

MICROFINANCE INDUSTRY – FINANCIAL REPORTING STANDARDS INITIATIVE



Survey Results Brief

EXECUTIVE SUMMARY

From September to October, 2008, the SEEP Network sponsored the survey “Financial Reporting Standards for Microfinance.” The following brief provides a short summary of the results. More than 160 people responded, with strong geographic distribution around the world. Respondents represented a wide range of stakeholders, including MFI directors, industry practitioners, network leaders, raters, MIS software vendors, investors, donors, bankers and researchers.

Overall, views expressed concurrence that financial reporting standards are a priority both for the industry and for individual institutions to address. 87% saw this initiative as ‘very important’ or ‘important’ for the industry. Common concerns and priorities were expressed across the spectrum of interest groups, including that this initiative needs to:

- 1) Develop internal consensus within the industry of a common platform for reporting to save microfinance institutions (MFIs), investors, and donors time, and
- 2) Establish external connection with international standards efforts, such as the International Accounting Standards Board (IASB) International Financial Reporting Standards (IFRS).

While there was preponderance among responses that the initiative would be well served by a formal entity, such as a committee, there is not unanimity on its management. The vast majority of respondents (83%) recommended instituting a centralized body to lead financial reporting standards for microfinance. Despite this high overall support, there was no consensus on where to house it: 26% suggested IASB and 21%

said an independent entity. The most common response (44%) suggested to house it within an existing microfinance support organization - the MIX, SEEP, and CGAP were split almost evenly. One conclusion to be drawn is respondents propose to avoid “re-inventing the wheel” or “duplicating existing effort.”

The SEEP Network is prepared to continue to facilitate this collaborative effort, with inclusive communication of other industry representatives. A number of thoughtful comments were provided by respondents regarding how it could operate, which will help the initiative as it moves forward. Resolution as to the entity’s form, membership, and process are identified as next steps.

Information on this initiative can be found online, at www.seepnetwork.org. A short concept paper came out earlier in 2008. A report on business model options from standards work in other industries, a corollary to this brief, is also available online. The initiative actively seeks the input, ideas, and time from stakeholders. Initiative Facilitator, Drew Tulchin, can be contacted at drew@socialenterprise.net. The aggregated survey data (with entries listed anonymously) is available upon request.

Though the industry is made up of a wide range of stakeholders with diverse opinions, the results of this survey highlight extensive common ground as well as interest in advancing the financial reporting standards initiative for microfinance. The initiative looks forward to colleagues’ continued thoughtful contributions of both ideas and time for the betterment of the industry as a whole.



SECTION 1

Introduction & Background

The fast pace of change in the microfinance industry calls for reporting standards that ensure industry developments are quickly translated into comparable information. New products, operational models and service delivery channels require that standards, particularly for financial reporting, remain up-to-date and applicable. In 2005, the SEEP Network published the first update to microfinance reporting standards in ten years, a process of consensus that engaged practitioners, donors (including CGAP), investors and other stakeholders. The “Framework” as it is commonly referred to is now considered the “industry standard.” While widely accepted in the industry, acceptable ratios and terms still are not universally adopted.

Microfinance as an industry does not have a central body or mechanism to address compliance or updates to financial reporting standards. A number of issues are rising in importance for which a central industry umbrella entity would be well

placed to address. These include updating the 2005 standards, responding to the increase in international investors, aligning national level regulatory requirements with international standards, supporting MFI vendors (including raters, MIS software sellers, and consultants) to more readily have a “gold standard” for their products, increasing dissemination of performance / management tools such as the SEEP FRAME, and ensuring MFIs can readily adapt to international standards such as IFRS.

In the 2007 SEEP Network Conference Annual General Meeting, SEEP Financial Service Working Group members identified financial reporting standards as one of the top needs for SEEP to focus attention. A sub-committee of the Working Group was founded to facilitate what is now called the Microfinance Industry Financial Reporting Standards Initiative. This survey was a major step in the process of gathering input to chart a path forward.

CHART 1

Respondents

Respondent Profile	Rate
MFI Practitioner	21%
Network/Association	19%
MFI Service Provider	15%
Investor or Commercial Bank	13%
Researcher/Education	12%
Consultant	11%
Donor	8%

SECTION 2

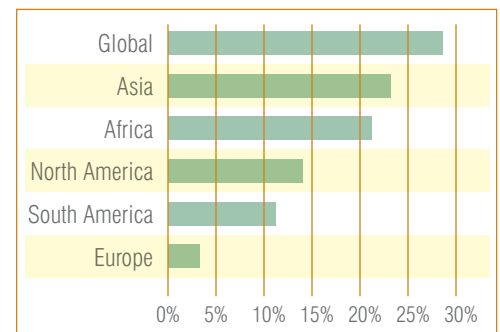
Respondents' Profile

The sample of respondents had both breadth and depth. 162 people responded to the survey. They represent a broad cross-section of institutions (see Chart 1). The initiative heard from leading voices in microfinance. Respondents' positions included: Manager/Program Officer (29%), Organizational Head (22%), V.P./Director (16%) and Analyst (9%).

Respondents cover the globe; the most common areas of focus were those identifying their work as Global – covering more than one continent (28%), Asia (23%) and Africa (21%) (see Chart 2).

CHART 2

Geographic Focus



SECTION 3

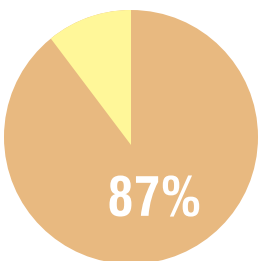
Opinions on Microfinance Reporting Standards

CHART 3

Rank Order: Reasons for Using Reporting Tools

1. Internal Management
2. Operational Control
3. Provide Information to Investors
4. Regulatory Compliance
5. Audit Information
6. Industry Comparisons
7. Easier to Understand MFIs
8. Normalize Differences Between MFIs

Survey Fact...



87% of the microfinance industry recognizes the importance of reporting standards.

This survey asked questions regarding microfinance industry use of reporting standards and perceptions about its importance. Overall, the data confirm that while the industry’s approach to reporting standards remains fragmented, there is a consensus that reporting standards are important for the industry. And, there is widespread support for more universal benchmarks and mechanisms to adopt standards. In order to establish effective industry-wide reporting standards, the data suggests the microfinance industry must not only focus on generating a common “vision” among major stakeholders on what standards should consist of, but also on building the institution-level capacity necessary to ensure information is effectively disseminated and widely adopted.

Most organizations have reporting standards, but the industry’s approach remains fragmented.

The vast majority of respondents (76%) reported their organization had a specific tool for financial reporting. However, their motivations for reporting standards varied. A weighted scoring was taken of respondents’ priority answers as to why they valued reporting tools, listed in Chart 3.

Among those using reporting tools, **the leading reasons** why they used such tools were **internal management** (40% cited as the top priority, 62% first and second priority combined) **and operational control** (20% cited as the top priority, 65% chose as the first or second priority). These were followed by the tools’ use to provide information to investors, regulatory compliance. Next, respondents cited the value of standards tools for audit information and industry comparisons (such as the Mix’s MBB). Lower priorities included that that tools made it easier for the financial sector to understand microfinance and for use to normalize differences between MFIs.

Among networks and service providers, use and understanding of standards tools

were notably higher than respondents as a whole. This reflects an uneven value placed on standards efforts in the industry, a range of knowledge on the subject, and varied levels of adoption. Though not unexpected, these results confirm while the microfinance industry is making headway in understanding and valuing financial reporting standards, progress towards industry-wide utilization remains uneven.

The microfinance industry recognizes the importance of reporting standards generally, and universal standards specifically.

There is broad agreement among respondents that reporting standards are either “very important” or “important” for the industry as a whole (87%). Respondents expressed support for the establishment of universal standards for the industry, with 81% supporting this issue as “very important” or “important”.

Barriers to establishing standards must be understood.

Respondents were helpful in identifying challenges for this industry initiative to overcome. The most common reasons cited AGAINST universal standards were that different stakeholders want different information (19%) and that the diversity of institutions within microfinance makes universal standards inappropriate (18%). Such observations correctly identify real challenges to both the development of universal standards and convergence around reporting. Strategies to overcome these barriers include dialogue and engagement. First advancements are possible in areas where there is common ground, by focusing on best practice, and acknowledging that this is an on-going process for continued improvement. It is important to note the difference between application of specific ratios in various reports, where different institutions have the flexibility to use the information they value, and an over-arching process for industry standards that can interface with other international guidelines.



What Survey Respondents Had To Say

COMMENTS A

"There must be a thorough discussion among MFIs, regulator, investors, donors and auditors on the need of standard reporting. It may not be possible to have one set of reporting globally because there may be some local issues such as methodology of services, maturity of industry and auditing and taxation acts. Thus, the standard should have some flexibility to adopt as per local requirements."

"Reporting standards need to respect accounting principles and reports need to be TRUE AND FAIR and be complete..."

COMMENTS B

"Each report adds to the burden of an MFI. With less than adequate MIS, they have to create many of them manually. This takes a lot of time from addressing real issues faced by the MFI. I wish this reporting was made easier for them. There is a huge need for a universal MIS capable of generating universal reports in compliance with the industry's best practices."

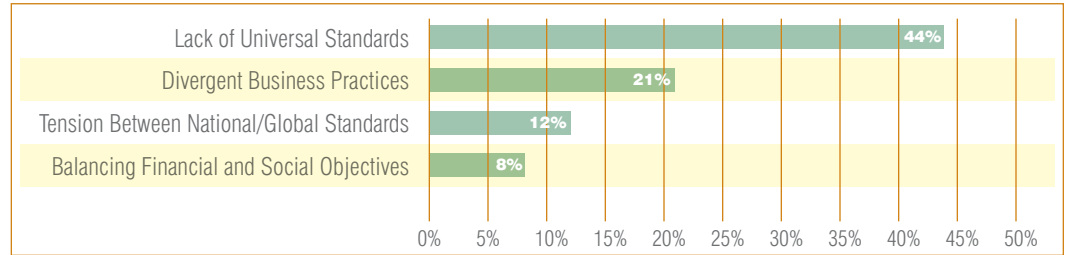
"Accountability is a key issue because an MFI may not always validate results reliably and may not be held responsible either."

MICROFINANCE INDUSTRY FINANCIAL REPORTING STANDARDS INITIATIVE

SECTION 3, CONTINUED

CHART 4

Key Issues in Reporting for Microfinance to Resolve



Our colleagues elaborated upon factors limiting reporting in the microfinance industry. The most common responses are identified here, and listed on the accompanying Chart 4. Forty-four percent cited lack of universal standards as the primary barrier limiting reporting. Twenty-one percent commented upon divergent business practices such as differing treatment of loan loss provision, delinquency, write-offs, etc. Twelve percent mentioned the tension between meeting global standards and domestic regulatory requirements. Meanwhile, 8% emphasized the balance needed between financial and social objectives for standards.

COMMENTS A SEE SIDEBAR

Survey respondents were also asked about industry challenges at the institutional level. Firm level challenges include lack of capacity (45%), the high cost associated

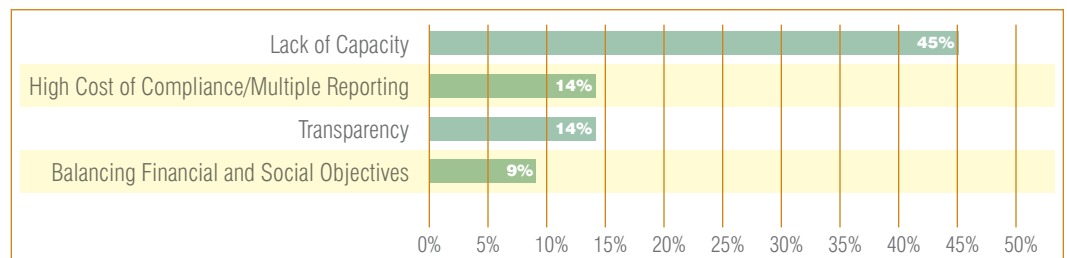
with completing multiple reports (14%), lack of transparency (14%), and the need to balance financial and social reporting (9%). See Chart 5 below.

The institutional level problems are congruent with the industry wide problems mentioned above. Taken together, they highlight the fact that correct balance is needed when advancing this initiative. It is important to establish and maintain rigorous, industry-wide, universal, global standards as a "gold ring" to reach for. Progress for this initiative must ensure reporting tools are affordable, internal industry dialogue on-going, communication maintained with external players, information widely disseminated, education available to ensure adoption, and incentives are provided to fuel adoption.

COMMENTS B SEE SIDEBAR

CHART 5

Key Standards Issues at the Institutional Level



SECTION 4

Establishing an Entity to Lead Standards Efforts

What Survey Respondents Had To Say

COMMENTS C

"If all MFIs are equipped with an effective reporting tool, that will free up much capacity on the MFI level, and allow the network organizations (if applicable) to more easily analyze and consolidate data for better reporting to stakeholders."

"If we are to maintain the integrity of the industry then this is vital. When I talk to individuals about investing in MF they invariably ask similar questions, all of which may be answered with simple, basic, honest reporting. If this is the case, people will tend to be much more forthcoming in supporting institutions and the industry. Where there are unanswered questions and things obviously being avoided then people get rightly nervous and skeptical, which spells disaster for the industry as a whole."

"The industry needs an entity to lead the stakeholder engagement process to develop reporting standards. The committee could play this role."

Wide-spread industry agreement on the importance of reporting standards provides common ground from which diverse stakeholders can work together. The survey also enquired how such work should be done. Responses largely supported the idea to establish a formal industry entity, such as a committee, to focus on setting common guidelines, standards and benchmarks for the microfinance industry. Questions remain to be answered as to where the initiative should be housed and how it would effectively operate day-to-day.

to the industry. Furthermore, 76% percent agreed that this would be either "very important" or "important" for the industry.

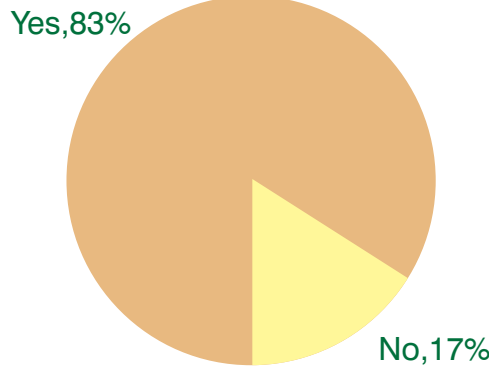
Among those agreeing a committee would be worthwhile, the lead reason stated for its utility was to set industry common guidelines and benchmarks (41%). Other value for a committee included bringing together diverse stakeholders (14%), to serve as a watchdog/regulatory body (8%), and act as a global face for microfinance to external parties (7%).

COMMENTS C SEE SIDEBAR

Though in the minority, respondents who did not think establishing a committee would be useful provided important information to explain their position. The following reasons for this stance include: it would be a duplication of existing efforts within the microfinance industry (CGAP and SEEP's other activities were cited); it would not be possible to forge a consensus because of the diversity among MFIs; and it would not be an effective body without sanctioning powers. This initiative will develop written responses to these reasonable critiques to document the value a new initiative would bring to the industry to have available as a means to foster better discussion. Furthermore, the initiative will coordinate with other industry initiatives to ensure there is no duplication of efforts and to avoid 're-inventing the wheel.'

CHART 6

Is a Microfinance Entity or Committee Worthwhile?



There is widespread support for establishing a central body to guide industry efforts on microfinance reporting standards.

Eighty-three percent of respondents agreed establishing an entity to guide industry efforts on microfinance financial reporting standards would be a worthwhile addition



SECTION 4, CONTINUED

What Survey Respondents Had To Say

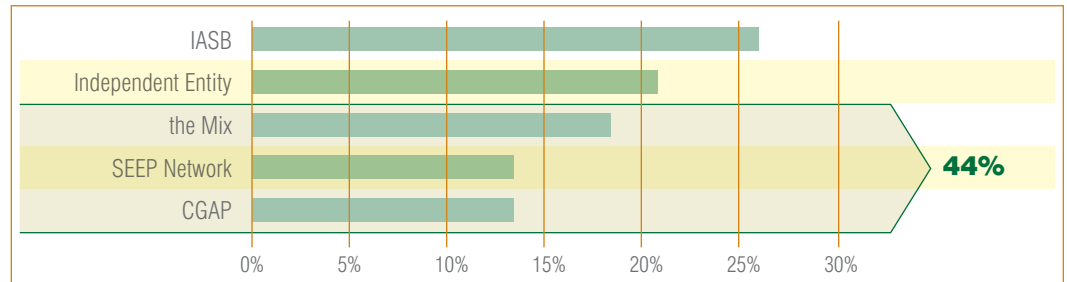
COMMENTS D

“Oversight of reporting standards requires leverage (e.g. ability to assess penalties), otherwise the committee is unlikely to gain credibility.”

“There are enough entities working on reporting standards. And, adding another one dealing with it could complicate a correct use of information.”

CHART 7

Where Should the Initiative be Housed?



COMMENTS D SEE SIDEBAR

The survey data raise both answers and questions about the committee’s structure and logistics. Though respondents generally support forming an entity, organizational details must now be resolved to move the process forward. There were multiple suggestions regarding where a committee should be housed, with no answer receiving a majority. This is detailed in the Chart 7. Externally: the International Accounting Standards Board (IASB) was the single most popular option (26%), followed by establishing an independent entity (21% response). Housing this initiative within an existing MFI institution was the most common response at 44%. This was split among the MIX at 18%, SEEP at 14%, and CGAP at 14%.

Respondents noted important considerations affecting the decision on where to house the entity. Comments emphasized the importance of impartiality, industry connections to on the ground organizations, global reputation, and the host’s core competencies. To gather an informed response to these comments, the initiative thus investigated business models of standards bodies in other

industries to see how others addressed similar problems. The Business Models Report is available as a corollary work, also available at www.seepnetwork.org.

There were multiple suggestions on how best to inform the industry about standards and encourage their widespread adoption. The leading methods included trainings, publications, website, developing useful tools, and helping external auditors. No suggestion received more than 25% of votes. Therefore, a diverse and coherent dissemination strategy, as well as on-going process will be necessary to ensure ‘uptake’ of standards. Leading suggestions on managing information flows from throughout the industry to a central body and then back out included conducting surveys, working with industry coordinating bodies, using an advisory council, and going through MFI associations at the national level.

In conclusion, the initiative thanks the survey respondents for providing their time and opinions. The information gleaned was highly valuable and informative. More time and support will be needed across industry sectors to collectively make these next important steps forward.

The Microfinance Industry Financial Reporting Standards Initiative is supported by the SEEP Network. It is currently housed as a Sub-Committee of the Financial Services Working Group.

Project information is available online at www.seepnetwork.org. The project facilitator is Drew Tulchin, Social Enterprise Associates. He can be reached at drew@socialenterprise.net. We welcome input, comments, opinions, and support to advance this for the benefit of the entire industry. The greater data from this survey, provided in anonymous form, is available by request.

The SEEP Network is a membership association of international organizations that support micro- and small enterprise development programs around the world. SEEP’s mission is to connect microenterprise practitioners in a global learning community. William Tucker, Executive Director

