NEW DEVELOPMENTS IN MFI REPORTING STANDARDS

HOSTED BY DREW TULCHIN OF SOCIAL ENTERPRISE ASSOCIATES AND LEAD OF THE SEEP NETWORK MICROFINANCE REPORTING STANDARDS INITIATIVE. FACILITATED BY RUTH DUECK MBEBA, BLAINE STEPHENS, LYNN EXTON, SHERI SEXTON, EILEEN MIAMIDIAN AND SCOTT GAUL.

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DAY ONE: BARRIERS AND SOLUTIONS FOR MFI REPORTING

DAY 1: INTRODUCTION

Post by Drew Tulchin

Good morning (or good day, or good evening if applicable). Welcome to this two-day online discussion about microfinance reporting standards. This effort is co-sponsored by the SEEP Network and USAID microLINKS. Thanks to everyone in the Financial Services Working Group (FSWG).

The MFI Reporting Standards Initiative is gaining momentum. We have lots of new activity, including a standards adoption process adapted from IASB. We are updating the consensus guidelines, for the first time in 6 years, and adding new ratios – and we need your input.

Over the next two days, we hope to engage you with a variety of discussion questions related to barriers and solutions for MFI reporting and international standards. We always welcome more voices in the conversation, so share with your colleagues and friends! People are welcome to write in their native languages. Spanish, French and Portuguese are no problem. We'll find people to translate any other language.

We look forward to a dynamic conversation!

CONSENSUS-BUILDING, ENGAGEMENT AND COMPLIANCE

Post by Drew Tulchin

In this first day of discussion, we'd like to focus on challenges and proposed steps forward related to reporting, standards setting, and transparency in the microfinance industry.

To start, how should microfinance, as an industry, move toward consensus decision-making for standards and financial reporting? How do we keep stakeholders engaged in the process and reporting compliant?

Looking forward to reading your thoughts!

Post by Lynn Exton

I would like to get an idea of how many MFI are currently reporting as per IFRS and the kind of issues that they confronted as they transitioned?

Post by Blaine Stephens

Great question, Lynn, and one that MIX hopes to be able to begin to answer with data in the coming year as we document IFRS compliance in audits.

While we do not have a global count of MFIs that produce IFRS compliant statements, it is worth looking at audits of MFIs that are going through the transitions to see what this entails for first time reporters (IFRS 1).

Here are a couple to look at:

OI Savings and Loan (Ghana): 2007 audits that show the transition from local accounting standards to IFRS (see detailed explanation starting at note 40)

First MicroFinance Bank (Pakistan): 2007 audits that show gradual adoption of certain IASs and IFRSs by Pakistani authorities and their impact on reporting (see note 7).

We have heard investors and other global analysts clamoring for this level of comparability financial data. Clearly, some MFIs, their boards, or their investors have seen the value of producing such financial statements even when not required by local regulations.

Post by Scott Gaul

To add to Blaine's point, and to provide a lead-in to some of the day 2 topics (and a preview of data to come from MIX), here is a bit more on IFRS compliance in a single country.

Attached is data on the reporting standards used by 14 MFIs in Cambodia over a period of 5 years (2003 - 2007). These statements of IFRS compliance are pulled directly from MFI audits; all of the underlying reports are available on the MIX Market site. The statements allow us to track changes in the adoption of local reporting standards (Cambodian Accounting Standards (CAS)) or IFRS by MFI. For instance, VFC switched from CAS to IFRS for 2007; HKL switched from IFRS to CAS in 2006; many other MFIs remained on CAS for the entire period. More interesting perhaps are the detailed explanations provided by the auditors of the variance between standards (see CHC-Limited's note for 2007, for instance). Hopefully this detail also provides a window into standards adoption by MFIs.

Our use of XBRL allows us to capture and consolidate this information; we hope to expand the availability of this type of data in the coming months. These particular data points come from our internal XBRL testing (and thus may have some minor errors). We used Cambodia as a sample due to the depth of reporting available there.

Post by Ruth Dueck Mbeba

Thanks Scott and Blaine,

Are there comments or feedback from others? What have your IFRS transition experiences been -- as auditors? as networks or analysts? as an MFI?

Post by Ruth Dueck Mbeba

In my visits to MFIs and reviews of MFI financial Statements, I have seen few statements that reflect "transition" to IFRS. The vast majority of MFIs I have contact with have worked in environments where national accounting standards were non-existant or not well-articulated, and as part of national financial or regulatory reform, they have adopted IFRS directly.

I see challenges for MFIs in countries where national accounting standards are well known and practiced in the profession (e.g. India) where transition will be carefully planned.

Are there good cases and examples of IFRS transition issues?

Post by Eileen Miamidian

CHF International's MFIs in Lebanon and Romania are compliant with IFRS. The major differences in terms of day to day management include tracking of additional information, such as exchange rate and maturity gaps. Especially in the case of Romania, which operates in multiple currencies, this type of additional information has proven important.

This change has been a bit of learning curve. For example IFRS requires loan commissions/fees be recognized over the life of loan (as opposed to GAAP which can recognize such a commission when received), thus some changes needed to be made in how transactions are booked.

Additionally, disclosures are significantly more detailed for external audits, which increases the cost of the audits, and requires additional demands on board members to understand them.

It would be interesting to hear from other institutions as to their experiences in going through such a transition, or impressions for those who have started to look into it.

Post by Chris Baltrop

This initiative might benefit from linking in with the regulatory reporting requirement that is increasingly reaching down to MFIs. If the reporting requirements are structured to require IFRS compliant reports, that will act as a catalyst for MFIs to adopt that standard. And having a common reporting standard would simplify reporting requirements for MFIs that operate in multiple juristictions.

Post by Eileen Miamidian

Good point. I agree strongly with this. We have some instances in our network where an MFI needs to conduct two audits: an IFRS for the investors and a one adhering to local accounting standards.

Linking standards to regulatory work would definitely be critical in order to encouraging compliance

Post by Ruth Hoffman

Good day to everyone. I am wondering if there is a list in your background documents, or elsewhere, of the differences in accounting and reporting for the most common transactions between GAAP and IFRS. For example it was just mentioned in an email I received that commissions on loans must be recognized over the term of the loan under IFRS, rather than at time of loan issuance, as is the case in MFIs I have seen in India and Africa. The MIS would have to be altered to accommodate this change.

A list clearly showing these differences would be extremely helpful.

Post by Eileen Miamidian

Ruth,

Thank you, that is a great question. Has anyone compiled such a list that they could share?

Post by Haoua Sienta

I definitely share that idea of Ruth. Log in to the forum few minutes ago and was looking to such a list on difference. I believe that a list on similarities and differences regarding accounting and reporting of MFI's in accordance to GAAP and IFRS procedures will help MFI practitioners to clearly identify pros and cons of both systems and of course to easily adhere to best practices in order to be competitive in the market.

Post by Lynn Exton

Can anyone comment on for the materiality of the differences in terms of net income and shareholders' equity from moving to IFRS?

Post by Scott Gaul

Why is the comparison between GAAP and IFRS? (Also, when people say 'GAAP' do they mean 'US GAAP'? As I understand it, there's no single GAAP for comparison, but many different local GAAPs, which presumably don't agree.)

From the example that Eileen gave of CHF affiliates who are required to report to two different standards, it seems like the relevant comparison is between IFRS and the local accounting standards (or the many local GAAPs). A regulated MFI *must* report to its regulator. Perhaps the MFI *should* report to investors using a different global format. But only one of these is a requirement. I can see how cross-border stakeholders would benefit from a list of this type of variances, but how does this relate out to MFI needs (especially for MFIs that are not part of international networks)?

Fortunately, many MFIs do provide information about how their local accounting standards differ from global standards. We often see this information in the statements of IFRS compliance in MFI audits. From the Cambodia post from earlier, here is one example (also here: http://www.mixmarket.org/sites/default/files/medialibrary/20501.2273/CHC_Audit_Report_2007Final.doc):

"The financial statements of the Company represented in United States Dollar ("USD") are prepared under the historical cost convention in accordance with the guidelines issued by the NBC and in accordance with accounting principles generally accepted in the Kingdom of Cambodia and practices within the micro-finance industry. Those principles require that financial instruments be carried at cost less provisions for impairment. This practice differs from the International Financial Reporting Standards which require that loans and receivables be carried at amortised cost using the effective interest method of any difference between the initial amount and the maturity amount, and minus any reduction for impairment or uncollectability.

The presentation of financial statements in conformity with accounting principles generally accepted in the Kingdom of Cambodia requires the Management to make the best estimates and reasonable assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on the information available as of the date of the financial statements. Actual results, therefore, could differ from those estimates. The accompanying financial statements are prepared for jurisdiction of Cambodia and are not intended to present the financial position and results of operations and cash flows in accordance with generally accepted accounting principles and practice in other countries and those who are not informed about Cambodia's procedures and practices."

Post by B. Schneider

There has been discussion about the level of commitment of US policymakers to convergence. This Financial Director article notes that the SEC is taking some time in replacing its chief accountant, which is seen as a negative for convergence. And there are indications that SEC Chair Mary Schapiro is less than enthusiastic about a move to IFRS.

Given the strains the US financial system is under, it's not surprising that Ms. Schapiro will want to focus on more pressing issues. Still, it does seem that convergence may not be accomplished as quickly as was forecast during Chairman Cox's tenure.

Post by Ruth Dueck Mbeba

Thank you for your input on the topic of US convergence with IFRS.

I am curious what delays in US convergence may have on the many microfinance institutions already IFRS compliant -- if any?

Are there implications for US based networks or holding companies that own and operate MFIs that are IFRS compliant in reporting?

Post by Blaine Stephens

Several participants here (incl. myself) have alluded to the growing importance of IFRS in MFI reporting, either because of changes in national accounting standards or to fulfill requirements of investors or other stakeholders.

If MFIs converge on IFRS for accounting standards, what role would a MF reporting standards body have? Suggesting ratios that are relevant to MFIs? What if the mainstream regulatory reporting, such as what Chris suggests, already includes most information that MFI managers would want to know? Does it, or are there other pieces of management information that mainstream banking overlooks?

Perhaps one role is to stretch the breadth of MF operating models, from brick-and-mortar MFIs that take deposits to those that don't, from service companies with no assets on their books (but significant client bases) to telcos with transaction accounts for client.

What role do other participants see for such a body?

DAY 1: ARE SAVINGS AND CAPITAL ADEQUACY RATIOS NEEDED?

Post by Ruth Dueck Mbeba

Currently the SEEP publication "Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring" describes 18 ratios commonly used in monitoring profitability, asset/liability management, efficiency and portfolio quality.

Are additional ratios for savings and capital adequacy important and would they add value to stakeholders?

Would additional ratios add value to MFIs?

What additional ratios would you propose be used to monitor MFI strength and performance?

Post by Nancy Sommer

Dear Ruth,

We (responsAbility) think that with the maturing stage of the industry additional indicators are necessary yes. If you have deposit taking institutions, you are interested e.g. in deposit concentration (10/20 largest depositors ratio) Capital Adequacy is more of value for regulated institutions but there are sufficient out there.

We are looking at a variety of indicators for each of our investments, currency management is another very important point which should become industry standard: % open currency position (% of equity and subordinated debt)

Regarding portfolio quality, in recent days the refinancing/ restructuring ratios are gaining value.

Post by Blaine Stephens

Thanks for the investor's perspective, Nancy.

Do you track other ratios for Asset Liability Management that you find particularly important for deposit taking institutions?

Do other investors, industry analysts, or MFIs have other ALM ratios (or disclosures) that they find key for assessing risks in deposit taking MFIs?

Post by Nancy Sommer

Hi Blaine,

I have to run out of the office now but will contribute more tomorrow, even though its day 23 :) but well, this is what happens when working in different time zones.

Post by Blaine Stephens

No problem, Nancy, and thanks for your contributions. This is an on-going discussion for which these two days really serve as a launching point. More about that at the end-of-the-day wrap-up.

Post by Elissa McCarter

Greetings,

I wanted to share the latest update that SEEP FSWG is working on to update the Frame ratios and address some missing pieces that have been identified - namely those ratios related to capital adequacy, ALM and savings. Attached you will find a very first draft of these additions, still a work in progress. There are (8) new ratios selected as an update to the 18 core ratios listed in the 2005 publication. The end objective is to reach consensus on an updated set of ratios and release a "second edition" of the SEEP publication.

In addition, FSWG members have agreed that including some tables on ALM would be good to include in the update, borrowing from the CGAP publication recently released. Found at: http://www.cgap.org/gm/document-1.9.34818/FN55.pdf

We welcome any additional comments from you on the ratios update as we finalize the draft.

Post by Ruth Dueck Mbeba

Thank you Elissa!

We invite all participants to review the materials referenced or attached.

Do you think the proposed ratios for savings and capital adequacy are adequate? Necessary? What else is missing?

DAY 1: SUMMARY

Post by Ruth Dueck Mbeba

Thanks to everyone who contributed to discussion today. Obviously, the conversation is just getting started!

1. Understanding IFRS and GAAP differences is one issue.

Both PWC and Deloitte have produced helpful resources showing the differences between Indian GAAP and US GAAP (available on their websites). Deloitte's website publishes comparative documents for roughly 20 countries at l http://www.iasplus.com/country/compare.htm

These resources maybe helpful, but remember that countries usually have slightly different interpretations and practice of GAAP.

2. Transitioning to IFRS is an issue for many MFIs. Let's table this for a session on the IFRS Discussion Board to follow this conference.

3. Regulatory reporting will increase for most MFIs as regulators pay attention to the sector. What are the regulators requiring in terms of reporting? Another session to table for the IFRS Discussion Board!

You are invited to continue this discussion thread -- or comment on the additional threads posted for Day 1.

Thanks again and good evening!

DAY TWO: INTERNATIONAL STANDARDS

DAY 2: INTERNATIONAL FINANCIAL REPORTING STANDARDS

Post by Ruth Dueck Mbeba

Hello everyone!

How are MFIs, national etworks and international networks addressing IFRS requirements that are increasingly becoming national accounting standards in many countries? What are the issues for many MFIs?

Refer to the article from the Economist article (attached) and the Overview of IFRS for Microfinance Reporting Discuusion July 09 (attached).

Enjoy the conversations!

Post by Muhammad Junaid

Greetings, Ruth….

My name is Muhammad Junaid. Currently, I am Microfinance Regional Technical Advisor for Asia/Pacific with UNCDF. In the recent past, I led a USAID funded financial sector development program in Azerbaijan.

Although there seems to be a general lack of participation, this is an interesting and useful discussion. The question you raised could be addressed at three levels.

1. Policy:

How the governments and the central banks could be encouraged to adapt IFRS into the national accounting standards remains the first and foremost challenge. Unless the governments are committed to the accounting reforms at the national level, financial sector, and particularly microfinance industry may not fully switch to the IFRS. The good news is that in many countries, financial sector and the central banks have taken lead on such reform.

Although developing a policy to adopt IFRS need to be a well coordinated effort by the major stakeholders, presence of a national champion within the government enormously facilitates the process. For example, a champion in Ministry of Finance could influence introduction and incorporation of IFRS in the national accounting standards. In Azerbaijan, Central Bank encouraged the financial institutions (including the MFIs) to adopt IFRS even before the law required compliance.

Effective stakeholder participation in the policy making process is critical. Financial sector associations, accounting and auditing professional bodies and donors can play significant role in adaptation, translation and dissemination of relevant reporting standards.

2. Regulation:

We need to look at the total picture. How the MFIs regulated in the country? (and the oft repeated yet relevant question: to what extent the industry should be regulated?) who should regulate the MFIs? When considering the different ratios, the questions about the "downscaled" banks should be considered as well. Should the microfinance portfolios of the licensed banks be treated differently than their regular portfolios?

Majority of the MFIs in many countries, particularly operating at NGO level, lack capacity to prepare and submit professionally prepared accounting statements complying with national or international standards. The governance bodies are either not present or fail to pay attention to this aspect. No amount of regulation can make for the lack of capacity within the MFIs.

Even the central banks lack capacity (and in most cases willingness) to regulate the microfinance industry. In a number of countries, even deposit taking MFIs continue to operate in regulatory gray area because central banks resist persuasion to regulate citing "insignificant size" of the industry among other reasons. Industry

3. Training and Capacity Building:

While initiatives at policy and regulatory level are important, training and capacity building at the industry and organizational level are most important to introduce effective reporting standards. This is where everything comes together to make a difference. SME Support through Financial Sector Development, a USAID funded project in Azerbaijan, introduced an initiative to address this need. At the beginning of the project in 2005, there were only two accountants in the entire financial sector with any kind of accounting certification. Within a couple of years, accountants from most banks and MFIs earned the designation of "Certified Accounting Practitioners" from Eurasian Council of Accountants and Auditors. The CAP certification is based on IFRS. This was achieved through mobilizing support from a wide range of stakeholders, including Azerbaijan Microfinance Association, Azerbaijan Bank Training Centre, Accountants' Association, Central Bank, Ministry of Finance and Chamber of Auditors. My team and I made sure that all these stakeholders were involved in this effort from the very outset of this effort, and we consider this as the main reason for our success.

Post by Blaine Stephens

I am sure that many of us out there have questions on IFRS and their application in microfinance. Whether we are MFIs applying these accounting standards or investors, boards or other stakeholders interpreting the information, the standard and its impact on how we analyze MFIs is important.

One question that the Economist article raises is the valuation of loans -- whether at historical cost or fair value. As the single biggest asset (~75-80% of the typical MFI's asset base), this decision is critical in looking at financial position.

Two questions for the participants:

1. What practice for reporting on loan portfolio is most common where you are located or in the MFIs that you analyze?
2. What other accounting and reporting standards questions do you struggle with and do you think have a material impact on your analysis of your own or other MFI accounts?

Don't hesitate to ask the detailed questions, because you may find that others have the same ones or can contribute answers from their experience and environment!

Post by Ruth Dueck Mbeba

Good questions Blaine,

Are there any MFIs who have reported their loan portfolio at fair value? How and who determined fair value?

Post by Sheri Sexton

I think another applicable part of Blaine's question, would be how to report interest income from these loans? Should it be on a cash or accrual basis? Participants how are you currently reporting interest income?

Post by Kevin Fryatt

The majority of MFIs that our network supports here at World Relief report interest income as it is received (cash basis). Our more mature MFIs (CREDIT in Cambodia and BZMF in Kosovo) both report interest income using an accrual basis. I think a point that was made above about the competence of Finance personnel in some countries are hindering the full adoption of IFRS amongst MFIs - especially those that are in the early stages of development and within contexts in which education related to this stuff is difficult to come by.

Post by Ruth Dueck Mbeba

Thank you Kevin,

I have also seen that many MFIs report interest income on a cash basis, and in many cases it can be argued as a prudent or conservative approach.

Are there other MFIs who accrue interest on loan or fee revenue? Is interest accrued for delinquent loans as well?

At what point do you stop accruing?

Post by James Dailey

From working with a number of MFIs, the accounting policies being proposed and implemented are often a matter of training and experience of the accountant or member of the Board that pushes this - which can be a key limitation. Its all good and fine to insist on "IFRS compliance" but unless that is backed up with good support, this becomes just another operational hurdle on an already over-crowded plate.

The question of treatment of portfolio value is a particularly difficult one: fair market value pre-supposes the possibility of sale of the asset. This is possible, but not general practice in Microfinance. Secondly, if a person can start to make payments on a different schedule - and that rescheduling is fairly dynamically handled by the field officer on site - then how do we characterize the loan? In default? Rescheduled? No change?

My sense is that there are a lot of "standard rules" that would force a change in the very innovativeness that makes many MFIs successful. It may not be a good argument to resist good practice from the formal financial sector, but it is something to consider.

Post by Ruth Dueck Mbeba

Thank you James,

We did receive your comments -- and appreciate you inputs. The issue of capacity of finance managers and accountants has been raised several times in the past days.

During the past week, a number of comments and questions have been raised on specific accounting standards and their application to microfinance reporting.

We expect to release a digest in the coming days of last week's conversations. It will include information of where and how to continue the discussion, including your comments on portfolio valuation, and the method of recording interest.

DAY 2: TECHNOLOGY AND REPORTING STANDARDS

Post by Scott Gaul

Another topic area we hope to address in this discussion is the interaction between reporting standards and technology.

We particularly want to highlight the interaction between IFRS and XBRL, a business reporting language now used widely in the financial sector.

First though, it might help to focus on the types of problems that we want technology to help us solve.

A good way to frame this might be looking at the reporting burden for MFIs. Yesterday, for instance, Eileen gave the example of some MFIs that report by both local and international standards in order to meet the needs of multiple audiences. Who are the audiences for MFI reporting? (Do these audiences have mandatory or optional reporting requirements?) Do these organizations share a common format? Do they ask for reporting with the same frequency or depth (or in the same languages)? What report formats are used (Excel, PDF, hard copy, electronic submission, etc.)?

If we can look at these types of questions, it can help us to think about how technology and standards adoption might be linked. Later, we can talk about how some particular technologies, including XBRL, have been used for standards adoption.

Post by Scott Gaul

Or for those participants coming from outside the microfinance sector, what are some other ways that you may have seen in which technology has helped to reduce (or increase) reporting burdens? The example of the US SEC that was brought up in another thread offers some parallels. Are there global examples?

Post by James Dailey

IFRS compliance in accounting would certainly force a new set of conversations with software vendors. As someone who has helped a number of MFIs implement systems, one of the challenges is the sheer variability in accounting policies that MFIs use. e.g. Flat interest rates with commissions and % based fees and apr based on 10 month rates, etc. All of that makes it difficult for a banking software vendor to even understand the configuration changes, never mind to implement them. So, I think for certain vendors, a set of rules that are similar to the banks that already use their software would have a very positive effect. Other vendors would have to play catchup to get rules enforced in systems - and some systems in the market would have to be scrapped entirely as they lack the auditability required for IFRS.

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