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." This brief provides a short summary of the results. More than 160 people—broadly distributed around the world—responded, representing a wide spectrum of stakeholders, including microfinance institution (MFI) directors, industry practitioners, network leaders, raters, MIS software vendors, investors, donors, bankers, and researchers.

Overall, they expressed a concurrence that financial reporting standards are a priority both for the industry and for individual institutions to address. At least 87 percent saw this initiative as "very important" or "important" for the industry. Common concerns and priorities were articulated across the spectrum of interest groups, including a need for this initiative to:

1) develop internal consensus within the industry on a common platform for reporting that saves MFIs, investors, and donors time; and

2) establish external connections to existing international standards efforts, such as the International Accounting Standards Board (IASB) International Financial Reporting Standards (IFRS).

While there was a preponderance among responses that the initiative would be well served by a formal entity, such as a standing committee, there was no unanimity on its management. The vast majority of respondents (83 percent) recommended instituting a centralized body to lead financial reporting standards for microfinance. Despite this overarching support, there was no consensus on where to house such a body: 26 percent suggested IASB, and 21 percent an independent entity. The most common response (44 percent) suggested that it be housed within an existing microfinance support organization. Support for the Microfinance Information eXchange (the MIX), The SEEP Network, or the Consultative Group to Assist the Poor (CGAP) was split almost evenly. One conclusion is that respondents strongly want 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 from other industry representatives. The respondents had a number of thoughtful comments regarding how the initiative could operate, which will be helpful as it moves forward. Resolution on the entity's form, membership, and process were identified as next steps.

Information on this initiative is online at www.seepnetwork.org and the Enterprise Development Exchange http://communities.seepnetwork.org/edexchange/node/1799. A short concept paper on the Microfinance Reporting Standards Committee was published earlier in 2008.[1] A report on business model options from work by other industries on standards, a corollary to this brief, is also available for free download online.[2] The initiative actively seeks input, ideas, and time from stakeholders. The initiative facilitator, Drew Tulchin, can be contacted at drew@socialenterprise.net. The aggregated survey data (with entries listed anonymously) is available upon request.

Although the industry is made up of diverse stakeholders with widely varying opinions, the results of this survey highlight the extensive common ground as well as common interest in advancing the financial reporting standards initiative for microfinance. The initiative is energized by the continued contributions from its supporters of thoughtful ideas and generous time commitments for the betterment of the industry as a whole.

[1]Financial Services Working Group. "Microfinance Reporting Standards Committee Concept Note," The SEEP Network, November, 2008. www.seepnetwork.org/files/6172_file_MF_Standards_Committee_concept_note_logo_up_11.09.08_ONLINE.pdf

[2]Financial Services Working Group. "Business Models Report," The SEEP Network, November, 2008. www.seepnetwork.org/files/6171_file3_MFI_Reporting_Standards_Biz_Models_11_4_08.pdf

SECTION 1

Introduction & Background

The fast pace of change in the microfinance industry calls for reporting standards that ensure industry developments can be 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 10 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 have not been 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 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 develop a "gold standard" for their products, increasing dissemination of performance and management tools (such as the SEEP FRAME), and ensuring that MFIs can readily adapt to international standards (such as the International Financial Reporting Standards, or IFRS).

In 2007 at the SEEP Network Annual General Meeting, SEEP Financial Service Working Group members identified financial reporting standards as one of the top priorities for SEEP's attention. A sub-committee of the Working Group was founded to facilitate what is now called the "Microfinance Industry Financial Reporting Standards Initiative." The survey reported here 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

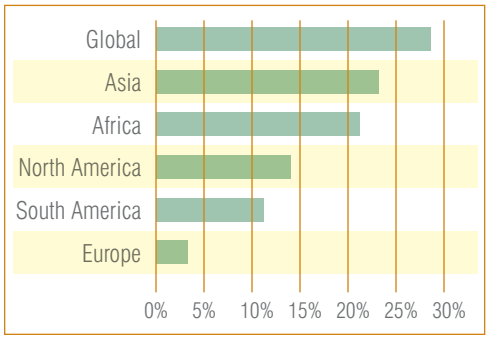
Respondents' Profile

The sample of respondents had both breadth and depth, as 162 people responded to the survey. The respondents represented a broad cross-section of institutions (see chart 1), including the leading voices in microfinance. Respondents' positions included manager/program officer (29 percent), organizational head (22 percent), vice president/director (16 percent), and analyst (9 percent).

Respondents spanned the globe. The most common areas of focus were those identifying their work as global—28 percent covered more than one continent; 23 percent, Asia; and 21 percent, Africa (see chart 2).

CHART 2

Geographic Focus



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SECTION 3

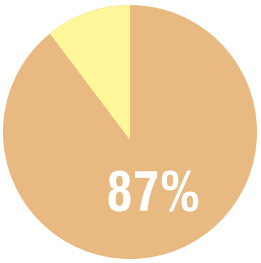
Opinions on Microfinance Reporting Standards

BOX 1

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 respondents recognize the importance of reporting standards

The respondents were asked questions about the microfinance industry's use of reporting standards and perceptions of its importance. Overall, the data confirmed 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 was widespread support for more universal benchmarks and mechanisms to adopt standards. In order to establish effective industry-wide reporting standards, the data suggested that the microfinance industry must not only focus on a common "vision" among major stakeholders regarding what standards should consist of but also focus 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 percent) reported that their organization had a specific tool for financial reporting. However, their motivations for reporting standards varied. A weighted scoring was made of respondents' priority answers as to why they valued reporting tools, listed in Box 1.

Among those using reporting tools, the leading reasons they used such tools were **internal management** (40 percent cited this as the top priority; 62 percent as the first or second priority), and **operational control** (20 percent cited this as the top priority; 65 percent chose it as first or second priority). These were followed by using the tools to provide information to investors and to ensure regulatory compliance. Next, respondents cited the value of standards tools for audit information and industry comparisons (such as the MIX's *Microbanking Bulletin (MBB)*). Lower priorities used reporting tools to make it easier for the financial sector to understand microfinance and to normalize the differences between MFIs.

Among networks and service providers, use and understanding of standards tools were notably higher than for 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. Although not unexpected, these results confirm that while the microfinance industry is making headway in understanding and valuing financial reporting standards, progress toward 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 percent). They also expressed support for the establishment of universal standards for the industry, with 81 percent supporting this issue as "very important" or "important."

Barriers to establishing standards must be understood. Respondents were helpful in identifying obstacles that must be overcome. The most common reasons cited **against** universal standards were that different stakeholders want different information (19 percent) and that the diversity of institutions within microfinance makes universal standards inappropriate (18 percent). Such observations correctly identify real challenges to both the development of universal standards and convergence around reporting. Strategies to surmount these barriers include dialogue and engagement. Initial advancement is possible in areas where there is common ground, by focusing on best practices and acknowledging that this is an on-going process of continued improvement. It is important to note that the difference between the 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.

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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 a less-than-adequate management information system (MIS), an MFI has to create many of them manually. This takes a lot of time away from addressing real issues faced by the MFI. I wish this reporting was made easier. There is a huge need for a universal MIS capable of generating universal reports in compliance with the industry's best practices."

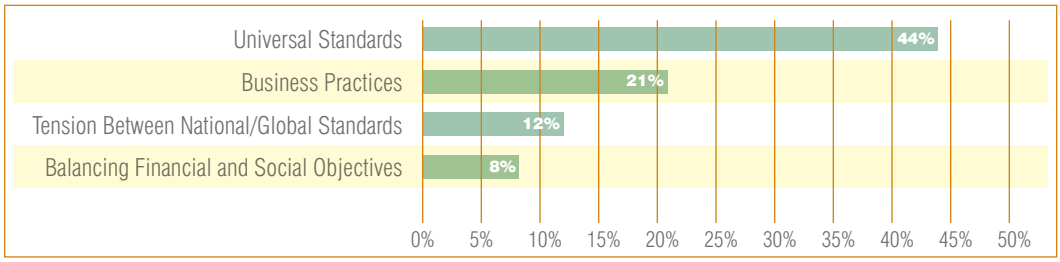
"Accountability is a key issue because an MFI may not always validate results reliably and may not be held responsible either."

SECTION 3, CONTINUED

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

CHART 3

Key Issues in Reporting for Microfinance to Resolve

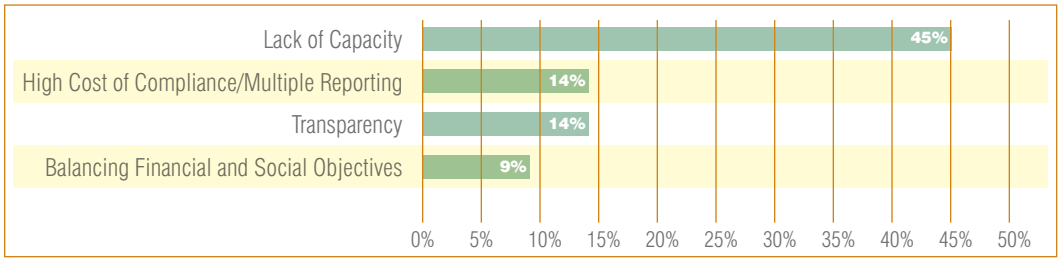


COMMENTS A SEE SIDEBAR

Survey respondents were also asked about industry challenges at the institutional level. Firm-level challenges include lack of capacity (45 percent), the high cost associated with completing multiple reports (14 percent), lack of transparency (14 percent), and the need to balance financial and social reporting (9 percent). See Chart 4 below.

CHART 4

Key Standards Issues at the Institutional Level



Institutional-level problems are congruent with the industry-wide problems. 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 that reporting tools are affordable, internal industry dialogue is on-going, communication is maintained with external players, information is widely disseminated, education and training is available to ensure adoption, and incentives are provided to fuel adoption.

COMMENTS B SEE SIDEBAR

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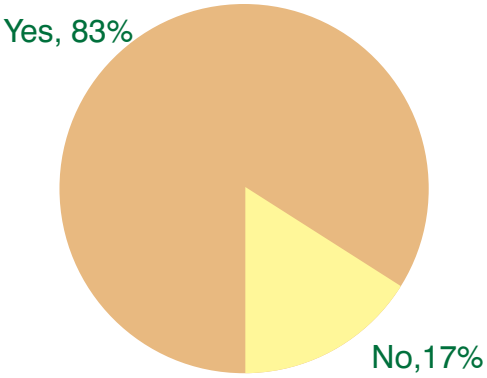
SECTION 4

Establishing an Entity to Lead Standards Efforts

Industry-wide 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 of establishing a formal industry entity, such as a committee, to focus on setting common guidelines, standards, and benchmarks for the microfinance industry. Questions of where to house the initiative and how to effectively operate it day-to-day remain to be answered.

CHART 5

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 that establishing a central entity to guide industry efforts on microfinance financial reporting standards would be a worthwhile addition to the industry.

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

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

COMMENTS C SEE SIDEBAR

Although in the minority, respondents who did not think establishing a committee would be useful provided important information to explain their position. The reasons for this stance included belief that it would be a duplication of existing efforts within the microfinance industry (CGAP and SEEP's other activities were cited), skepticism that it would not be possible to forge a consensus because of the diversity among MFIs, and concern that it could not be an effective body without sanctioning powers. This initiative will develop written responses to these reasonable critiques and document the value a new initiative would bring 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."

What Survey Respondents Had To Say

COMMENTS C

"If all MFIs are equipped with an effective reporting tool, that will free up much capacity at 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 microfinance, 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."

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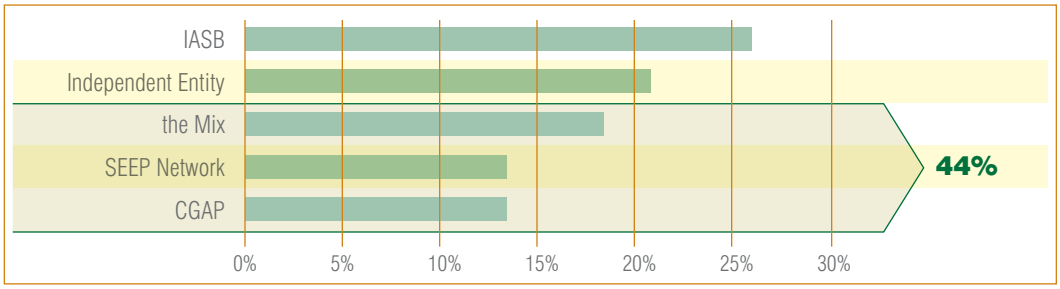
SECTION 4, CONTINUED

COMMENTS D SEE SIDEBAR

The survey data raised both answers and questions about the committee's structure and logistics. Although respondents generally support forming a central 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 (see chart 6). Externally, the International Accounting Standards Board (IASB) was the single most popular option (26 percent), followed by establishing an independent entity (21 percent response). Housing this initiative within an existing MFI institution was the most common response at 44 percent. This was split among the MIX at 18 percent, SEEP at 14 percent, and CGAP at 14 percent.

CHART 6

Where Should the Initiative be Housed?



Respondents noted important considerations affecting the decision on where to house the entity. Their 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 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, available at http://www.seepnetwork.org/files/6171_file3_MFI_Reporting_Standards_Biz_Models_11_4_08.pdf.

There were multiple suggestions on how best to inform the industry about standards and encourage their widespread adoption. The leading ideas included trainings, publications, specific web site, development of useful tools, and help for external auditors. No suggestion received more than 25 percent of the votes. Therefore, a diverse and coherent dissemination strategy, as well as an on-going process will be necessary to ensure "uptake" of standards. Primary suggestions for managing information flows 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.

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."

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 and http://communities.seepnetwork.org/edexchange/node/1799. 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. Full data from this survey, provided in anonymous form, is available on 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.