

MEMORANDUM

For : RISK MANAGEMENT COMMITTEE
From : CREDIT REVIEW
**Re : Guidelines for use of Alternative sources of financial
information of applicants for credit facilities.**
Date : November 25, 2015

- ❖ This is to seek the Committee's approval for the following Guidelines that may be used in the validation of financial information derived from sources other than the audited financial statements of prospective borrowers, for purposes of assessing their capacity to fully service and settle the credit facilities with the bank.
- ❖ This is in line with the provisions of BSP Circular 855, entitled Credit Risk Management, which now recognizes data obtained from alternative sources of financial information, outside of the traditional audited financial statements, provided that the guidelines for said use are clearly articulated and documented.

Prepared by:


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GUIDELINES FOR VALIDATION OF FINANCIAL INFORMATION

- Circular 855 states :

*"In performing financial analysis, FIs shall use, **to the extent available**, credible audited financial statements and other relevant documents and sources. **FI/s may opt to use financial information / data from other sources** provided that the process at arriving at such disposition and an evaluation of how much reliance or value was attached into the financial information used is clearly articulated and documented."*

- In line with the foregoing, therefore, the following guidelines were formulated to standardize the validation and/or evaluation of data from sources other than the audited financial statements.

FINANCIAL STATEMENTS

ITEM for VALIDATION	SUGGESTED VALIDATION METHOD
I. INCOME STATEMENT	
SALES /REVENUES	<ul style="list-style-type: none"> ❖ AO/RO shall establish/ determine the business model, more specifically, the manner by which it generates its cash flows and its profits. ❖ The validation may start with Trade Checkings with customers and suppliers of the borrower. ❖ This may be done by the AO/RO himself/herself or by the bank's Credit Investigation team. <p>1. For Estimation / Validation of Sales</p> <ul style="list-style-type: none"> ➤ Trade Checkings with Clients' Customers: <ul style="list-style-type: none"> - Volume and frequency of delivery - Average selling price - Terms of payment - Overall experience with the client ➤ If client is an Exporter – proof may be the export PO's or LCs and/or export drafts and/or inward remittances to establish : <ul style="list-style-type: none"> - Volume and frequency of purchases - Average Selling price ➤ If client is an importer – volume may be derived from importation data from query from the Bureau of Import Services (BIS)

<p>COST OF GOODS (CGS) / GROSS MARGINS</p>	<ul style="list-style-type: none"> ➤ When possible, AO may ask for invoices, delivery receipts of the company – as proof of sales volume. ➤ <i>Estimation of sales may also start with the validation of client's purchases tantamount to the cost of goods by dividing same by the average gross margins – based on financial data of other companies in the same or similar line of business.</i> ➤ Estimated sales may likewise be matched with the movements and volumes in client's deposit accounts with us or with other banks (SOAs / passbooks) if client allows access. <p>2. For estimation / validation of Cost of Goods</p> <ul style="list-style-type: none"> ➤ First method is to arrive at an indicative gross margin percentage, to be derived from the bank's own data base of clients in a business similar to the nature of business of the client. ➤ Derive the CGS figure after estimating the gross profit using the aforementioned industry average gross margin. ➤ For Importers – from BIS data
<p>NET MARGIN / NET INCOME</p>	<ul style="list-style-type: none"> ❖ Check / compare vs. other companies in the same or similar business and validate viability of the net margin taking into consideration client's direct (cos. with the same products) and indirect (e.g. cos. with substitute products) competitors
<p>II. BALANCE SHEET ITEMS</p>	
<p>CASH</p>	<ul style="list-style-type: none"> ❖ Passbooks or other deposit records (ADB)
<p>Merchandise Inventory</p>	<ul style="list-style-type: none"> ❖ Volume may be based on ocular inspection by the bank's representative and validated against the volumes and prices in the BIS and/or in the trade checking with suppliers.
<p>Fixed Assets</p>	<ul style="list-style-type: none"> ❖ Ocular inspection by the bank appraiser and/or AO/RO. When possible, AO shall request client to show document, e.g. TCT, that the borrower is the owner of the property.

Trade Payables		❖ Based on Trade Checking results with suppliers. This may be derived by comparing the volume of purchases and the credit terms granted by the supplier. E.g. P10M per month, credit terms of 60 days = estimated trade payables as of yearend may be P20.0M.
Short term Loans / Trust Receipts		❖ Based on the Credit Investigation Report.
Long Term Loans		❖ Based on the Credit Investigation Report
Equity		❖ Residual amount after deducting the estimated total liabilities from the estimated total assets. ❖ If with estimated data from previous year, consider cumulative effect in retained earnings

❖ **OTHER GUIDELINES / PRINCIPLES:**

- a. All trade checkings shall be requested from our CPS-CI who shall prepare a formal report of the results. When needed, the AO/RO may likewise conduct his/her own trade checkings, albeit results of same, along with the names of the respondents, are to be summarized in a report and/or incorporated outright in the CA write-up.
- b. Meanwhile, inquiry from BIS may be originated by the Account Officer. Results of the Trade Checkings and/or the BIS response are to be summarized and also incorporated in the body of the CA containing the "validated and/or reconstructed" financial information.

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