital
4. Corporate social responsibility

For more information go to
http://www.cerise-microfinance.org/pdf/En/spi_quest.pdf.

MFC Quality Audit Tool for Managing Performance

The Quality Audi Tool (QAT) assesses the quality of management systems. It is designed specifically to review and improve the effectiveness of the management processes to align the mission and organizational social performance objectives. QAT reviews internal systems, assesses their status and effectiveness in relation to social performance management, and identifies action areas where performance can be improved.

It can be used as a self-assessment tool and can be integrated into the organizational internal and external auditor's work or used by external parties to conduct objective assessments, including management processes assessments for a social rating.

Although embarking on the adventure of balancing social and financial performance requires firm conviction and dedication from top management, the series has been developed to be bottom-up and participatory. The tool is organization-driven, securing buy-in from all levels in the organization, and giving MFI staff ownership of the process. The tool describes solutions that are scalable and flexible so that each MFI can adapt it to its own organizational settings. In addition to the processes, the tool also offers actual

examples from different regions, which make it possible to learn from others and to be inspired.

For more information, go to www.microfinancegateway.org/resource_centers/social performance/article/40726.

ACCION SOCIAL Tool

SOCIAL is an acronym for the six elements of social performance that the ACCION tool seeks to capture: social mission, outreach, client service, information transparency, association with the community, and labor climate. This diagnostic tool evaluates the success of an MFI in fulfilling its social mission and its contribution to broadly accepted social goals. Five SOCIAL audits have been conducted in Latin America and Asia. The tool is administered by ACCION.

Triodos Bank and the Global Reporting Initiative: Transparency in Sustainability and Finance

Triodos Bank and the Global Reporting Initiative (GRI) have initiated a project called Transparency in Sustainability and Finance (TSF). The purpose of this project is to help MFIs manage sustainability by reporting that is based on GRI guidelines. A sustainability report explains a company's social, environmental, and economic aspects of performance, in the context of its commitments, strategy, and management approach toward the goals of sustainable development—a principle known as Triple-Bottom Line (TBL). Currently, there are no standards for reporting on sustainability specifically designed for microfinance. The TSF project is considering the development of a GRI sector supplement to meet the needs of the microfinance industry for standardized sustainability reporting.

For information, contact Geert Jan Schuite at Triodos Facet: gj.schuite@facetbv.nl or Teodorina Lessidrenska at GRI: Lessidrenska@globalreporting.org

FMO Environmental & Social Risk Audit

FMO is developing practical and easy-to-use support tools, a course, and Internet support targeted to MFIs, to help MFIs build an Environmental and Social Management System. Support tools include the following:

- An exclusion list—an overview of those activities that in the opinion of FMO under no circumstances should be financed
- An Activity Assessment Tool—a matrix, summarizing the key environmental and

social risks for each of the sectors in which MFIs work (e.g., various forms of agriculture, services, and manufacturing)

- Environmental & Social Evaluation Guidelines—guidance on how environmental and social evaluation and follow-up processes (i.e., the Environmental and Social Management System) can be put in place in alignment with the MFI's regular credit evaluation, approval, and monitoring and reporting processes.

For more information contact Anton van Elteren at A.van.Elteren@fmo.nl

M-CRIL's Social Rating

Microcredit Ratings International Limited (M-CRIL) is an India-based rating institution that has conducted over 400 ratings for 208 MFIs in 16 Asian countries. M-CRIL has developed a social performance rating tool to assess "the likelihood of an MFI achieving its social mission in line with accepted social values." It covers both organizational-level and results indicators. It analyzes mission statements, policies, and internal systems of the organization to determine whether they effectively reflect its social mission and whether there are mechanisms in place for staff and client protection.

For more information go to www.m-cril.com/social-rating-microfinance-institutions.html.

Microfinanza Rating's Social Rating

Microfinanza Rating is a rating institution that offers social ratings, financial ratings, and impact assessment services to MFIs and stakeholders, such as donors, social and commercial investors, networks, and regulators. Microfinanza Rating has created two different types of social rating. The Social Rating Survey is similar to the M-CRIL rating tool. It, too, covers the range of social performance dimensions, including the social and economic context in which the institution works; its mission, strategy, and systems; the quality of its services; its social responsibility; and client-level information. In this rating, Microfinanza Rating surveys clients directly.

The other tool, Social Rating, is a simplified version of the Social Rating Survey and excludes client surveys. Instead, the rating assesses information available at the institutional level, including staff interviews. It, too, provides diagnostic information on how well the institution is achieving its social mission by meeting its social responsibility goals and providing quality services to its clients, especially the poor.

For more information go to http://www.microfinanzarating.com/upload/5/att_microfinanza%20rating,%20social%20rating%20methodology,%20may%202007.pdf.

Planet Rating Social Rating

Ratings will provide an opinion on "the likelihood that the MFI produces significant social impact both now and in the future."

Planet Rating conducted pilot evaluations using CERISE and SPA tools during 2005 and 2006 and then went on to develop its own social rating tool. Planet Rating's tool differs from the M-CRIL and Microfinanza Rating social ratings in that it relies completely on data the MFI already collects. The Planet Rating Social Rating tool provides an opinion on the "probability that the MFI produces a significant social impact now and in the future." It relies on an analysis of the MFI social performance management systems with specific attention to the integration of social goals in planning processes, MIS, and human resources as well as the MFI's achievements in terms of outreach and quality of services.

Planet Rating carried out six pilot ratings in Mali with its own tool in July–August 2007; three ratings are available at www.planetrating.com.

Social Performance Assessment Tool

The Social Performance Assessment (SPA) audit tool is based on information on organizational processes. It assumes that much of the financial and client information institutions regularly collected by MFIs can be used as proxies for their social performance and that new formats and fresh data collection are not essential. SPA includes a scorecard with a set of indicators under six dimensions of outreach: breadth, depth, length, scope, cost, and worth of outreach to clients and the community. The indictors are selected to favor readily available information. SPA is conducted by an external consultant/auditor.

For more information go to http://www.microlinks.org/ev_en.php?ID=9940_201&ID2=DO_TOPIC.

MicroRate (SPA)

Piloting a social rating tool based on the SPA tool.
http://www.microfinance.com/#Poverty_Scoring.

FINCA's Client Assessment Tool

FINCA's Client Assessment Tool (FCAT) is a comprehensive, open-source tool that has

been implemented in 25 countries across five regions. The 2007 FCAT has been updated from previous years to align with questions used in best practice development surveys.

FCAT is primarily focused on using detailed question sets to measure the standard of living of clients and their households. Specifically, FCAT seeks to measure poverty levels, high priority social indicators, household demographics, and information on client loans and businesses.

FCAT methodology provides every client an equal probability of being surveyed and uses a two stage cluster sampling approach to ensure practicality. FCAT is recorded using personal digital assistant devices to increase accuracy in reporting. FCAT is an integral component in FINCA's Social Performance Management structure.

For more information go to www.villagebanking.org.

SEEP/AIMS Assessing the Impact of Microenterprise Services

Learning from Clients: Assessment Tools for Microfinance Practitioners is a manual to help practitioners assess their clients. Its core is a set of five assessment tools that practitioners can use to gather information about their programs—information that is useful for impact assessment, market research, and improving program products and services. The tools come with step-by-step instructions for using them, starting with initial preparations and ending with data analysis. The manual was developed by the SEEP Network as part of the PVO and NGO component of the larger AIMS (Assessing the Impact of Microenterprise Services) project funded by USAID. It was developed by and for practitioners and responds to the particular needs and challenges they face in determining how their programs and services are affecting their clients.

Tool 1: Impact Survey

The purpose of the Impact Survey is to test multiple hypotheses that correspond to various types of impact using a quantitative tool that is practical, cost-effective, credible, and valid. It is administered to up to three groups selected at random: a group of short-term clients (about one year's time in the program), a group of longer term clients (two years or more in the program), and a group of new clients who have joined the program but have not yet received any services. The survey is administered in the same way to all respondents; their answers are expressed largely in terms of numbers corresponding to precoded responses. The following hypotheses are tested by this tool:

At the household level:

- Increased income
- Increased assets
- Increased welfare (in such aspects as food security, housing, and health)
- Increased ability to cope with emergencies

At the enterprise level:

- Increased income
- Increased assets
- Increased ability to survive periods of reduced cash flow
- Changes in business practices associated with increased profitability

At the individual level:

- Increased personal saving

At the community level:

- Reduced problematic child labor in clients' enterprises
- Increased employment in clients' communities

Tool 2: Client Exit Survey

The Client Exit Survey is a quantitative tool that seeks information about why a client left a microfinance program, as well as the client's opinion about the program and its impact. The purpose of the Client Exit Survey is to find out and track the following information:

1. When the client left the program;
2. Why the client left the program;
3. What the client thinks about the program's impact on her and her business;
4. What the client thinks about the program's strengths and weaknesses; and
5. When (or if) the client will rejoin the program and/or recommend the program to friends and family.

Tool 3: Use of Loans, Profits, and Savings Over Time Tool

The Use of Loans, Profits and Savings Over Time Tool documents and illuminates client decision-making about the use of loan funds, profits, and savings, how it changes over

time, and identifies the perceived outcomes of these decisions about resource allocation. Furthermore, it attempts to understand the evolution of the client's business and to explore the relationship between the client's household and her enterprise. The tool is composed of two distinct modules—one on loan use and the other on savings. These two modules can be used together or singularly. The following hypotheses are tested by this tool:

At the household level:

- Increased income
- Increased assets
- Increased welfare (in such aspects as food security, housing, and health)

At the individual level:

- Increased control over economic resources on the part of women clients
- Increased role in decision-making primarily among women clients

At the enterprise level:

- Increased income
- Increased assets
- Increased ability to survive periods of reduced cash flow
- Diversification of enterprise activity

Tool 4: Client Satisfaction Tool

The Client Satisfaction Tool is a focus group interview tool that will help users learn the extent to which clients are satisfied with the program and what specific changes would better meet their needs.

Tool 5: Client Empowerment Tool

The purpose of the Client Empowerment Tool is to determine if clients have grown more confident and gained more self-esteem while participating in the program. Furthermore, it aims to identify how those qualities have translated into specific changes in behavior that demonstrate empowerment. The tool is an in-depth individual interview designed for women clients who have participated in the program for more than two years. During the

interview, the client is asked to identify differences in her behavior in the past and the present. The following hypotheses are tested by this tool:

Individual level:

- Clients' increased control of economic resources
- Clients' increased self-esteem and confidence
- Increased role in decision-making
- Increased ability to negotiate with others

For more information:
English tools available at: http://www.seepnetwork.org/content/library/detail/646.
French tools available at: http://www.seepnetwork.org/content/library/detail/5135.
Spanish tools available at: http://www.seepnetwork.org/con-tent/library/detail/5136.

MicroSave Market Research for MicroFinance Toolkit

The toolkit includes the Focus Group Discussion tool and several Participatory Rapid Appraisal (PRA) tools, a set of 20 tools. When designing products and trying to understand delivery issues, you typically use a combination of tools to understand your research questions.

If you want to look specifically at outreach you can use either the Simple or Detailed Wealth Ranking tool, or a Financial Services Matrix.

If you want to focus on Services you tend to focus on Financial Landscape Analysis, Pair Wise Ranking, Image/Position Analysis, Life Cycle Analysis, Relative Preference Ranking and Financial Sector Trend Analysis.

When looking at change, use a modified Time Series of Asset Acquisition & Ownership tool, changes in Detailed Wealth Rankings, and Financial Services Matrix.

For more information and a copy of the toolkit, visit www.MicroSave.org.

INAFI-Oxfam Novib-Ordina Social Impact Mesurement tool (SIM)

INAFI (International Network of Alternative Finance Institutions) network of microfinance practitioners launched a research study project on Social Impact Measurement (SIM) to explore possibilities of measuring social impact of microfinance interventions.

The Social Impact Measurement project is a tripartite cooperation of INAFI, Oxfam Novib, and Ordina. The project uses participatory methods and brings together experiences of 10 MFIs to explore bottom-up processes of household survey techniques and microfinance proven financial tracking practices. The project has developed an Internet-based tool, including a simple common set of social indicators that is acceptable across its membership in Africa, Latin America, and Asia. The social indicators aim first and foremost to track changes in five dimensions aligned to the Millennium Development Goals not only from a MFI/client perspective, but also from a national/regional and global level in the network. The challenge was to balance level of rigor/complexity and simplicity, cost of data collection and an attempt to create linkage of the changes to microfinance activities in the methodology. Attribution of changes in the lives of microfinance clients to the microfinance services is envisaged though, given the SIM tool's close link to the business processes of practicing MFIs, the use of a universally applicable questionnaire and the use of national data as benchmark for the changes observed. The tool covers the following dimensions that are assumed to be influenced by the interventions of MFIs while providing microfinance services to the poor:

1. Wealth
2. Social welfare
3. Empowerment of women
4. Social capital
5. Environment

For more information on SIM Web-based automated data submission process and indicators email INAFI International at sim@inafiinternational.org or Oxfam Novib: Peter.Huisman@oxfamnovib.nl or Ordina ICT company: ronald.veerbeek@ordina.nl

Annex 4. Appraise.xls Instructions

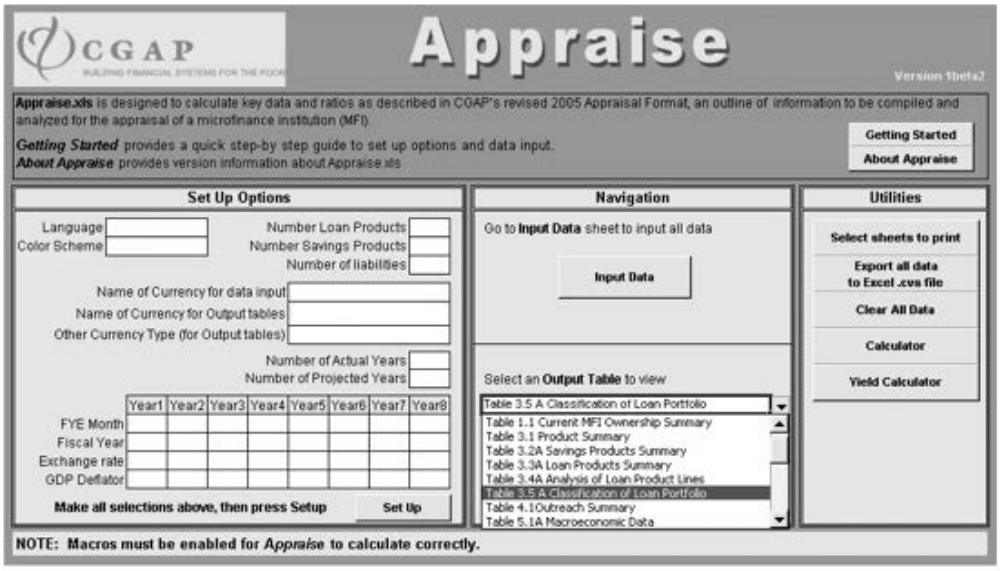
Getting started

Appraise.xls is an Excel workbook that will help the analyst complete all the tables outlined in CGAP's revised 2007 Appraisal Format. Appraisers may wish to send appraise.xls to MFIs for preappraisal data collection and input.

Appraise.xls sheets are protected (without password). To make changes to protected cells, unprotect the sheet (Tools/Protection/Unprotect sheet). You may change formulas or add your own tables to blank sections of the workbook. However, if you insert or delete any rows or columns, or delete existing sheets, the existing navigation system may no longer operate correctly.

The basic steps to follow when using appraise.xls:

1. Enable macros upon opening the workbook.
2. Select set-up options on the **Intro sheet** to tailor Appraise to your needs. Then press the Set Up Button to activate your selections.
3. Input all data on the **Input Data sheet** in white cells. Red comment indicators throughout the workbook provide guidance for data input and explanations of calculations.
4. Use the Output table menu located **on all sheets** to select an output table to view. You can also use the sheet tabs to navigate between sheets or the Appraise Menu located first on the Excel menu at the top of your screen. There are 23 Output Tables, numbered according to CGAP's 2005 Appraisal Format. Output tables are formatted and calculated per the Set Up options you select (e.g., number of years, number of products, currency conversion, etc.).
5. Cut and paste finalized tables into your appraisal format document.



The Intro Sheet

Set Up Options

On the **Intro sheet**, set up appraise.xls to meet your needs. Make all selections, then click on the **Set Up button** to finalize. Options include the following:

1. **Language:** Select a language preference for Appraise (English, French, or Spanish).
2. **Color Scheme:** Select a color scheme for the entire workbook. Depending on your viewing preference, you may choose CGAP (default), Sky, Ocean, Earth, or Forest colors.
3. **Number of Loan Products**: Select from 1 to 15 loan products. Your selection will determine the number of available loan product-specific input sections on the Data Input sheet and format for corresponding output tables.
4. **Number of Savings Products:** Select from 1 to 15 savings products from the drop-down menu. Your selection will determine the number of available loan product-specific input sections on the Data Input sheet and format for corresponding output tables.
5. **Number of Liabilities**: Select from 1 to 15 liabilities to format your Composition of Liabilities table.
6. **Local Currency Name:** Enter the name of the currency you plan to use to enter all data. Your input data will remain as entered on the Input Data sheet.

7. **Name of Currency for Output Tables**: Enter the name of the currency you want for Financial Statements output tables. (Excel will calculate all output tables using the exchange rate you specify).
8. **Other Currency Type (for Output tables):** Select the currency type to show financial statements output tables in Nominal local currency, Constant local currency, or Constant other currency.
9. **Number of Actual Years**: Select the number of Actual Years (from 1 to 5) you wish to input and show data. This selection will determine the number of years shown in all output tables (but all input years will remain visible on the Data Input sheet).
10. **Number of Projected Years:** Select the number of Projected Years (from 0 to 3) you wish to input and show data. Projected years are those years following actual years for which you wish to show projected data. This selection will determine the number of years shown in Table 8.1 Projected Performance (all input years will remain visible on the Data Input sheet).
11. **Month:** From the drop-down menu, select the last month of the fiscal year for all full years, and the last month for which there is available data for the last year you plan to use.
12. **Year:** Enter the fiscal years you plan to use.
13. **Exchange Rate:** Enter the exchange rate for each year you plan to use.
14. **GDP Deflator:** Enter the GDB deflator for each year you plan to use.

Additional Options Available on the Input Data Sheet

1. **Loan Classification:** Overwrite default to suit your needs.
2. **Loan Aging Categories:** Overwrite default to suit your needs.
3. **Average (Mean or Median):** Select to use Mean or Median for Average calculations.
4. **Institutional/Individual Accounts:** Select to use Individual Accounts, Institutional Accounts, or both.
5. **Calculation of average annual data:** Overwrite with data calculated from monthly entries.

Utilities

The following additional utilities are available:

1. Select sheets to print
2. Export all data to an Excel .csv file (for import into other programs)

3. Clear all data
4. Calculator
5. Yield calculator
6. Graph calculator

Navigation

1. Use buttons and drop-down menus available on all sheets to navigate.
2. Use the Appraise Menu (located first on the Excel menu) to navigate.

The Input Data Sheet

Compilation of all data required to complete all 23 tables may not be possible for some MFIs. In such cases, data should be compiled and entered for at least the following critical output tables:

List of Critical Tables
Table 4.1 Product Summary
Table 4.3 Loan Products Summary
Table 7.1 Income Statement
Table 7.2 Balance Sheet
Table 7.3 Cash Flow Statement
Table 7.6 Macroeconomic Data
Table 7.7 Performance Ratios and Peer Group Benchmarking
Table 7.8 Comparison of Actual and Theoretical Yields
Table 7.9 Analytical Adjustments

Appraise Worksheets—Summary of usage: Appraise.xls contains 19 visible worksheets.

Visible Worksheet Name and Order		Usage	Appraise Format Table Name
1.	**Intro**	Set Up options, Utilities	
2.	**Getting Started**	Quick guide to Appraise.xls	
3.	**Input Data**	All data input cells	
4.	**Summary Data**	Output table Output table	Table 2.1 Summary of Key Data Table 3.2 Staffing Summary Data
5.	**Ownership**	Output table	Table 3.1 Current MFI Ownership Summary
6.	**Products**	Output table Output table Output table Output table	Table 4.1 Product Summary Table 4.4 Classification of Loan Portfolio Table 4.5 Analysis of Product Lines Table 6.1 Loan Portfolio Report
7.	**Products2**	Output table Output table	Table 4.2 Savings Products Summary Table 4.3 Loan Products Summary
8.	**Outreach**	Output table	Table 5.1 Outreach Summary
9.	**Financial Statements**	Output table Output table Output table	Table 7.1 Income Statement Table 7.2 Balance Sheet Table 7.3 Cash Flow Statement
10.	**Liabilities**	Output table	Table 7.4 Composition of Funding Liabilities
11.	**Grants & Subsidies**	Output table	Table 7.5 External Grants and Subsidies
12.	**Adjustments**	Output table Output table	Table 7.6 Macroeconomic Data Table 7.9 Analytical Adjustments
13.	**Yield**	Output table	Table 7.8 Comparison of Actual and Theoretical Yields
14.	**Yield Calculator**	Loan Yield Calculator	

Visible Worksheet Name and Order		Usage	Appraise Format Table Name
15.	**Performance Ratios**	Output table	Table 7.7 Performance Ratios and Peer Group Benchmarking
16.	**Projections**	Output table	Table 8.1 Projected Performance
17.	**Risk management**	Output table Output table Output table	Table 7.10 Asset/Liability Maturity Mismatch Table Table 7.11 Foreign Currency Mismatch Table Table 7.12 Interest Rate Sensitivity Mismatch Table
18.	**Graphs**	Graphs	
19.	**About**	Version information	

Presite Visit Input Tables

Human Resources	Prior Year 1	Prior year 2	Current, as of (date)	MBB Peer Group
Total number staff, beginning of period				
Total number staff, end of period				
Number of staff hired during period				
Number of loan officers, end of period				
Number of savings officers, end of period				
Average annual loan officer compensation				

Current Ownership: Owner Name	Type (individual, company, bank NGO, other)	Domestice or International	Amount of Ownership (in local currency)	Percentage Ownership

Products	Number of Products	Number of Active Clients	Total balance or Value	Average Account Balance
Savings Products				
Loan Products				
Other Financial Products				
Other Nonfinancial Products				

	Voluntary Savings Products Summary	Prior Year 1	Prior Year 2	Current, as of (date)	Projected Year 1	Projected Year 2
Savings Product 1						
1	Interest rate (%) and calculation method					
2	Minimum deposit to open account					
3	Fees to open account					
4	Minimum deposit per transaction					
5	Fees per transaction					
6	Penalty for early withdrawal					
7	Minimum account balance					
8	Withdrawl frequency (average per period)					
9	Deposit frequency (average per period)					
10	Number of active savings accounts					
11	Number of inactive individual accounts					
12	Total individual account balance, end of period					
13	Individual account balance as percentage of total savings balance					
14	Average individual account balance (mean or median)					
15	Number of active institutional savings accounts					
16	Number of inactive institutional accounts					
17	Total institutional account balance, end of period					
18	Institutional account balance as percentage of total savings balance					
19	Average institutional account balance (mean or median)					
Savings Product 2						
1	Interest rate (%) and calculation method					
2	Minimum deposit to open account					
Etc.	Fees to open account					

	Loan Products Summary	Prior Year 1	Prior Year 2	Current, as of (date)
Loan Product 1				
1	Initial amount			
2	Increment / Maximum			
3	Term			
4	Repayment frequency			
5	Interest rate			
6	Commissions and fees			
7	Guarantees and collateral			
8	Theoretical interest yield (APR)			
9	Savings requirement (if any)			
10	Number of active loans (clients), end of period			
11	Average principal balance per client			
12	Median principal balance per client			
13	Average principal balance outstanding, over period			
14	Total principal balance outstanding, end of period			
15	Percentage of total loan balance			
16	Total outstanding balance associated with loans that are: On time (and never renegotiated) Overdue 1 to 30 days (and never renegotiated) Overdue 31 to 90 days (and never renegotiated) Overdue 91 to 180 days (and never renegotiated) Overdue 181 to 365 days (and never renegotiated) Overdue over 365 days (and never renegotiated)			

Loan Products Summary		Prior Year 1	Prior Year 2	Current, as of (date)
Loan Product 1				
	Renegotiated loans—On time Renegotiated loans—overdue 1–30 days Renegotiated loans—overdue 31–90 days Renegotiated loans—overdue 91–180 days Renegotiated loans—overdue 181–365 days Renegotiated loans—overdue over 365 days			
Loan Product 2 …				
1	Initial amount			
2	Increment / Maximum			
Etc.	Term			

Annex 5. Financial Statements

The financial statement references and definitions below are based on the framework developed by the Small Enterprise Education and Promotion (SEEP) Network.[70]

Income statement

Reference	Account name	Definition	Calculation
I1	Financial Revenue	All revenue earned from the provision of financial services.	**I2 + I5 + I6**
I2	Financial Revenue from Loan Portfolio	Revenue from interest, fees, commissions, and other fees earned on the loan portfolio. This includes not only interest paid in cash but also interest accrued but not yet paid.	**I3 + I4**
I3	Interest on Loan Portfolio	Interest earned on the loan portfolio. If the MFI is earning interest on loans to employees or board members, this interest should be disclosed. If this interest is significant, the MFI should create two subaccounts for I3—one for Interest from Clients and the other for Interest from Related Parties	
I4	Fees and Commissions on Loan Portfolio	Penalties, commissions, and other fees earned on the loan portfolio. This may also include revenue under Islamic finance methods. If the MFI is earning fees and commissions on loans to employees or board members, these should be disclosed. If these fees and commissions are significant, the MFI should create two sub-accounts for I3 one for Fees and Commissions from Clients and the other for Fees and Commissions from Related Parties	

[70] For further details, see SEEP and USAID Accelerated Microenterprise Advancement Project 2005.

Reference	Account name	Definition	Calculation
I5	Financial Revenue from Investments	Revenue from interest, dividends, and other payments generated by financial assets other than the loan portfolio, such as interest-bearing deposits, certificates of deposit, and treasury obligations. This may include net trading income (gains less losses) from securities and foreign currency trading and the recovery of any interest revenue that was previously written off.	
I6	Other Operating Revenue	All other revenue from the provision of financial services, including transaction fees, premiums, membership fees, passbooks, and smartcards. If the MFI provides loans to employees or board members, the interest and fee revenue from those loans should be included here. This account also includes net foreign exchange gains.	**I8 + I11**
I7	Financial Expense	Total value of all financial expenses incurred from operations.	
I8	Financial Expense on Funding Liabilities	Total of Interest and Fee Expense on Deposits (I9) and Interest and Fee Expense on Borrowings (I10), as defined below.	**I9 + I10**
I9	Interest and Fee Expense on Deposits	Interest and fees incurred on all deposits taken by the MFI.[71]	
I10	Interest and Fee Expense on Borrowings	Interest and fees incurred on all borrowings that fund the loan portfolio. This account does not include interest and fees on nonfunding liabilities, such as mortgages or car loans. These items are included in Other Financial Expense (I11).	

[71] Managers may want two subaccounts: Interest Expense on Deposits (I9-1) and Fee Expense on Deposits (I9-2). These two subaccounts will enable managers to calculate the spread between Interest on the Loan Portfolio (I3) and Interest Expense on Deposits (I9-1).

Reference	Account name	Definition	Calculation
I11	Other Financial Expense	Other financial expense related to financial services, including interest on nonfunding liabilities, such as mortgages, and loans linked to fixed assets, such as vehicles. This account also includes net foreign exchange loss. For MFIs required by national law to use inflation-based accounting, this account also includes the amount of net loss on monetary position because of inflation as defined by International Accounting Standard (IAS) 27, known as the Net Inflation Expense.[72] Finally, it includes any expenses used to reduce Interest Receivable on Loan Portfolio (B6), if the interest is considered uncollectible.[73]	
I12	Net Financial Income	Net value of financial earnings from financial services.	**I1 – I7**
I13	Impairment Losses on Loans	Previously knows as Net Loan Loss Provision Expense; now Provision for Loan Impairment (I14) net of Value of Loans Recovered (I15).[74]	**I14 – I15**
I14	Provision for Loan Impairment	Previously known as Loan Loss Provision Expense; the noncash expense calculated as a percentage of the value of the loan PAR of default. This value is calculated in the portfolio report and is used to create or increase the Allowance for impairment (B5) on the balance sheet.	

[72] I11 does not include inflation adjustments that are made for analysis purposes only, as discussed in SEEP and USAID Accelerated Microenterprise Advancement Project 2005, pp. 39–64.

[73] International Accounting Standard (IAS) 18.34 states that if uncertainty arises on whether accrued revenue will be paid, the institution should recognize an expense (rather than a reversal of revenue) for the uncertain amount. This results in an expense to the income statement, Other Financial Expense (I11) and a reduction of Interest Receivable on Loan Portfolio (B6).

[74] According to IAS 37, the proper term for this account is Impairment Losses on Loans. Although the term Net Loan Loss Provision Expense is still commonly used by MFIs, International Financial Reporting Standards (IFRS) are very clear on the need to use the proper term, and MFIs are encouraged to do so.

Recovery of loans written off is included here as part of Impairment Losses on Loans in accordance with IFRS. Some institutions include recoveries as extraordinary income, part of Non-Operating Revenue (I23); however, IAS 8 prohibits this. Institutions are recommended to show both the Provision for Loan Impairment and the Value of *Loans Recovered* on the income statement as subaccounts. If the amount of recoveries is material, SEEP recommends that the amount be presented as its own account.

Reference	Account name	Definition	Calculation
I15	Value of Loans Recovered	Total value of principal recovered on all loans previously written off. This includes principal on partially recovered loans and those recovered in full. Subsequent recoveries of loans previously written off decrease the amount of the Provision for Loan Impairment (I14), and the net amount is booked as Impairment Losses on Loans (113).	
I16	Operating Expense	All operating expenses, including Personnel Expense (I17) and Administrative Expense (I18), incurred in providing financial services.	**I17 + I18**
I17	Personnel Expense	Includes staff salaries, bonuses, and benefits and employment taxes. It also includes the cost of employee recruitment and initial orientation, but not the cost of ongoing or specialized training for existing employees, which is an Administrative Expense (I18).	
I18	Administrative Expense	Nonfinancial expenses (excluding personnel) directly related to the provision of financial services or other services that form an integral part of an MFI's financial services' relationship with its clients.	**I19 + I20**
I19	Depreciation and Amortization Expense	The noncash expense that allocates the purchase cost of an MFI's fixed assets over their useful economic life. The depreciation expense is used to create or increase Accumulated Depreciation and Amortization (B11) on the balance sheet. Amortization is used for other tangible assets, such as software. If amortization is significant, it should be disclosed, and the MFI should add two subaccounts: one for Depreciation Expense and the other for Amortization Expense (I19).[75]	

[75] Because IFRS regulations are strict regarding amortization, MFIs should amortized tangible assets only and not include intangible assets, such as goodwill.

Reference	Account name	Definition	Calculation
I20	Other Administrative Expense	All administrative expenses other than Depreciation and Amortization Expense (I19). Examples include rent, utilities, supplies, advertising, transportation, communications, and consulting fees. It may also include certain taxes related to administration, such as a value-added tax. These expense categories may be listed as separate line items as appropriate.	
I21	Net Operating Income	Net earnings from the provision of financial services.	**I12–I13–I18**
I22	Net Non-Operating Income/(Expense)	Net earnings from products and services not directly related to core microfinance operations. Institutions should disclose large material amounts of nonoperating revenue separately by creating accounts under Non-Operating Revenue (I23) or Non-Operating Expense (I24).	**I23–I24**
I23	Non-Operating Revenue	All revenue not directly related to core microfinance operations, such as revenue from business development services, training, consulting services, MIS sales, or sale of merchandise. It does not include Donations (I28). This account also includes any exceptional gains and revenues. Large or relevant nonoperating revenue categories should be listed as separate line items, as appropriate.	
I24	Non-Operating Expense	All expenses not directly related to core microfinance operations, such as the cost of providing business development services or training. This account also includes any exceptional losses and expenses. Large or relevant nonoperating expense categories should be listed as separate line items as appropriate.	

Reference	Account name	Definition	Calculation
I25	Net Income (Before Taxes and Donations)	All net earnings from the institution's operations before the inclusion of taxes and donations.	**I21 + I22**
I26	Taxes	Includes all taxes paid on Net Income (I25) or other measure of profit as defined by national tax authorities.	
I27	Net Income (After Taxes and Before Donations)	All net earnings from the institution's operations, net of Taxes (I26) and before the inclusion of Donations (I28).	**I25–I26**
I28	Donations	Value of all donations recognized as revenue during the period, whether restricted or not.	**I29 + I30**
I29	Donations for Loan Capital	Value of all donations used to fund the loan portfolio. Many MFIs are accustomed to applying Donations for Loan Capital directly to the balance sheet. To increase transparency, this framework requires that they are first booked as nonoperating revenue.	
I30	Donations for Operating Expenses	Value of all donations used to pay for operations other than funding the loan portfolio. These operations include paying personnel and administrative expenses and purchasing fixed assets.	
I31	Net Income (After Taxes and Donations)	All net earnings from the institution's operations, net of Taxes (I26) and after the inclusion of Donations (I28).	**I27 + I28**

Balance sheet

Reference	Account name	Definition	Calculation
		Assets	
B1	Cash and Due from Banks	Cash on hand, near cash, and other highly liquid instruments paying little or no interest. This may include noninterest-bearing bank balances and deposits. For MFIs that are banks, it may include very short (overnight, daily, weekly) money market investments or treasuries.	
B2	Trade Investments	Any financial assets acquired or incurred primarily for the purpose of selling or repurchasing in the near term—that is, convertible to cash within or at 12 months or having a longer term but used for short-term profit taking or trading. These may include certificates of deposit, including interest-bearing deposits and treasury bills, and are often used in liquidity management.	
B3	Net Loan Portfolio	Gross Loan Portfolio (B4) less Allowance for Impairment (B5).	B4–B5
B4	Gross Loan Portfolio	All outstanding principal due within or at 12 months for all outstanding client loans. This includes current, delinquent, and renegotiated loans, but not loans that have been written off. All delinquent loans should be considered short term and included here. It does not include interest receivable. If the MFI makes loans to employees, board members, or others associated with the institution, it should disclose this and, if the amount is significant, create two subaccounts for (B4)—one for Loans to Clients (B4-1) and the other for Loans to Related Parties (B4)	

Reference	Account name	Definition	Calculation
		Assets	
B5	Allowance for Impairment	Previously known as Loan Loss Allowance, the portion of the Gross Loan Portfolio (B4) that has been expensed (provisioned for) in anticipation of losses because of default. This item represents the cumulative value of the impairment losses on loans less the cumulative value of loans written off. Express this item as a contra asset account, and state it as a negative number.[76]	
B6	Interest Receivable on Loan Portfolio	Interest receivable on the Gross Loan Portfolio (B5) net of any expense to reduce accrued interest if the collection of the accrued interest is considered uncertain (see I11).	
B7	Accounts Receivable and Other Assets	Accounts receivable, notes receivables, and other receivables, net of any allowances for doubtful or uncollectible accounts. This includes all receivables other than client loan accounts, including employee loans and interest receivable on nonfunding liabilities, such as mortgages.	
B8	Other (Long-term) Investments	Include investments that have a fixed maturity or payments the MFI intends to hold to maturity. This item may include bonds or shares the MFI plans to hold for 12 months or more or other financial assets available for sale but not considered loans, receivables, or Trade Investments (B2).	
B9	Net Fixed Assets	Cost or value of all physical property and other tangible assets that the MFI currently uses less accumulated depreciation expense (B11).	B10 + B11

[76] Some MFIs may increase Allowance for Impairment (B5) by taking a direct charge to Retained Earnings (B26) or some other account. For transparency, MFIs should create the Allowance for Impairment through Impairment Losses on Loans (I13).

Reference	Account name	Definition	Calculation
		Assets	
B10	Fixed Assets	Cost or value of all physical property and property improvements, furniture, and equipment the MFI currently uses (including all donated equipment the MFI owns). This may include other tangible assets, such as software. Intangible assets (assets that have no physical properties but represent a future economic benefit to the MFI) may be included here, if permitted by national accounting standards.[77]	
B11	Accumulated Depreciation and Amortization	Sum of all depreciation expenses for Fixed Assets (B10) and the amortization of other tangible assets that have not yet been retired and removed from the balance sheet. Accumulated depreciation represents the reduction in value of Fixed Assets corresponding to the assets' remaining useful life. Amortization of intangible assets may be included here if the practice is permitted by national accounting standards. This contra asset account is expressed as a negative number.	
B12	Total Assets	The value of all asset accounts net of all contra asset accounts.	B1 + B2 + B3 + B6 + B7 + B8 + B9
		Liabilities	
B13	Demand Deposits	Deposits mobilized from the general public and members that the MFI is liable to repay on demand. This includes any current, checking, or savings accounts that are payable on demand.	

[77] Because IFRS is strict in its definition of intangible assets, MFIs should review IFRS guidelines before creating goodwill or other intangible assets on their books.

Reference	Account name	Definition	Calculation
		Liabilities	
B14	Short-term Time Deposits	Deposits mobilized from the general public and members that the MFI is liable to repay on a fixed date within 12 months of the statement date. This includes certificates of deposit or fixed-term deposits. It also includes compulsory deposit accounts held by the MFI as a condition for a current or future loan or other service, such as cash collateral accounts or guarantee deposits.[78]	
B15	Short-term Borrowings	Principal balance due within or at 12 months from the statement date for all funds received through a loan or other contractual debt agreement. This includes loans, lines of credit, and overdraft facilities with outstanding balances, as well as the portion of long-term obligations payable within 12 months.	
B16	Interest Payable on Funding Liabilities	Interest accrued on liability accounts that fund financial operations, including B13, B14, B15, B18, and B19. It does not include borrowing for purchasing or improving real estate or other fixed assets, such as vehicles. This item is included in B17.	
B17	Accounts Payable and Other Short-term Liabilities	Other short-term liabilities due within 12 months, including tax and salary liabilities, payroll withholdings, and other accounts payable. It should also include any short-term portion of deferred revenue.[79]	

[78] MFIs are encouraged to distinguish compulsory and voluntary deposits in subaccounts to (B14) for analysis.

[79] For MFIs, deferred revenue is primarily donations or grants received that have not been used yet for a future or specific purpose. If the funds are contractually short term (that is, must be spent in the coming 12 months), they should be included in Accounts Payable and Other Short-term Liabilities (B17). If they must be spent for the specific purpose in more than 12-months time or the timeframe is unspecified, deferred revenue should be included in Other Long-term Liabilities (B20).

Reference	Account name	Definition	Calculation
		Liabilities	
B18	Long-term Time Deposits	Deposits mobilized from the general public and members that the MFI is liable to repay with a fixed maturity date greater than 12 months from the statement date.	
B19	Long-term Borrowings	Principal balance due in more than 12 months for all funds received through a loan or other contractual agreement and all subordinated debt.[80] This account should not include long-term funds for which no set repayment date exists, such as long-term subsidized loans from related companies or public agencies (see B20).	
B20	Other Long-term Liabilities	Other long-term liabilities due in more than 12 months, including long-term deferred revenue, pension liabilities, and liabilities that do not directly fund the financial operations of the MFI portfolio, such as mortgages on real estate and other loans for fixed asset purchases. Long-term concessional funding for which no repayment date is set or anticipated, but is not a grant, is also included in this account.	
B21	Total Liabilities	Total value of all liability accounts.	B13 + B14 + B15 + B16 + B17 + B18 + B19 + B20 ...
		Equity	
B22	Paid-In Capital	Value of capital paid by shareholders or members net of any shares repurchased or capital repaid.	

[80] If the MFI can distinguish between the short- and long-term portions of subordinated debt, these portions should be correctly divided between (B15) and (B19). If not, all subordinated debt should be in Long-term Borrowings (B19).

Reference	Account name	Definition	Calculation
		Equity	
B23	Donated Equity	Total value of all Donations (I28) received and recognized as revenue.	B24 + B25
B24	Prior Years	Cumulative value of Donations (I28) from prior fiscal years.	
B25	Current Year	Value of Donations (I28) from the current fiscal year.	
B26	Retained Earnings	Total value of Net Income (After Taxes and Before Donations) (I27) from current and prior periods, net of dividends paid to shareholders or members.	B27 + B28
B27	Prior Years	Cumulative value of Net Income (After Taxes and Before Donations) (I27) from prior periods, net of dividends paid to shareholders or members.	
B28	Current Year	The value of Net Income (After Taxes and Before Donations) (I27) from the current fiscal year.	
B29	Reserves	Reserves such as those imposed by law, statute, or board decisions.	
B30	Other Equity Accounts	Other equity accounts, including all revaluations and adjustments. For MFIs required to use inflation-based accounting, this account should be used to offset the Net Inflation Expense, included in I11. The MFI should disclose any substantial item in this account.	
B31	Adjustments to Equity	Adjustments to the balance sheet to account for subsidized funds, in-kind subsidies, and inflation.	
B32	Total Equity	Total value of all equity accounts.	B22 + B23 + B26 + B29 + B30 + B31 ...

Cash flow statement

Reference	Account name	Definition	Calculation
		Cash flows from operating activities	
C1	Cash Received from Interest, Fees, and Commissions on Loan Portfolio	Total value of financial revenue received in cash from the Gross Loan Portfolio (B4). If an MFI uses cash accounting, this account is the same as Financial Revenue from Loan Portfolio (I2). It does not include fees described in Other Operating Revenue (I6).	
C2	Cash Received from Interest on Investments	Total value of all financial revenue received in cash from Trade Investments (B2) and Other (Long-term) Investments (B8). If an MFI uses cash accounting, this account is the same as Financial Revenue from Investments (I5).	
C3	Cash Received as Other Operating Revenue	Total value of all other operating revenue received in cash for the provision of financial services. If an MFI uses cash accounting, this account is the same as Other Operating Revenue (I6).	
C4	Value of Loans Repaid	Value of all loan principals repaid in cash by the MFI's clients during the period. This includes payments related to current and past-due loans as well as recoveries of written-off loans.	
C5	(Cash Paid for Financial Expenses on Funding Liabilities)	Total value of all interest and fee expenses paid in cash on deposits and borrowings. If the MFI uses cash accounting, this account is the same as Financial Expense on Funding Liabilities (I8).	
C6	(Cash Paid for Other Financial Expenses)	Total value of any other financial expense paid in cash. Most MFIs' other financial expenses are noncash (such as inflation expense) and so are not included in this account.	

Reference	Account name	Definition	Calculation
		Cash flows from operating activities	
C7	(Cash Paid for Operating Expenses)	Total value of personnel and administrative expenses paid in cash to support the provision of financial services. This account does not include noncash expenses, such as depreciation. If the MFI uses cash accounting, this account is the same as Personnel Expense (I17) plus Other Administrative Expense (I20).	
C8	(Cash Paid for Taxes)	Total value of taxes paid in cash. This includes taxes paid on net income or other measures of revenue or profit. Taxes related to employment or purchases, such as a value-added tax, are included in Operating Expense (I16). If the MFI uses cash accounting, this account is the same as Taxes (I26).	
C9	(Value of Loans Disbursed)	The value of all loans disbursed *in cash* during the period.	
C10	Net (Purchase)/Sale of Trade Investments	Cash paid for the purchase (net of cash received for the sale) of Trade Investments (B2). If purchases exceed sales, this number will be negative. These purchases may include certificates of deposit, including interest-bearing deposits, and treasury bills, and because they are typically used in liquidity management, they are considered an operating activity. This account should be the same as the change in Trade Investments ($B2^0 - B2^1$).	
C11	Deposits/(Withdrawals) from Clients	Cash deposits/(withdrawals) made by the institution's clients as Demand Deposits (B13) or Short-term Time Deposits (B14), or Long-term Time Deposits (B18) held at the institution, calculated as $(B13^1 - B13^0)+(B14^1 + B14^0)+(B18^1 - B18^0)$.	

Reference	Account name	Definition	Calculation
		Cash flows from operating activities	
C12	Cash Received/(Paid) for Other Operating Assets and Liabilities	Any cash receipt of payment that increases Accounts Receivable and Other Assets (B7) or Accounts Payable and Other Short-term Liabilities (B17) and Other Long-term Liabilities (B20). Examples include disbursements of repayment of advances or loans to employees and cash payouts of pensions. This account does not include payments for services that increase assets—such as prepaid rent or insurance—that are included in Cash Paid for Operating Expenses (C7).	
C13	Net Cash from Operating Activities	Sum of all cash flows arising from the principal revenue-producing activities of the institution and other activities that are neither investing nor financing activities.	C1 + C2 + C3 + C4 + C5 + C6 + C7 + C8 + C9 + C10 + C11 + C12
		Cash flows from investing activities	
C14	Net (Purchase)/Sale of Other Investments	Cash paid for the purchase (net of cash received from the sale) of Other (Long-term) (B8) Investments. If purchases exceed sales, this will be a negative number. This account may include bonds or shares that an institution plans to hold for longer than one year. This number should be the same as the change in Other (Long-term) Investments ($B8^0 – B8^1$).	
C15	Net (Purchase)/Sale of Fixed Assets	Cash payments to acquire property, buildings, and equipment less any cash proceeds from the sale of property, buildings, and equipment. This number should be the same as the change in Fixed Assets ($B10^0 – B10^1$).	

Reference	Account name	Definition	Calculation
		Cash flows from investing activities	
C16	Net Cash from Investing Activities	Sum of all cash flows arising from the acquisition and disposal of long-term assets and other investments not included in cash equivalents.	C14 + C15
		Cash flows from financing activities	
C17	Net Cash Received/ (Repaid) for Short- and Long-term Borrowings	Cash proceeds/payments from borrowing or issuing notes. This number should be the same as the change in Short-term Borrowings (B15) and Long-term Borrowings (B19), $[(B15^1 - B15^0) + (B19^1 - B19^0)]$.	
C18	Issuance/(Repurchase) of Paid-In Capital	Cash proceeds (payments) from issuing (repurchasing) shares or other equity instruments.	
C19	(Dividends Paid)	Amount of dividends distributed to shareholders or members in cash. These distributions should be made from Retained Earnings (B26).	
C20	Donated Equity	The value of donations received in cash from the current period.	
C21	Net Cash from Financing Activities	Sum of all cash flows from activities that result in changes in the size and composition of the funding liabilities and equity of the institution.	C17 + C18 + C19 + C20
C22	Net Cash Received/ (Paid) for Non-Operating Activities	Sum of all cash received and paid for nonoperating activities.	
C23	Net Change in Cash and Due from Banks	Sum of cash flows from operating, investing, financing, and nonoperating activities.	C13 + C16 + C21 + C22
C24	Cash and Due from Banks at the Beginning of the Period	Cash on hand, near cash, and other highly liquid instruments paying little or no interest at the beginning of the period. This number is the same as Cash and Due from Banks (B1) for the end of the previous period.	

Reference	Account name	Definition	Calculation
Cash flows from financing activities			
C25	Exchange Rate Gains/(Losses) on Cash and Cash Equivalents	Unrealized gains and losses arising from changes in Cash and Cash Equivalents in foreign currency exchange rates.	
C26	Cash and Due from Banks at the End of the Period	Cash on hand, near cash, and other highly liquid instruments paying little or no interest at the end of the period. This number is the same as Cash and Due from Banks (B1) for the end of the current period.	C23 + C24 + C25

Annex 6. Analytical Adjustments to Financial Statements

MFIs, regardless of their social missions, are financial intermediaries. As such, it is important for managers and others to accurately assess the viability and soundness of MFIs as financial institutions. Analytical adjustments to the financial statements of MFIs are often made to support these assessments, usually for one or both of the following reasons:

- To reflect the true performance of MFIs (or analyze their viability, based on their ability to cover costs and maintain their level of operations over the long term)
- To enable meaningful comparisons of MFIs—that is, benchmarking—across a wide range of institutions, despite the diversity of the industry[81]

Although commercial banks usually do not engage in analytical adjustments, the need for analytical adjustments in microfinance is gaining acceptance. Most MFI managers are accustomed to hearing the term *adjustments* when referring to financial reporting; however, it means different things to different people. CGAP's *Microfinance Consensus Guidelines: Definitions of Selected Financial Terms, Ratios and Adjustments for Microfinance* (2003) defines some of the most common adjustments used in analyzing MFIs.

Three main types of adjustments are traditionally applied to MFIs: for subsidies, inflation, and PAR.[82] These adjustments are summarized in Table A6.1

Table A6.1 Summary of Adjustments to Microfinance Institutions

Reference	Account name	Definition
		Subsidies
A1	Subsidized Cost of Funds Adjustment	Examines the difference between an MFI's financial expense and the financial expense it would pay if all its funding liabilities were priced at market rates.

[81] The adjustments suggested in this annex use a standard approach that allows for benchmarking. It is based on the approach described in SEEP Network Financial Services Working Group and Alternative Credit Technologies, LLC, 2005. See that publication for specific methods on how to perform the adjustments. Any other adjustment methodology used should be clearly defined and all related information disclosed. Analysts should explain their choice of a particular adjustment methodology and its effect on the MFI's financial statements.

[82] A further adjustment is the reversal of interest accruals. This adjustment reverses all revenue from the loan portfolio on an accrual basis that records interest when it is earned, rather than when a cash payment is received from the borrower. This adjustment applies only to MFIs that accrue interest on their loan portfolios. Analysts are encouraged to use their discretion when considering this additional adjustment.

Reference	Account name	Definition
		Subsidies
A2	In-Kind Subsidy Adjustment	Difference between what an MFI pays for a donated or subsidized good or service and what it would have to pay on the open market. Donors often give MFIs funds as well as goods and services at no cost or at below-market cost. Examples of these in-kind subsidies include computers, consulting services, office space, and managerial services.
		Inflation
A3	Inflation Adjustment	The rationale behind this adjustment is that an MFI should, at a minimum, preserve the value of its equity (and shareholder or donor investments) against erosion because of inflation. This adjustment is important to consider when benchmarking institutions in different countries and economic environments. Unlike subsidy adjustments, recording an inflation adjustment is common in many parts of the world and is mandated by Section 29 of the International Accounting Standards (IAS) in high-inflation economies.
		Nonperforming loans
A4	Adjustment for Impairment Allowance	Intended to bring an MFI's Allowance for impairment in line with the quality of its Gross Loan Portfolio. The standard loan loss allowance provisioning rates used by *MicroBanking Bulletin* to create international benchmarks are: • Current portfolio → 0 percent • PAR 1–30 days → 10 percent • PAR 31–60 days → 30 percent • PAR 61–90 days → 30 percent • PAR 91–180 days → 60 percent • PAR > 180 days → 100 percent • Renegotiated portfolio? → 100 percent

Reference	Account name	Definition
		These rates correspond to the minimum proposed provisioning. If there is no information to support a more sophisticated provisioning policy, a simple alternative is to provision a fixed percentage (such as 2 percent) of every loan at the time of its disbursement. Provisioning should be based on the MFI's loan terms, repayment frequencies, and historical experiences. The choice of provisioning method can have a substantial impact on certain financial ratios. Thus, whatever method used should be fully explained in a note to the balance sheet.
A5	Write-off Adjustment	Intended to identify loans on an MFI's books that, by any reasonable standard, should be written off. This adjustment can significantly reduce the value of an MFI's assets if persistent delinquent loans are not counted as part of the gross loan portfolio.

Annex 7. Financial Risk Management: Asset–Liability Management Analysis

The analyses of financial risk management described in this annex are for large or mature MFIs. The analyses described here should be conducted only if the analyst is concerned that the MFI's asset–liability risks—including maturity, interest rate, or foreign exchange mismatch—pose significant actual or *potential* risks to the MFI.

Asset–liability maturity matching analysis

Because MFIs typically borrow long and lend short, tenors of liabilities often exceed those of assets. Using Table 7.10, the analyst should comment on the extent of the MFI's asset–liability maturity mismatch and indicate how large and risky it is given the interest rate environment in which the MFI operates. For example, maturity gaps should account for less than 10 percent of shareholder equity in each maturity bracket and cumulative maturity gaps should account for less than 20 percent.[83] The analyst also should identify any regulatory limits related to such mismatches, such as a maximum percentage of short-term assets that can be lent out and the impact these have on the MFI's risk levels.

[83] These recommendations—from Women's World Banking 2005—are new to the microfinance sector and should be used only as a point of reference.

7.10: Asset/Liability Total Maturity Mismatch Table

As of (Date):
Currency:

		<1 mth	1–3 mths	>3–6 mths	>6–12 mths	>1–2 yrs	>2–3 yrs	>3–4 yrs	>4–5 yrs	>5 yrs	No Maturity or Un-known	Total
ASSETS												
1	Cash and Due from Banks											
2	Trade Investments											
3	Net Loan Portfolio (top line only)											
4	Interest Receivable on Loan Portfolio + Accounts Receivable and Other Assets											
5	Other Investments											
6	Net Fixed Assets (top line only)											
7	**Total Assets**											
LIABILITIES												
8	Demand Deposits: Voluntary Savings											
9	Demand Deposits: Forced Savings											
10	Short-Term Time Deposits											
11	Short-Term Borrowings											
12	Interest Payable on Funding Liabilities + Accounts Payable and Other Short-Term Liabilities											

As of (Date):
Currency:

	Table 7.10: Asset/Liability Total Maturity Mismatch Table (continued)	<1 mth	1–3 mths	>3–6 mths	>6–12 mths	>1–2 yrs	>2–3 yrs	>3–4 yrs	>4–5 yrs	>5 yrs	No Maturity or Un-known	Total
13	Long-Term Time Deposits											
14	Long-Term Borrowings											
15	Other Long-Term Liabilities											
16	**Total Liabilities**											
17	**Total Equity**											
18	**Total Liabilities & Equity**											
19	**Asset--Liability Gap**											
20	**As % of equity**											
21	**Cumulative Gap**											
22	**Cumulative Gap as % of Equity**											

Foreign currency matching analysis

Using Table 7.11, the analyst should evaluate the MFI's foreign currency exposure risk. How much does the MFI borrow in hard currency? Does it meet suggested prudential guidelines for such borrowing, such as maintaining a ratio of foreign currency assets to foreign currency liabilities between 0.9 and 1.1?[84] If not, the analyst should describe the MFI's plans to address the mismatches or mitigate the risks. What steps, if any, does the MFI take to hedge foreign exchange risk? Are they adequate and sufficient?

Table 7.11 Foreign Currency Mismatch Table

						As of (Date):
						Exchange Rate:
		US $	**Euro**	**Local Currency**	**Others**	**Total**
ASSETS						
1	Cash and Due from Banks					
2	Trade Investments					
3	Net Loan Portfolio (top line only)					
4	Interest Receivable on Loan Portfolio + Accounts Receivable and Other Assets					
5	Other Investments					
6	Net Fixed Assets (top line only)					
7	**Total Assets**					
LIABILITIES						
8	Demand Deposits: Voluntary Savings					
9	Demand Deposits: Forced Savings					
10	Short-Term Time Deposits					
11	Short-Term Borrowings					
12	Interest Payable on Funding Liabilities + Accounts Payable and Other Short-Term Liabilities					
13	Long-Term Time Deposits					

[84] Women's World Banking 2005.

Table 7.11 Foreign Currency Mismatch Table (continued)

						As of (Date):
						Exchange Rate:
		US $	**Euro**	**Local Currency**	**Others**	**Total**
14	Long-Term Borrowings					
15	Other Long-Term Liabilities					
16	**Total Liabilities**					
17	**Total Equity**					
18	**Total Liabilities & Equity**					
19	**Net Open Position (A-TL and Equity)**					
20	**Net Open Position as % of equity**					
21	**Assets/Liabilities**					

Interest rate mismatch analysis

The analyst should analyze the MFI's interest risk exposure using Table 7.12. If there is an interest rate mismatch, the MFI's financial management team should be aware of it and keep abreast of the interest rate environment. The MFI's board may want to set a maximum risk tolerance level for interest rate mismatches or at least develop minimum guidelines.

In Table 7.12, assets and liabilities are classified based on the dates when their underlying interest rates are reset, not their maturity dates.

7.12: Interest Rate Sensitivity Mismatch Table

As of (Date):
Currency:

		<1 mth	1–3 mths	>3–6 mths	>6–12 mths	>1–2 yrs	>2–3 yrs	>3–4 yrs	>4–5 yrs	>5 yrs	Non-Interest bearing	Total
ASSETS												
1	Cash and Due from Banks											
2	Trade Investments											
3	Net Loan Portfolio (top line only)											
4	Interest Receivable on Loan Portfolio + Accounts Receivable and Other Assets											
5	Other Investments											
6	Net Fixed Assets (top line only)											
7	**Total Assets**											
LIABILITIES												
8	Demand Deposits: Voluntary Savings											
9	Demand Deposits: Forced Savings											
10	Short-Term Time Deposits											
11	Short-Term Borrowings											
12	Interest Payable on Funding Liabilities + Accounts Payable and Other Short-Term Liabilities											

As of (Date):
Currency:

	Table A. 7.12: Asset/Liability Total Maturity Mismatch Table (continued)	<1 mth	1–3 mths	>3–6 mths	>6–12 mths	>1–2 yrs	>2–3 yrs	>3–4 yrs	>4–5 yrs	>5 yrs	Non-Interest bearing	Total
	Long-Term Time Deposits											
14	Long-Term Borrowings											
15	Other Long-Term Liabilities											
16	**Total Liabilities**											
17	**Total Equity**											
18	**Total Liabilities & Equity**											
19	**Asset–Liability Gap**											
20	**As % of equity**											

*Annex 8. MicroBanking Bulletin Definitions for Benchmarking Peer Groups**

Setting up Peer Groups

The *MicroBanking Bulletin* (MBB) is designed to create performance benchmarks against which managers and directors of MFIs can compare their institution's performance with that of similar institutions. Because the microfinance industry consists of a range of institutions and operating environments, some with very different characteristics, an MFI should be compared to similar institutions for the reference points to be useful. MBB addresses this issue with its peer group framework. Peer groups are sets of programs that have similar characteristics—similar enough that their managers find utility in comparing their results with those of other organizations in their peer group. MBB forms peer groups on two bases: simple and compound peer groups.

Simple Peer Groups look at MFIs based on a single characteristic. This allows users to analyze performance based on a common factor, such as age, location, or scale of operations. MFIs have been grouped according to the following 10 characteristics for the 2005 edition of MBB:

1. *Age*: MBB classifies MFIs into three categories (new, young, and mature) based on the maturity of their microfinance operations. This is calculated as the difference between the year they started their microfinance operations and the year of data submitted by the institutions.
2. *Charter Type*: The charter under which the MFIs are registered is used to classify the MFIs as banks, credit unions/cooperatives, NGOs, and nonbank financial institutions.
3. *Financial Intermediation*: This classification measures the extent to which an MFI intermediates between savers and borrowers, funding its assets through mobilized deposits. It is calculated as a percentage of total assets funded by voluntary savings.
4. *Lending Methodology*: Performance may vary by the way the institution delivers its loan products and serves borrowers. MBB classifies MFIs based on the *primary* methodology used, determined by the number and volume of loans outstanding.

*Source: MicroBanking Bulletin, Issue No. 11, August 2005, pp. 84–85.

5. *Outreach*: Scale of outreach is measured as the total number of borrowers served.
6. *Profit Status*: According to their registration, MFIs are classified as not-for-profit or for-profit institutions.
7. *Region*: MFIs placed into one of five main geographic regions: Africa, Asia, Eastern Europe and Central Asia (ECA), Latin America, and Middle East and North Africa (MENA).
8. *Scale*: Institutional scale is measured by the size of an institution's loan portfolio in U.S. dollars. The measure of scale is regionalized to reflect differences in income levels across regions.
9. *Sustainability*: MFIs are grouped according to their level of financial self-sufficiency, representing their ability to cover all costs on an adjusted basis.
10. *Target Market*: MBB classifies MFIs into three categories—low end, broad, and high end—according to the average balance of loans served. For international comparison, this balance is stated as a percentage of local income levels (GNI per capita).

Compound Peer Groups use a more complex set of variables to analyze MFI performance. This creates benchmarks where institutions have a greater number of similar factors affecting performance. MBB considers two main indicators in forming these groups: *Region* and *Scale*. A third indicator is used to further group similar institutions. Past editions of MBB traditionally have used *target market* as a final grouping factor. Given the growth of retail financial intermediation, both within the industry and in the MBB data set, *financial intermediation* has become a more decisive factor for comparing MFIs. Either one factor or the other is used in this edition, depending on the distribution within the resulting compound peer group.

Annex 9. Calculating Theoretical Interest Yields

Explanation on method of calculation of effective yield for use in completing Table 7.9, Comparison of Actual and Theoretical Yield

If the rate is not stated as an annual rate, multiply the periodic rate by the number of periods in a year to produce an annual percentage yield; do not use a compounding method. If the program has compulsory savings, exclude these when calculating theoretical APR yields. Note that in some cases there may be a significant discrepancy between the way the methodology in Annex 9 enters cash flows into the calculator and the way these cash flows show up in the MFI's accounting.

When calculating the yield gap, make sure the theoretical (expected) yield is calculated the same way as the actual yield will be calculated from the MFI's accounting information. This possible problem will be most pronounced where there are compulsory savings and where prepaid interest or other large amounts are deducted up front at the time of loan disbursement. In these cases, a yield gap analysis is sometimes best done using a simple spreadsheet model rather than the financial calculator approach illustrated in Annex 5.

A yield calculation module is available in Appraise.xls. (If the gap is substantial, try to determine how much of the gap can be explained by the MFI's reported delinquency. See the analysis in Holtmann and Mommartz 1996, pp. 110–11.)

A microcredit interest rate quoted at, say, 3 percent a month may be equivalent to a much higher effective rate, depending on how the loan and its repayment are structured. The real cost to the borrower, and the lending institution's real income from its loan portfolio, can be raised significantly by such practices as:

- Computing interest on the original face amount of the loan (a flat interest charge) rather than on the declining balances remaining in the borrower's hands as successive installments of principal are repaid.
- Requiring payment of interest at the beginning of the loan (as a deduction from the amount of principal disbursed to the borrower) rather than spreading interest payments throughout the life of the loan.
- Charging a commission or fee in addition to the interest.

- Quoting a monthly interest rate, but collecting principal and interest weekly and counting four weeks as a month.
- Requiring a portion of the loan amount to be deposited with the lender as compulsory savings or a compensating balance.

As used here, the effective interest rate of a loan is the rate the client is really paying, relative to the loan proceeds actually in the client's hands at each point during the life of the loan. It is equivalent to a rate charged on declining balances.[85]

Computing effective interest rates

The computations of effective interest rate illustrated here can be performed using a basic financial calculator.[86] The user enters the known loan variables, and the calculator computes the remaining variable:

PV=present value, the net amount of cash disbursed to the borrower at the beginning of the loan
i=interest rate, which must be expressed in the same time unit as *n*, below
n=term (number of periods) of the loan
PMT=payment made each period[87]
FV=future value, the amount left in the client's hands after the loan is repaid, which is usually zero except in the case of a loan with a compulsory savings component

[85] In standard practice, the effect of compounding is included in calculating an annual effective rate: for example, if a borrower pays 3 percent every month, the effective annual rate is not 36 percent (12 x 0.03) but 42.6 percent (1.0312 – 1). This compounded rate is the appropriate one to use when comparing the real cost to a borrower of different interest rate structures, especially when different time periods are involved. But in this annex, when a weekly or monthly rate is annualized, an annual percentage rate (APR) method is used; that is, compounding is not taken into account. This produces an annual rate more in line with the actual income generated by an institution's portfolio. For example, a portfolio whose effective monthly yield is 3 percent—almost all of which is used to pay costs rather than reinvested—will generate returns of about 36 percent a year, not 42.6 percent. Note that delinquency and other factors can reduce the actual yield on a portfolio well below the APR being charged on the loans making up that portfolio.

[86] The computations also can be performed using the financial functions of a computer spreadsheet application, such as Excel or Lotus 1-2-3.

[87] Microloans are usually structured so that the borrower's payment is the same each period. Where the payment amount changes from one period to another (because of a grace period, for example), the computation requires a calculator with an internal rate of return function or a computer spreadsheet.

The computations are illustrated through a base case and eight alternatives. In the base case, where interest is calculated on declining balances, the calculator is used to determine the necessary monthly payment amount. Each of the alternatives involves two steps. First, the actual cash flows received and paid by the client are computed. Next, those cash flows are entered into the calculator to determine the effective rate per period, which is then annualized by multiplying by the number of periods in a year.

The results show how wide a range of yields can be produced by loans with the same nominal (stated) rate but differences in the structure of charges and payments.

Base case: Declining balance

The loan amount is 1,000, to be repaid in four equal monthly payments of principal and interest. The stated interest rate is 36 percent a year, or 3 percent a month, calculated on declining balances—that is, the interest is charged only on the amount of the loan principal that the borrower has not yet repaid. In this base case, the effective monthly interest rate is the same as the stated rate.

Compute monthly payment: $PV = 1{,}000$; $n = 4$; $i = 36/12 = 3$. Solving for PMT yields a monthly payment of 269.03.

Alternative 1: Up-front interest payment

The parameters are the same as in the base case except that all interest is charged at the beginning of the loan.

Compute cash flows: Total payments of principal plus interest in the base case are 1,076.12 (269.03 x 4). Subtracting 1,000 of principal gives total interest of 76.12. Since in this case the interest is paid up front, it is for all practical purposes deducted from the loan disbursement, leaving the borrower with a net cash disbursement of 923.88 (1,000 – 76.12). Monthly payments are principal only, in the amount of 250 (1,000/4).

Compute effective interest rate: $PV = 923.88$; $PMT = -250$;[88] $n = 4$. Solving for i yields an effective monthly rate of 3.24 percent, which is multiplied by 12 for an APR of 38.9 percent.

[88] On most financial calculators, present value and payment must be entered with opposite signs, so if PV is positive, PMT must be negative, and vice versa.

Alternative 2: Initial fee

The parameters are the same as in the base case except that a 3 percent loan commission is charged up front.

Compute cash flows: The net disbursement to the borrower is 970 (1,000 – commission of 30). Monthly payments are 269.03, as in the base case.

Compute effective interest rate: $PV = 970$; $PMT = -269.03$; $n = 4$. Solving for i yields an effective monthly rate of 4.29 percent, which is multiplied by 12 for an APR of 51.4 percent.

Alternative 3: Weekly payments

The parameters are the same as in the base case except that four months' worth of payments are paid in 16 weekly installments.

Compute cash flows: Total payments of 1,076.12 (269.03 x 4) are broken into weekly payments of 67.26 (1,076.12/16).

Compute effective interest rate: $PV = 1{,}000$; $PMT = -67.26$; $n = 16$. Solving for i yields an effective weekly rate of 0.88 percent, which is multiplied by 52 for an APR of 45.6 percent.

Alternative 4: Flat interest

The parameters are the same as in the base case except that interest is calculated on the entire loan amount rather than on declining balances and is prorated over the four monthly payments.

Compute cash flows: Total interest is 120 (1,000 x 3 percent x 4 months). Total principal plus interest is 1,120 (1,000 + 120), or 280 each month (1,120/4).

Compute effective interest rate: $PV = 1{,}000$; $PMT = -280$; $n = 4$. Solving for i yields an effective monthly rate of 4.69 percent, which is multiplied by 12 for an APR of 56.3 percent.

Alternative 5: Flat, with up-front interest

The parameters are the same as in alternative 4 except that all the interest is paid up front at the beginning of the loan.

Compute cash flows: Total interest is 120, paid on loan disbursement. Thus the borrower's net disbursement is 880 (1,000 – 120). Monthly payments of principal are 250 (1,000/4).

Compute effective interest rate: $PV = 880$; $PMT = -250$; $n = 4$. Solving for i yields an effective monthly rate of 5.32 percent, which is multiplied by 12 for an APR of 63.8 percent.

Alternative 6: Flat, with up-front interest and fee

Flat interest is charged on the entire loan amount, and the total interest plus a 3 percent commission is collected up front, at the time of loan disbursement.

Compute cash flows: Total interest is 120 (1,000 x 3 percent x 4 months). The net disbursement to the client is 850 (1,000 – interest of 120 – commission of 30). Monthly payments are 250 (1,000/4).

Compute effective interest rate: $PV = 850$; $PMT = -250$; $n = 4$. Solving for i yields an effective monthly rate of 6.83 percent, which is multiplied by 12 for an APR of 82.0 percent.

Alternative 7: Compulsory savings

The parameters are the same as in the base case except that, as a condition of the loan, the client is required to make a savings deposit of 50 along with each month's payment. The savings account yields interest of 1 percent a month, uncompounded, and the client may make withdrawals at any time after paying off the loan.

Compute cash flows: The disbursement to the borrower is 1,000. Monthly payments are 319.03 (269.03 in principal and interest, as in the base case, plus a savings deposit of 50). The future value of the savings account to the client, its value at the end of the loan, is 203 (200 in deposits plus interest of 0.50 for the second month, during which the savings account has a balance of 50; 1.00 for the third month, during which the balance is 100; and 1.50 for the fourth month, during which the balance is 150).

Compute effective interest rate: $PV = 1{,}000$; $PMT = -319.03$; $n = 4$; $FV = 203$. Solving for i yields an effective monthly rate of 3.26 percent, which is multiplied by 12 for an APR of 39.1 percent.[89]

This alternative and the following one assume that the MFI holds the compulsory savings, in which case the yield to the MFI and the cost to the client are the same. If the compulsory savings are held by another entity, however, the amounts deposited should not enter into the computation of yield to the MFI. But the deposits do enter into a calcula-

[89] This rate is the yield on the net amount of cash in the client's hands. An MFI wanting to estimate its theoretical annual interest income as a percentage of the loan portfolio shown on its books would take into account only the loan part of the transaction, ignoring the receipt or return of deposits and any interest on them.

tion of the loan's effective cost to the client. In this case, comparing the client's cost and the MFI's yield can be instructive. Compulsory savings regimes in which the MFI does not hold the savings sometimes lead to a high effective cost to the client, a significant share of which is not captured as yield by the MFI.

Alternative 8: Flat, with up-front interest and fee, and compulsory savings

The parameters are the same as in alternative 6 except that the client is required to make a savings deposit of 50 along with each month's payment. The savings account yields interest of 1 percent a month, uncompounded, and the client may make withdrawals at any time after paying off the loan.

Compute cash flows: Total interest is 120 (1,000 x 3 percent x 4 months). The net disbursement to the client is 850 (1,000 – interest of 120 – commission of 30). Monthly payments are 300 (principal of 1,000/4, plus savings deposit of 50). The future value of the savings account to the client is 203 (200 in deposits plus interest of 0.50 for the second month, during which the savings account has a balance of 50; 1.00 for the third month, during which the balance is 100; and 1.50 for the fourth month, during which the balance is 150).

Compute effective interest rate: $PV = 850$; $PMT = -300$; $n = 4$; $FV = 203$. Solving for i yields an effective monthly rate of 7.67 percent, which is multiplied by 12 for an APR of 92.0 percent.

Yield gap computations

Sometimes an MFI needs to generate a theoretical expectation of interest and fee income on its loan portfolio, for comparison with the interest and fee income it actually receives. The purpose is to see whether there is a significant gap, which could signal such problems as delinquency, fraud, or accounting mistakes. When using the calculation method set forth in this annex, such yield gap analysis can be complicated because the method sometimes reflects cash flows in a different way than an MFI's accounting system would.

For example, in alternative 5 (flat interest paid up front) the calculator yields a present value of 880 (1,000 of loan amount – 120 of prepaid interest). On an MFI's accounting books, however, the portfolio would be increased by the full 1,000 of principal at the time the loan is disbursed, while the 120 of prepaid interest might be entered in a liability account for deferred interest (paid but not yet earned).

In fact, MFIs seldom use prepaid interest of the type illustrated in alternatives 5 and 6. Compulsory savings schemes, such as alternatives 7 and 8, are much more common. These

Table 1.1R Annualized effective interest rates with charge and payment structures

Stated monthly rate	Base case[a]	Alternative 4[b]	Alternative 5[c]	Alternative 6[d]	Alternative 8[e]
1.0	12.0	19.0	19.8	35.6	38.9
1.5	18.0	28.5	30.3	46.6	51.5
2.0	24.0	37.8	41.0	58.0	64.5
2.5	30.0	47.1	52.5	69.8	78.0
3.0	36.0	56.3	63.8	82.0	92.0
3.5	42.0	65.5	75.8	94.7	106.0
4.0	48.0	74.6	88.3	108.0	121.8
4.5	54.0	83.6	101.3	121.7	137.8
5.0	60.0	92.6	114.8	136.1	154.2
5.5	66.0	101.5	128.8	151.1	171.4
6.0	72.0	110.4	143.5	166.7	189.5

Notes:

a. Interest charged on declining balances; four equal monthly payments.
b. Flat interest charged on initial balance, prorated over four monthly payments.
c. Flat interest charged on initial balance and deducted from loan disbursement.
d. Flat interest on initial balance and 3 percent commission deducted from loan disbursement.
e. Same as alternative 6, with forced savings of 50 added to each payment, and 1 percent monthly interest paid on savings.

schemes also involve differences between the way an MFI's books are kept and the way a calculator produces an effective interest rate. The example of a flat interest computation at the end of the annex provides another case of a (relatively minor) discrepancy between how the calculator treats a series of cash flows and how an accounting system treats them.

When performing yield gap analysis for such cases, the analyst should build a simple spreadsheet model that tracks the way loan principal and interest income are actually recorded to the MFI's accounts and build a theoretical yield expectation on that basis, rather than using a financial calculator.

A note on flat-rate computations

When computing effective interest rates as in the examples above, a financial calculator uses a consistent method to determine the outstanding principal balance at any point in the loan. For each payment, the calculator computes the amount needed to cover the inter-

est on the previous period's balance. Then it assigns the rest of the payment to principal, thus reducing the loan balance for the next period. Under this method *the proportional division of each payment between interest and principal changes over the life of the loan.* At the time of the early payments the outstanding loan balance is relatively large, thus the portion of the payment devoted to interest also is relatively large, and the amount devoted to reducing principal relatively small. Later, this situation is reversed.

MFIs that charge interest on a flat-rate basis usually follow a different procedure. For the sake of simplicity, they assume that the division between principal and interest is the same for every payment. In alternative 4, for example, the MFI charges 3 percent flat interest per month on a four-month loan of 1,000. The total to be paid by the client is 1,120, split between principal of 1,000 and interest of 120 (3 percent x 4 months x 1,000). Dividing this total by the number of payments produces a monthly payment of 280. On its books, the MFI would probably allocate 250 of each month's payment to principal (1,000/4) and 30 to interest (120/4).

When an MFI uses this method to account for its outstanding loan portfolio, the average outstanding balance of its portfolio would be slightly smaller than the balance produced by the calculator's method, because the MFI would reduce the principal balance on early payments faster than the calculator would. Because of the smaller average outstanding portfolio, the interest income represents a slightly higher percentage of portfolio.

The difference between a financial calculator's method and an MFI's accounting system can be illustrated with alternative 4. The calculator computed an effective monthly rate of 4.69 percent. Implicit in this calculation is a schedule of loan balances that yields an average outstanding balance over the life of the loan of 639.32.

Dividing interest received (120) by that average outstanding balance, and dividing the result by four months, gives a monthly effective rate of 4.69 percent ([120/639.32]/4).

But if the MFI's accounting system assigns exactly one-fourth of the principal (250) to each payment, the average outstanding balance over the life of the loan would be 625.00.

Performing the same computation as above, the MFI would put the effective rate at 4.80 percent ([120/625]/4). As predicted, the effective yield on the portfolio as calculated by the MFI's accounting method appears slightly larger because it produces a slightly smaller average outstanding portfolio.

Table 1.2R Loan balances and effective interest rates under a financial calculator's method and an MFI's accounting system

	Financial calculator's method	MFI's accounting system
During the 1st month	1,000.00	1,000.00
During the 2nd month	766.92	750.00
During the 3rd month	522.91	500.00
During the last month	267.45	250.00
Average over life of loan	639.32	625.00
Monthly effective interest rate (percent)	4.69	4.80

Note: The table is based on alternative 4, in which flat interest of 3 percent is charged, prorated over the four monthly payments.

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BRC Investor Services: http://www.brc.com.co

Class & Asociados S.A.: http://www.classrating.com

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Microfinanza Ltd.: http://www.microfinanza.it
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