Zak’s Key:  
More attention needed

Ready for Review

Cleared

PERFORMANCE STANDARDS FOR

DEVELOPMENTAL FINANCE INSTITUTIONS (DFIs)

IN AFGHANISTAN

September 2011

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ACKNOWLEDGEMENTS

Reporting, production and operating standards are common practices in the commercial world,

and the financial services sector is no exception. International Financial Reporting Standards and

International Accounting Standards are commonly accepted means of reporting financial results

in a global marketplace for transparent, comparable and consistent information. In recent years, microfinance reporting and operating standards are receiving increasing attention, and the sector in Afghanistan is no exception. This document, the framework, standards and means of measurement have been developed for the Afghan context, but draw on the work, practice and tools of the broader international microfinance sector. In particular, the following bodies and their publications have been referenced extensively, in addition to the resources highlighted in the bibliography:

 Consultative Group to Assist the Poorest (CGAP)

 Small Enterprise Education Network (SEEP)

 ACCION International, The ACCION CAMEL: Technical Note

 Institute of Internal Auditors

 International Accounting Standards Board

ACCONYMS AND APPREVIATIONS

AISA Afghanistan Investment Support Agency

DAB Da Afghanistan Bank

DFI Developmental Finance Institution

CGAP Consultative Group to Assist the Poor

IAS International Accounting Standards

IASB International Accounting Standards Board

IFRS International Financial Reporting Standards

KYC Know Your Customer

MEDA Mennonite Economic Development Associates

MISFA Microfinance Investment Support Facility for Afghanistan

MIX Microfinance Information eXchange

NPL Non Performing Loan

SEEP Small Enterprise Education and Promotion (SEEP) Network

SME Small and Medium Enterprises

SWOT Strengths, Weaknesses, Opportunities and Threats

FRAMEWORK

Framework for the Development of Performance Standards for Developmental Finance Institutions (DFIs) in Afghanistan

**Background and Rationale**

The Microfinance Investment Support Facility for Afghanistan (MISFA) was set up in 2003 at the

invitation of the Afghan government to get donor coordination right from the start and avoid the

counter-productive efforts that have emerged from conflicting donor objectives in other postconflict

situations. It was established as a vehicle through which the Afghan Government and

international donors could channel technical assistance and funding to build Afghanistan’s

microfinance sector. More recently, this mandate was expanded to include the lower ranges of

small and medium enterprises (SME) lending. In 2006, MISFA was registered as a limited liability

non-profit company whose sole shareholder is the Ministry of Finance of the Islamic Republic of

Afghanistan.

MISFA’s overall mission is to facilitate the development and growth of long-term, strong and

healthy DFIs in Afghanistan that provide high quality and efficient financial services to low income

people. Its purpose, therefore, includes the development, and promotion of sound practice in the

delivery of appropriate microfinance products and services by DFIs in the Afghan context.

Although it does not have legal authority as a regulatory or supervisory body, MISFA has been

identifying the need to define further the role it plays for the microfinance sector in Afghanistan in

this regard and to formalize the activities donors, DAB (the Central Bank) and others believe

MISFA is and should be already undertaking.

This need was further reinforced by the progress and performance of the sector and by MISFA’s

experiences. It was identified that MISFA needs to develop a more formal ‘supervisory’ approach,

and shape its individual DFI Internal Audit functions to support this. Subsequently, a separate

Monitoring and Supervision Department was established and an initial set of sector-wide

performance standards including a code of conduct for DFI partners was developed by MISFA.

**Key Components**

The following sets out the framework for MISFA’s ‘supervisory’ role and specifically the

preparation and development of performance standards for the sector. This framework harvests

the ideas, vision, and content of sound microfinance and supervisory practice, bearing in mind

that MISFA is not seeking to become a regulator with formal powers, but rather to identify a set of

practical, implementable, and achievable performance standards which can be promoted and,

when necessary, enforced through contractual relationships with the DFIs financed by MISFA.

The framework considers three key components in the preparation and development of

performance standards, namely, that they are (1) measurable, attainable, relevant, and specific,

(2) principle-based, and (3) based on sound practice. These components are further articulated

as follows:

**1. Measurable, Attainable, Relevant, and Specific**

Progress towards meeting the standards will need to be monitored through clearly defined

performance indicators as the MISFA’s contractual partners develop and mature. It is very

useful to know what progress has been made and which standards have already been met. A

measurable standard achieves this end. Furthermore, it is important that the standards be

appropriate to the Afghanistan and developmental finance context and aligned with strategies

and higher goals including the social objectives of the sector. And finally, the standards need

to be well defined, presented clearly, free from jargon and clear to anyone with basic

knowledge of the sector. This helps the DFIs know what is expected of them and MISFA is able

to monitor and assess actual performance against the specific standard.

**2. Principle-based**

The performance standards will take a principle-based approach rather than a rule-based

approach, and will therefore always consider the purpose and rationale for setting and

upholding a standard. The performance standards will reflect MISFA’s core values, including:

 Stewardship and custodian for stakeholders and investors

 Respect for others

 Positive social impact

 Professionalism and Excellence

 Commitment to contextualized sound practices in financial service delivery in

Afghanistan

 Integrity and transparency with its stakeholders

Furthermore, MISFA establishes principles as a general statement of the fundamental

obligations of its contractual DFI partners operating in Afghanistan. They include:

a) **Integrity** –DFIs shall adhere to a code of ethics appropriate to a service provider of

developmental financial services

b) **Clients’ interests** –DFIs must pay due regard to the interests of their clients and treat

them fairly;

c) **Communications with clients** –DFIs must pay due regard to the information needs of

their clients, and communicate information to them in a way which is transparent, fair,

comparable and not misleading;

d) **Clients’ assets** –DFIs must arrange adequate protection for clients’ assets when they are

responsible for them;

e) **Skill, care and diligence** – DFIs must conduct business with due skill, care and diligence

f) **Management and control** – DFIs must take reasonable care to organize and control their

affairs responsibly and effectively, with adequate systems and controls and risk

management systems;

g) **Financial prudence** – DFIs must maintain adequate financial resources; and

h) **Relation with MISFA** – DFIs must deal with MISFA in an open and co-operative way, and

must disclose to MISFA appropriately anything relating to the provider of developmental

financial services of which MISFA would reasonably expect notice.

These core values and principles reflect the mission of MISFA and inform the purpose and

rationale of each performance standard measure. They are therefore also the ultimate

measure of performance of DFIs operating in Afghanistan.

**3. Based on Sound Practice**

The performance standards shall adhere to: (a) sound developmental financial service

practice as articulated and held by CGAP, SEEP and other sector bodies, (b) prudent banking

practice, when applicable, including local legal and regulatory guidelines as set by DAB and

international banking standards, (c) international accounting and auditing standards, and (d)

sound, practical judgment.

MISFA introduces these framework components to guide the development and implementation

of performance standards for the sector in Afghanistan. It recognizes the importance of its own

adherence to the core values and principles in particular in acting with integrity, prudence, skill,

care and diligence, and with appropriate care and respect towards its partners and other

stakeholders in accordance with the performance standards it seeks to promote.

**Use and Applicability**

The performance standards shall be used to (a) set clear expectations of performance for DFI

partners that have or seek financing from MISFA; (b) establish performance goals and targets for

the partner DFIs; (c) develop transparent assessment metrics for DFI self-evaluation and

evaluation by MISFA’s Monitoring and Supervision Department; and (d) instill ‘regulatory’

discipline in DFI partners, particularly those who may seek future licensing from DAB.

MISFA’s assessment of its partner DFIs will be conducted annually. Following completion of each

assessment, the respective DFI partner will be required to prepare and implement an action plan

for any gaps/deficiencies identified by the Monitoring and Supervision Department. The action

plan is expected to be prepared within an agreed time frame following MISFA’s submission of the

gap assessment report to the partner DFI. MISFA will have a monitoring and facilitating role

throughout the development and implementation process of the action plan.

The performance standards shall be applicable to all developmental financial service providers

that contractually access funding from MISFA, regardless of the type of funding, legal structure,

regulatory status, target market and ownership. Performance targets and consequences of

compliance will be laid out in the contractual agreements MISFA holds with its partners.

**The Standards**

By definition, a standard is an established norm or requirement. It is usually presented in a

formal document that establishes uniform technical criteria, methods, processes and practices.

To be effectively applied or adopted a standard requires legislated compliance, proprietary rights,

brand name, or moral authority.

Commercial banks are legally required to conform to central bank standards as a condition of

obtaining their license. Central banks generally follow international banking practice standards

articulated by the Bank for International Settlements and its Basel Committee on Banking

Supervision, based in Basel, Switzerland. Standards for operating and reporting in microfinance

are still less formalized. Stakeholder efforts in defining standards for social performance,

financial reporting and disclosure are generally considered as “best practice” and led by donor

and practitioner bodies such as CGAP and SEEP, respectively. The MIX’s database platform for

microfinance data collection and publication benchmarks institutional performance by peer

groups and is consistent with the “best practice” definitions and concepts laid out by CGAP, SEEP

and others.

MISFA seeks to establish performance standards for its contractual DFI partners to strengthen

and build increase quality and sustainable services for low income people in Afghanistan. The

following standards fall within the overall work and practices of performance and reporting

standards for the microfinance sector internationally. DFI partners operating with a license from

DAB and subject to those regulations will operate under additional standards not articulated in

this document.

For the sake of uniformity and clarity of presentation each performance standard follows a

similar format and includes (a) a purpose and rationale, (b) an objective, (c) key terms, and (d)

core principles. These key components have been described as follows:

** Purpose and Rationale.** The reason for the standard, its importance with respect to

microfinance and within the local context.

** Objective.** Each standard developed will be directly related to improved quality performance

of the DFI and have a clearly defined goal.

** Key terms.** Key terms will be identified but in order to focus on the principles and concepts at

work, rather than the rules and ensure a common understanding among partners.

** Principles.** Characteristics, qualities and descriptions of the performance to which DFIs are

expected to adhere.

In January 2010, a team comprising MISFA senior managers, technical advisors and consultants

met to draft an initial set of performance standards for MISFA’s partners. The process was

facilitated by consultants from Mennonite Economic Development Associates (MEDA). The

following twenty-two (22) standards below were set as priorities and are presented in detail in

this document.

1. Qualifying Organizations & Registration Requirements

2. Corporate Governance, Mission & Vision

3. Code of Conduct

4. Senior Management Arrangements

5. HR Administration and Succession Planning

6. Strategic & Business Planning, Budgeting & Projections

7. Capitalization

8. Accounting Treatment of Non Performing Loans (NPLs) & Write Offs

9. Financial Management

10. Products and Services

11. Credit Policies & Procedures and Credit Risk Management

12. Administration Policy

13. Business Continuity & Disaster Recovery

14. Management Information Systems

15. IT Systems Management

16. Documents & Record Keeping

17. Internal Controls

18. Accounting Policies & Cash Management

19. Internal Audit

20. External Audit

21. Transparency, Disclosure & Reporting

22. Training and Staff Development

The team also identified additional standards for future development including the following:

1. Consequences on violation of Standards

2. Exposure against Contingent Liabilities

3. Maximum Exposure of a borrower from DFIs / Other Financial Institutions / NGOs

4. Statutory Reserve

5. Depositors and lenders protection fund

6. Foreign Exchange Limits

7. Limit on exposure against unsecured financing facilities

8. Linkage between financial indicators of the borrower and total exposure from financial

institutions

9. Places of business

10. Contributions and donations for charitable, social, educational and public welfare

purposes

11. Prevention of Criminal Use of DFI Channels for the Purposes of Money Laundering

12. Suspicious transactions

13. Financing of Terrorism

At least on an annual basis, MISFA reviews the existing standards, evaluates the relevance,

identifies professional, regulatory or sector updates and changes, evaluates changes in weighting

and importance and updates the standards. This process will also recognize that as the sector

matures in Afghanistan, DFIs may look to fully regulate with DAB. The current performance

standards manual was last updated in September 2011.

**Conclusion**

The development of this framework is an evolving processin developing a more formal

‘supervisory’ approach to MISFA’s work. Management recognizes that broad stakeholder input

will enhance buy-in, commitment and compliance to the standards. As such, MISFA has always

been open to suggestions for improvement from its DFI partners throughout the development

and implementation process of this framework.

The performance standards have been used to develop an assessment tool for both DFI selfevaluation

and evaluation by MISFA. The assessments by MISFA include comprehensive desk

analysis, interviews, review of the external and internal audit and monitoring reports, review of

portfolio reports, client visits, and review of the finance and administration units within the DFI

partners. This framework is the main monitoring and supervision guide for MISFA. It helps

strengthen the capacity of the DFI partners to provide sound and sustainable financial services

for the low income people in Afghanistan.

While the intent of this document is to organize previously existing Shelter For Life International (SFL) documents so as to be compliant with the format presented in MISFA’s Performance Standards for Developmental Finance Institutions (DFIs) in Afghanistan, please refer to the following documents for a more comprehensive overview of information about operations in SFL: SFL Field Operations Manual 2013 & Shelter for Life International, Afghanistan Microfinance Department Credit Policies and Procedures Manual

PERFORMANCE STANDARDS

STANDARD 1

Qualifying Organizations & Registration Requirements

**Purpose and Rationale**

MISFA seeks to facilitate the development and growth of long-term, strong and healthy DFIs in Afghanistan comprised of institutions that provide high quality and efficient financial services to low income people. Fundamental to operating in the sector is meeting local legal and regulatory requirements and registering with the appropriate authority (DAB or AISA) as applicable. Furthermore, MISFA seeks to work with organizations that share its values and principles of stewardship, respect, professionalism and excellence, integrity, and transparency. All DFIs should openly disclose to MISFA their founding and governing documents, information with respect to its founders and sponsors, mission and vision and business plan and projections for operations.

**Objective**

The objective of this Standard is to provide guidance to DFIs and other parties interested in setting up as a developmental finance service provider in Afghanistan.

**Key terms**

DAB, AISA, Registration, Founder, Sponsor, Articles of Association, MOA

**Principles**

1) DFIs shall register with the appropriate body (DAB or AISA) under the Islamic Republic of Afghanistan.

SFL International is currently registered with the appropriate body under the Islamic Republic of Afghanistan, however, seeks to develop an independent branch of microfinance, SEMA, which seeks to register under the appropriate body under the Islamic Republic of Afghanistan.

2) The registration and organizational purpose shall be to engage in developmental finance in Afghanistan.

The purpose of SEMA is to engage in developmental finance in Afghanistan. For more information, please see Policies & Procedures Manual.

3) The articles of association (or MOA or other governing documents) shall have appropriate language describing the core activity as financial service providers.

Please see SEMA Articles of Incorporation Article 3:  
**Article 3.** The purpose of SEMA is to create a nationally recognized sustainable financial services institution, providing high quality and fair priced loan products in a transparent and sustainable manner to the economically poor which will increase their incomes, expand their businesses and improve their quality of life.

4) The sponsors of the organization shall contribute some equity capital to demonstrate

committed intent.

SFL is the primary investor in SEMA and the primary contributor of cash for loans, operations, property, plant & commitment. For more information, please see Field Operations Manual.

5) The organization shall provide all founding and governing documents of the DFI, including articles of association and by-laws; detailed information on the founders, administrators and sponsors; a business plan and projections for the operations of the DFI.  
  
 SEMA is able to provide articles of association and by-laws; detailed information on the founders, administrators and sponsors; a business plan and projections for the operations. See Articles of Incorporation, Bylaws, Policies and Procedures Manual and other supporting documents.

6) The DFI shall not engage in illegal or illicit activities, including money-laundering or other criminal activity.

SEMA complies with this principle. For more information, please see SEMA Field Operations Manual.

7) The DFI shall at all times make best efforts to be in compliance with the prevailing laws and regulations of Afghanistan relating to taxation, health, safety and environmental protection. Environmental guidelines will be in compliance with any requirements in law or as provided in any source funding document by donors, e.g. World Bank, USAID, DFID, etc.

SEMA is in compliance with all laws in Afghanistan. Environmental guidelines will comply with legal requirements or as provided in source funding document by donors. For more information, please see SEMA Credit Policies and Procedures Manual, SEMA Articles of Incorporation Article, and SEMA Field Operations Manual.

8) DFIs shall further refer and comply with the following standards of governance, and senior management arrangements before commencing operations.

SEMA shall further refer and comply with the following standards of governance, and senior management arrangements before commencing operations.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The founders and sponsors of the DFI are recognized developmental finance  practitioners (locally, regionally, or internationally) with a track record of sound  practice and commitment to providing high quality and efficient financial services  to low income people. The sponsors have contributed some initial capital to the  DFI and have plans to make additional contributions. The DFI has registered with  the appropriate body (DAB or AISA) and all legal and statutory filings are up to  date. The organizing documents state clearly that the DFI shall be engaged in  financial services as its core activity. All organizing documents including articles  of association and by-laws; detailed information on the founders, administrators  and sponsors; a business plan and projections for the operations of the DFI are  readily available and are updated regularly, as appropriate. |
| 4 | The DFI generally meets the standard. The sponsors have contributed some  initial capital to the DFI but have no plans to make additional contributions. A  business plan and projections for the operations of the DFI are readily available  but may not be up to date. |
| 3 | The founders and sponsors of the DFI are recognized developmental finance  practitioners (locally, regionally, or internationally) but do not have a strong track  record and limited or no experience in post-conflict environments. A business  plan and projections for the operations of the DFI are available but have some  deficiencies. The sponsors have made no financial commitment and/or have not  made plans to do so. |
| 2-0 | The founders and sponsors of the DFI have no experience in the development  and delivery of financial services to low income people and seem only interested  in doing so because donor funds are available. |

STANDARD 2

Corporate Governance, Mission & Vision

**Purpose and Rationale**

Good governance is fundamental to the sound practice of developmental financial services. Governance is the combination of processes and management structures implemented by a board in order to inform, direct, and monitor the activities of the organization toward the achievement of its objectives. Governance focuses on how well the institution’s board of directors functions, including the diversity of its technical expertise, its independence from management, and its ability to make decisions flexibly, effectively and in a timely manner. Effective governance depends primarily on the skills and characteristics of the individual directors and diversity in composition. The Board is responsible for setting the mission and vision of the DFI and ensuring both the social and financial objectives adhere to the mission and become a part of institutional culture.

**Objective**

The objective of this Standard is to provide details regarding recommended composition,

qualifications and responsibilities for members of the Boards of Directors (or equivalent) and its appropriate place in the governance of DFIs.

**Key terms**

Committees, fiduciary responsibility, governance, director

**Principles**

1) All DFIs shall be governed by a Board of Directors in accordance with their Articles of Association or other approved governance structure that is properly constituted and functioning.

SEMA has a Board of Directors in place. This is in accordance with SEMA Articles of Incorporation. For more information, please see SEMA Articles of Incorporation.

2) Collectively, the Board of Directors shall represent a diverse set of experiences, backgrounds, areas of expertise, ethnicity, and gender. Ideally, the collective Board will possess the following characteristics and skills:

a. Business knowledge and experience

b. Knowledge of the developmental finance sector and the client community

c. Banking and financial management knowledge and experience

d. Human resources and corporate management knowledge and experience

e. Legal and regulatory skills and experience

f. Qualified accounting knowledge and experience

g. Linkages with the local business, legal, banking and government community

SEMA Board of Directors represents diverse backgrounds and characteristics, while possessing skills in the aforementioned areas. For more information, please see to SEMA Bylaws. Officers and Board Members include:

**Brint Patrick**

**- Chairman of the Board**

Brint Patrick is the Executive Director of Restoration Gateway, whose mission is to bring empowerment, hope and healing to the war-torn people of northern Uganda through the focus of orphan care, medical and dental care. Prior to Restoration Gateway Mr. Patrick was the Director of Operations for Mateffy Engineering,Inc., He has also worked as the Vice President of Administration for Coldwell Banker, Jim Stewart Realtors. Mr. Patrick contributes management, business development, as well as technical expertise in construction and design. He holds a Bachelor of Administration from Baylor University, and an Associate’s Degree in Architectural Drafting and Design from Texas State Technical College. Mr. Patrick has demonstrated ongoing involvement with work in developing countries across the globe.

**Gordon Wright**

**- Vice Chairman**

Gordon A. Wright is Founder and President of over 40 years with JIMI. Mr. Wright owned and operated a lawn and tree service business for nearly 15 years. He possesses skills in leadership, discipline, and is highly intelligent. Mr. Wright has provided mentoring and counseling to leaders around the world. Mr. Wright helped to found and direct East/West Resources International and Global Assistance Partners International. Mr. Wright is committed to achieving results that reflect the mission of SEMA.

**Kyle Newkirk**

**- Treasurer**

Kyle A. Newkirk is Director of Commodity Risk Management for S&D Coffee. Prior to holding this post with S&D Mr. Newkirk was Senior Manager of Global Risk for The Hershey Company, and before that was Senior Global Sourcing Manger for General Mills. Mr. Newkirk also has work experience with USAID as a Foreign Service Officer. He holds a Master of Science degree in Animal Science and a Bachelor of Science in Education from Oklahoma State University. He has public and private sector experience in Asia, South America and Europe. In addition, Mr. Newkirk has knowledge of government contracting and assistance regulations, USAID programming and foreign assistance, sustainable agriculture development, and global supply chains. Originally from Kansas, Kyle has lived and worked overseas with USAID in Afghanistan and Thailand.

**Victor Weir III**

**- Secretary**

Victor A. Weir, III, or Trey, is Managing Partner for Bull Session, Inc., and Trey Weir Media, LLC. Prior to these roles Mr. Weir was Partner for Spectraband Inc., a company that specialized in providing Mergers and Acquisitions consulting to telecom and internet companies.  Before working with Spectraband, Mr. Weir was Director of Strategic Development for CoServ, an electric cooperative serving members in North Texas. Prior to CoServ, Mr. Weir was Strategic Development Manager for US Wavelink, Inc., a wireless network developer specializing in LMDS technology. Mr. Weir holds Bachelor of Arts degrees in Finance, Entrepreneurship and Real Estate from Baylor University. He has over 15 years of experience with financial analysis, contract negotiations, mergers and acquisitions, strategic business development, and capital funding and management. Originally from Arlington, Texas, Mr. Weir has knowledge of telecom, internet, deregulated power, and digital media industries.

**Thomas Lane**

**- Director**

Thomas M. Lane is owner of Advanced Metal Roofing, a construction company that manufactures and installs metal roofing. A retired carpenter and ironworker with over 45 years of experience in the construction industry, Mr. Lane has a wealth of expertise in drafting, design, sheet metal work, plumbing, electrical, roofing, steel fabrication and erection, wood construction and excavation.  Mr. Lane also has experience in the fields of agriculture, horticulture and aquaculture.

3) Individually, the Board of Directors shall have the following characteristics:

a. Commitment to the DFI’s mission

b. Understanding and commitment to their fiduciary responsibilities

c. Strong communication skills

d. Results-oriented

e. Of high repute. Integrity and moral character

f. Time availability

g. At least one of the skills of the collective Board

Please see above Board Members characteristics.

4) In meeting its overall commitment to the DFI’s stakeholders, the board shall conduct its duties with due skill, care and diligence. The board:

a. Holds fiduciary and legal responsibility for the organization;

b. Is responsible to protect, promote and strategically lead the organization in its dual mission of financial health and social performance;

c. Is responsible to ensure the achievement of objectives through operations and activities

delegated to management and staff;

d. Is responsible to manage its own work, performance and tasks;

e. Is responsible to appoint, supervise, compensate and terminate the chief executive; and

f. Must take reasonable care to organize and control its affairs responsibly and effectively, with adequate systems and controls and risk management systems.

The Board of Directors is committed to conducting business with due skill, care and diligence. For more information, please see SEMA Bylaws.

5) The board shall establish committees to handle matters that require detailed review or indepth consideration. At a minimum the board shall have an audit committee.

The board has previously established committees responsible for matters requiring greater consideration, including an executive committee, a nominating committee, an audit and finance committee, and a compensation and personnel policy committee. For more information, please see SEMA Bylaws.

6) The DFI board shall establish a board rotation and selection policy that ensures stability and continuity of board composition and the ability to enhance its own pool of skills and experience as the institution matures.

SEMA has existing policies and procedures in place to assure stability and continuity in terms of board composition. These policies also allow for the enhancement of skills and experience over time. For more information, please see SEMA Bylaws.

7) The DFI board shall hold quorum-based meetings at least twice annually, preferably quarterly.

The Board of Directors has specific guidelines in regards to meetings. For more information, please see SEMA Bylaws.

8) The DFI shall deal with MISFA in an open and co-operative manner, and shall disclose to MISFA all material and relevant information affecting the DFI.

SEMA is committed to establishing a positive relationship with organizations it works with. SEMA shall provide required material in a cooperative manner.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The institution has a strong board with excellent and varied technical expertise  and experience relevant to the provision of developmental financial services.  The board has adopted a mission and vision for the DFI which establishes the  organization as a socially conscious, pro poor and commercially viable financial  institution. The mission and vision is accepted by management and reflected in  the DFI’s operations. The board is active and independent of management. The  board receives excellent quality information from staff and third parties and has  clear decision-making authority over the institution’s strategic and key operating  decisions. The board makes decisions flexibly, effectively and in a timely  manner. The board operates with MISFA in an open and co-operative way and  discloses to MISFA all relevant and material matters. |
| 4 | The institution’s board functions fairly well, providing adequate governance to  the institution. |
| 3 | The institution’s board exhibits some deficiencies in the areas outlined above,  resulting in somewhat disengaged or not very effective governance. The board is  not cooperative in disclosing all relevant or material matters to MISFA. |
| 2 | The DFI has a board but with significant deficiencies. |
| 1-0 | The DFI has either a nonfunctioning board or one that rarely meets. |

STANDARD 3

Code of Conduct

**Purpose and Rationale**

Developmental financial service providers have a legal, professional, and ethical responsibility to operate with transparency and integrity, and to be proper stewards of their financial resources and guardians of their social mission. This is fundamental to establishing trust in the financial services sector and building an appropriate image and reputation with employees, partners, clients, and society. A Code of Conduct is a useful way to communicate the values, mission and vision of the DFI. In turn, the Code of Conduct influences the development and delivery of the DFIs products and services and solidifies the reputation of the DFI in the community.

**Objective**

The objective of this Standard is to provide guidance to DFIs in the development of a Code of Conduct which outlines the DFI’s vision regarding the behavior of employees towards client, as well as the relationship with its suppliers, other DFIs, donors and funders, and other stakeholders. The Code of Conduct of the DFI shall incorporate the principles outlined in this standard.

**Key terms**

Code of Conduct, ethical, integrity, transparency, stakeholders

**Principles**

1) Each DFI shall develop a Code of Conduct, available in the vernacular to stakeholders, staff and clients. The DFI should develop a process and methodology for adoption of the Code of Conduct that includes participation from the board and management (e.g. Legal department, Human Resources) as well as other key stakeholders. Employees should be informed of progress and invited to participate.

SEMA has existing Code of Conduct for all employees and is committed to upholding these standards. Employees are familiarized with information upon hiring. Any changes that take place will be made known to employees. For more information, please see SEMA Field Operations Manual & SEMA Credit Policies and Procedures Manual.

2) At a minimum, the Code of Conduct should address the following areas:

**a. Integrity**. A DFI should conduct its business with all internal and external concerned

parties in a manner that is ethical, fair, transparent, dignified, equitable and cost

effective.

**b. Clients’** interests. DFI clients shall have adequate repayment ability for loans and not at significant risk of over-indebtedness. Collection practices shall not be abusive or coercive.

Clients shall have access to timely and responsive mechanisms for feedback so that the

services can more closely meet their needs. Safeguards shall be in place to ensure that

staff complies with high ethical standards in their interaction with clients and to ensure

that clients are treated fairly.

**c. Clients’ assets.** DFIs shall adequately protect clients’ assets when responsible for them.

**d. Communications with clients.** DFIs shall give due regard to the information needs of

clients. Product information shall be transparent, fair, comparable and not misleading.

**e. Privacy of client data.** DFIs shall not use client data for other purposes without the

express permission of the client.

Code of Conduct addresses matters such as integrity, dealings with clients, behavior, ethics, and more. For more information, please see SEMA Field Operations Manual & SEMA Credit Policies and Procedures Manual Section.

3) The DFI shall establish a transparent, objective and documented process for monitoring and resolving cases of breach of the Code of Conduct. The DFI shall take appropriate disciplinary action in case of violation of the Code of Conduct by the employee/s.

Measures for breaches in Code of Conduct have been established. For more information, please see SEMA Field Operations Manual, SEMA Credit Policies and Procedures Manual, and the Codes of Conduct - Reporting and Enforcement Mechanism document.

4) The content of the Code of Conduct shall be updated and revised periodically as a way to meet the needs of the DFI and changes in its environment.

SEMA documents are working documents and change as better ways to operate are discovered, and as situations change in the environment. For more information, please see SEMA Field Operations Manual.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has undertaken a formal Code of Conduct process with participation  from the board, senior management, employees, as well as other key  stakeholders, as applicable. The Code of Conduct is properly constituted and  approved and has been submitted to MISFA. The Code of Conduct has been  properly communicated and understood by clients. It is prominently displayed  in all places of business in the vernacular, and copies are readily available.  DFI employees are fully aware of their obligations under the Code of Conduct  and breaches have been resolved through a formal, documented and  objective process. The Code of Conduct is including in the formal induction  process for new employees and orientation of clients. The DFI has a process  for monitoring the Code of Conduct. The Code of Conduct largely reflects the  DFIs operations and reputation in the society. The Code of Conduct is  updated regularly through a formal, documented process. |
| 4 | The DFI adequately meets the standard. The Code of Conduct is properly  constituted and approved and has been submitted to MISFA. There are some  deficiencies in the communication of the Code of Conduct to employees and  clients of the DFI. |
| 3 | The DFI has undertaken a formal Code of Conduct process that is generally  acceptable. However, the development, communication and integration of  the Code of Conduct exhibits basic deficiencies in the areas outlined above.  Reports exist of unresolved client complaints. |
| 2 | The DFI has developed a Code of Conduct but the board and/or employees  are largely uninformed as to its contents. It is not available in the vernacular  and is generally not available. There is no process of lodging or resolving  complaints. |
| 1-0 | The DFI has no Code of Conduct or has provided a written Code of Conduct  for the sake of meeting this standard only. |

STANDARD 4

Senior Management Arrangements

**Purpose and Rationale**

Building a solid and cohesive senior management team is one of the major challenges

confronting boards and executives of DFIs. This team should possess skills and qualifications appropriate for their roles, be committed to their work, have the authority and resources to effectively make decisions, and be accountable for their results. The ability to communicate openly and as a team is critical. Senior managers must work to build a strong internal control environment, respond to issues raised by internal and external auditors, and be able to manage change within the organization effectively.

**Objective**

The objective of this standard is to provide details regarding recommended composition,

qualifications and responsibilities for members of the senior management team and its

appropriate place in the operation of DFIs.

**Key Terms**

Senior manager, vacancies

**Principles**

1) DFIs shall have in place qualified and capable senior management team comprised of no less than CEO, CFO, COO, HR/Training Manager, Internal Auditor and dedicated MIS Manager, or their appropriate equivalents.

President – Mustafa Omar

Vice President - Enamullah

Director of Finance – Asfaw Seyoum

Operations Manager - Sharafullah

2) The senior management team should represent professional skills, qualifications and related experience. Each member should be an individual of the highest integrity, moral character, motivated and committed to the mission of the institution.

SEMA’s senior management team is comprised of individuals with professional skills, qualifications, who have experience in microfinance and related fields.

3) With respect to candidates for senior management positions, DFIs shall fulfill the following:

a. CVs shall be shared with MISFA and MISFA shall provide opinions on their suitability

CVs of SEMA’s management personnel will be shared with MISFA.

b. Candidates shall have been properly vetted and due diligence conducted prior to an

offer of employment

Candidates for any SEMA management position will be qualified individuals and SEMA shall perform background and reference checks for all employees.

c. Candidates shall be willing to make commitments to the organization above one year

All hiring candidates will be required to make the above time commitment. All current management staff have more than one year of microfinance management performance.

d. Candidates shall be physically capable of living in Afghanistan if sourced from outside

of Afghanistan

SEMA will ensure that any candidates, if sourced from outside Afghanistan, are capable of and authorized to reside in the country.

e. DFIs shall have a contingency and operational plan for absences of more than one

month that includes approval guidelines, signatory levels, delegated responsibilities,

and the notification of parties and stakeholders of arrangements.

SEMA has a operational Human Resources plan in place to account for absences of a month or more that provides for necessary guidelines, signatory levels, etc., and that also covers the duties and responsibilities of any individual on an extended absence.

f. Disclosure to MISFA of upcoming changes in key positions  
 SEMA will duly inform MISFA of all key personnel changes.

4) With respect to senior management vacancies, DFIs shall fulfill the following:

a. No key position shall remain vacant beyond a six month period

b. CEO shall not remain vacant for more than 3 months

c. Temporary resources shall be used to fill immediate needs, but may not be longer than 6 months

SEMA complies with this principle.

5) DFIs shall have in place a continuity or backup plan in the event of an inability of key persons to fulfill their responsibilities in the short term. DFIs shall give adequate thought and preparation to succession planning for the senior management in their medium to long-term plans.

SEMA has in place a backup plan to cover temporary vacancies or inability of key persons to carry out the duties of their role. Procedures for a succession plan are in place to cover absences of senior management staff.

6) Management shall be committed to the long-term development and success of the

organization and the sector.

Management is committed to a long-term success of the microfinance institution.

7) Management shall be responsible for proper oversight and development of the DFI’s

operations, finances, personnel and for implementing the DFI’s mission and vision.

Proper procedure is in place. For more information, please see SEMA Field Operations Manual

8) Management shall ensure a strong and pervasive internal control environment within the organization.

SEMA has proper internal control policies and procedures that are audited on a regular and frequent basis and enforced by senior operation and finance management.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has a CEO, CFO, COO, HR/Training Manager, Internal Auditor and  dedicated MIS Manager, or their equivalents, with the necessary  qualifications and skills to carry out their roles and responsibilities. The DFI  has shared candidate CVs for these positions with MISFA and MISFA has  provided opinions on their suitability. Candidates have been properly vetted  and due diligence conducted prior to an offer of employment. The senior  managers are committed to the organization as demonstrated by the  longevity of service of a number of managers. The senior management team  is characterized by cohesiveness. The management team is guided by clear  objectives that are communicated openly throughout the institution. Junior  staff is strongly supported by the management team. Decisions are taken on  a timely basis and are based on technical information. A strong and  pervasive internal control environment exists within the organization. |
| 4 | The DFI has major senior management positions filled with some gaps.  Managers are generally qualified, capable and experienced, as appropriate,  to the position. Candidate CVs have been shared with MISFA and MISFA has  provided opinions on their suitability. The internal control environment is  considered adequate. |
| 3 | The management team has some deficiencies based on the above criteria.  The management team lacks clear objectives and is unable to communicate  its role to the DFI’s staff. The institution exhibits deficiencies in the areas of  decision making, communications, and internal controls. |
| 2 | The management team has significant deficiencies based on the above  criteria. Prolonged absences by senior managers and/or vacancies leave  large gaps in the functioning and /or moral of the DFI and its staff. There is a  poor flow of communication and limited support provided by the  management team. There is no formal process for decision-making. The  internal control environment is poor. |
| 1-0 | The management team does not have the requisite skills, qualifications or  willingness to fulfill their roles and responsibilities resulting in serious  challenges for the DFI. Prolonged absences by senior managers and/or  vacancies leave large gaps in the functioning and /or morale of the DFI and  its staff. Key decisions have either been poorly made, or not made at all.  There is no commitment on the part of management to internal controls. |

STANDARD 5

HR Administration & Succession Planning

**Purpose and Rationale**

Strong human resources systems and administration for DFIs is key factor to building permanent, local financial institutions that serve low income people. Human resources administration supports DFI operations through recruitment and training of personnel, remuneration and incentive schemes, performance evaluation systems, and staff development programs. The DFI’s ability to retain, develop and promote staff to senior management positions are key indicators of successful human resources systems. Succession planning ensures key positions in the organization do not remain vacant for extended periods of time.

**Objective**

The objective of this standard is to provide guidance to DFIs on the administration of their human resources and in their succession planning.

**Key Terms**

Recruitment, Training, Remuneration, Incentive schemes, performance evaluation systems, succession planning, Code of Ethics, Code of Conduct

**Principles**

1) Qualified and Committed Senior management team shall be in place to ensure consistency, continuity of organizational management

Please refer to CVs of the senior management, previously mentioned.

2) Each DFI shall have a dedicated resource whose purpose is the recruitment, development and support of all persons employed by the DFI. This includes a performance management system that incorporates regular monitoring and a performance appraisal process.

SEMA has established a resource for recruiting, developing and supporting employees. There is a performance management system in place, which monitors and provides feedback, acting as a performance appraisal system. For more information, please see SEMA Field Operations Manual and SEMA Employee Performance Evaluation Form.

3) The HR resource shall also be responsible for the development and proper implementation of all HR policies and procedures that are consistent with the labor laws of Afghanistan.

SEMA complies with all laws of Afghanistan.

4) Policies and procedures shall recognize and promote fair and equitable treatment, working conditions and remuneration.

SEMA recognizes and promotes fair and equitable treatment, working conditions and remuneration. For more information, please see SEMA Field Operations Manual and Standard 3 for Code of Conduct policies and additional information.

5) The DFI shall have in place an organizational structure; future needs and planning shall be clearly documented and updated on a rolling 2 year basis at regular intervals, including succession and expansion/back up planning.

An organizational structure is already in place, which is reviewed on annual basis. Should amendments be needed, they will be added during review process. For example, changing President and Vice President require Board approval. All other changes are approved by the President and Vice President. For more information, please see SEMA Field Operations Manual and SEMA Bylaws.

6) All employees shall be aware of the rights and obligations as a member of the DFI team.

SEMA employees are informed of rights and obligations during the hiring process and upon acceptance of position. For more information, please see SEMA Field Operations Manual.

7) Each DFI shall develop a Code of Ethics consistent with the Code of Conduct (in the

vernacular), and ensure that the organization and its employees adhere to this code, as well as all applicable labor laws in Afghanistan.

All SEMA Code of Conduct is in compliance with laws of Afghanistan. For information on Code of Conduct, please see Standard 3. For Code of Ethics, please see SEMA Field Operations Manual and SEMA Credit Policies and Procedures Manual.

8) Training processes and materials shall be documented and available for review.

SEMA senior management will provide frequent staff development and training on appropriate topics. SEMA will also facilitate for continuing training and development to improve the professional conduct of the organization in Afghanistan. For more information, please see SEMA Field Operations Manual and SEMA Employee Handbook.

9) Staff induction and orientation shall be a minimum of one week and incorporate progress reviews during process. Minimum education level for all non-support staff must be Form 10 or higher.

All SEMA employees have at least a high school education. SEMA promotes the ongoing pursuit of higher education.

10) Code of Ethics reviewed and provided to staff in local language and signed acceptance by employee.

SEMA translates documents to Farsi. For more information, please see SEMA Field Operations Manual.

11) The DFI’s HR Policy Manual shall be available in the vernacular to every branch and center of the institution.

SEMA’s HR Policy Manual is available to each branch and center. For more information, please see SEMA Employee Handbook & WWH document, as well as SEMA Field Operations Manual.

12) All positions in the DFI shall have a written and current job description.

SEMA positions have written and current job descriptions. For more information, please see SEMA Field Operations Manual.

**Assessment**

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| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has a dedicated human resources department or unit guided by a clear  mission which reflects that of the organization as a whole. The human resources  strategy and objectives are well documented, has been disseminated through  the organization, and is updated on a regular basis. The department has the  necessary resources (budget, staff, and technology) to pursue its objectives.  Human resources policy has been approved by the board and reflects the DFIs  mission and objectives. The human resources department is pro-active in its  recruitment strategy. The DFI fills vacancies quickly and efficiently, and in a fair  and equitable manner. The institution monitors absenteeism, tardiness,  staff rotation and the working environment in general.. Job descriptions are  documented, known to staff, and correspond to actual job responsibilities. All  applications, promotions/ appointments, disciplinary records, terminations and  other records related to employee are available in writing. Performance  appraisals are conducted at a minimum annual with periodic feedback and  monitoring and include a staff development plan and career plan options. The  DFI has a Board approved staff benefits package and a clear salary scale based  on competitive analysis. The incentive scheme is well aligned with the DFI’s  operational targets and its policies and procedures. |
| 4 | The DFI has a dedicated human resources department or unit, and in generally  adequately supports the work of the DFI. The DFI has an adequate benefits  package, and a salary scale approved by the board. The incentive system, if any,  supports the institution’s targets and its policies and procedures. An Employee  Handbook includes the Code of Conduct/Ethics. Almost all personnel documents  are in writing. Files exist but are not 100% complete. An annual performance  appraisal is linked to access to salary raises. The DFI makes relatively strong  efforts to promote the work and function of HR in the institution and deficiencies  are addressed fairly regularly. |
| 3 | The DFI has a dedicated human resources department or unit. Human  Resources manuals, Employee Handbooks and Incentive systems exist but are  deficient in a number of areas (ie unclear job descriptions, lack of a transparent  recruitment method, incentive system accessible despite low performance). The  DFI exhibits some deficiencies in managing its HR and retaining qualified  personnel. Policies and procedures are in the vernacular, but not readily  available. |
| 2 | The DFI exhibits weaknesses in the management of human resources. The  systems and procedures described above do not exist or are barely discernable.  The board and management have made little or no effort to put cohesive human  resources systems in place. |
| 1 | The DFI has significant deficiencies in human resources management. This  results in serious problems such as a low staff retention rate and low staff  morale. |
| 0 | The DFI has no dedicated human resources department or unit. Policies may  exist but are not adhered to. |

STANDARD 6

Strategic & Business Planning, Budgeting & Projections

**Purpose and Rationale**

Strategic and business planning, and the development of budgets and projections are

fundamental activities of all businesses. Ideally the development of a strategic plan will be a formal process that considers all aspects of the business and involves participation from a crosssection of organization’s management and staff. The process should include an assessment of how resources will be allocated and result in a set of financial projections. An analysis of strengths, weaknesses, opportunities, and threats (SWOT) is also typically undertaken. Ultimately the plan should aid the internal decision-making and provide a roadmap for achieving the organizations objectives. Budgets forecast an organization’s expected revenues and expenses based on operational targets. Regular monitoring of budgets is critical not just to verify results against targets but to identify problems that need corrective action.

**Objective**

The objective of this standard is to provide guidance to DFIs on their strategic and business planning process and the development of their budgets and financial projections.

**Key Terms**

Projections, SWOT analysis, strategic planning, budgeting

**Principles**

1) DFIs shall have a process for the development of strategic and business plans, financial projections and budgets. The business plan shall be updated as needed and at a minimum on an annual basis.

SEMA has a developed business plan with financial projections and budget. This plan is updated more than once per year based on performance and changing market realities.

2) Plans shall reflect the DFIs mission and vision, and be based on past performance, sound assumptions, and realistic expectations that take into account the DFI’s operating

environment.

The plan in place reflects the mission, vision and past performance of the institution and is realistically forward looking based on ground realities of the local environment

3) Ownership and responsibility for the business plan shall lie with senior management and the board shall be in concurrence with the plan as presented by senior management i.e. approved by the Board. Senior Management shall be able to explain and articulate the plan in part or whole. Any tools used by DFI must be understood by the DFI and they must have the ability to explain the results.

SEMA’s business plan and personnel structure are in compliance with this principle.

4) The business planning process shall begin 4 – 5 months prior to the end of the fiscal year, and reflect an iterative process of management review and board input before its final submission. The final business plan update shall be approved by the DFI board and

submitted to MISFA not later than 2 months before the end of the fiscal year.

SEMA conducts business planning on a regular basis. Plans are reviewed and adjusted based on operation progress and success. Previously all reports were submitted to the Afghanistan Ministry of Finance. In the future, SEMA will provide reports to MISFA as well.

5) Business Planning and Budget projections and reporting will be presented in a format as required by MISFA and will include balance sheet, income & expenditure, cash flows, funding and capital requirements

SEMA business planning process, budget projection, and financial reporting follow an internal format. All these documents are audited by independent parties on an annual basis. The process is in compliance with GAAP.

6) Budgets shall flow from the plan and be coherent.

SEMA’s budget will be based on the business plan.

7) The plan shall include a work plan outlining activities and timing.

SEMA’s business plan includes a work plan with activities and schedules.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI undertakes a comprehensive and participatory strategic and business  planning, and budgeting process. This includes the generation of short- and  long-term financial projections based on realistic assumptions and a  reasonable assessment of the DFIs capacity and business environment. The  strategic plan incorporates a sound analysis of the DFI’s strengths, weakness,  opportunities and strengths. The plan has been formally approved by DFI board  and MISFA. The plan is updated regularly and as needed and is used in the  decision-making process. The DFI prepares comprehensive budgets that are  reviewed on a monthly basis by management and board. The DFIs plans and  budgets largely reflect actual performance. |
| 4 | The DFI undertakes a strategic and business planning process resulting in  short- and long-term financial projections with minor deficiencies. Plans, SWOT  analysis, budgets and plans are generally realistic and adequate with few  weaknesses or deficiencies that are systematically addressed by management. |
| 3 | The DFI has a written strategic plan that has been approved by the DFI board  and MISFA. The DFI has undertaken some projections, but more as an exercise  than as a process for generating information to aid its internal decision-making  process. Results of operations are reviewed monthly but not necessarily  against budgets. |
| 2 | The DFI has a business plan and financial projections but they are not up to  date and/or are not used in decision-making. Budgets are generally  inadequate and loosely monitored if at all. |
| 1 | The DFI’s has provided some documented indication of their plans but mostly  in response to external requests by potential donors and funders. There is no  indication that these documents inform internal business decisions. |
| 0 | The DFI has no process for strategic and business planning, budgeting, or  projections. |

STANDARD 7

Capitalization

**Purpose and Rationale**

A healthy institution has the financial capacity, strength and base to absorb the losses and

challenges of business operations without financial collapse and the capacity to attract and leverage additional resources and capital. Capitalization looks at both profitability and solvency matters. Balance sheets are built on an equity base, that is composed of both contributed and shareholder equity, and internally generated capital through profits.

**Objective**

The objective of this Standard is to provide guidance to DFIs in establishment and

implementation of sound capitalization policies, commitments, practices and trends that

consider both external equity and generating internal profits to build their financial base. DFIs subject to DAB regulations shall adhere to those standards.

**Key terms**

Equity, shareholder capital, internally-generated capitalization, leverage, balance sheet structure

**Principles**

1) The DFI shareholders or founding stakeholders shall contribute some equity stake into the institution. This shall be mandatory for new entrants, and part of new contractual

expectations for existing partners.

Shelter for Life is investing capital, finance and equipment to SEMA. SEMA has about $10,000 capital, and Shelter For Life is investing the remainder of the capital.

2) The DFI board and business plan shall demonstrate a strategic direction or policy regarding capitalization and building the strength of the balance sheet through profits (internally generated capital) and additional capital contributions.

SEMA will capitalize the excess profit (revenue less expenses). In addition, SEMA will generate additional capital from contributions from the general public and Unites States government.

3) The DFI board and senior management shall manage the institution in a manner that

increases its capacity to raise equity.

SEMA complies with this principle.

4) The DFI shall monitor operating budgets, portfolio quality and plans for growth monthly to ensure that the trends to break-even are achieved over time.

SEMA complies with this principle.

5) The DFI shall consider policies to establish special reserve as prudent for disaster, future expansion or preparation for regulation.

The SEMA Board of Directors will establish policies that assess the risk and designate and designate funds to mitigate the impacts of disaster or other manmade risks.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The institution has a proven capacity and history in both generating profits and  attracting some equity capital from its parent or other interested parties. The DFI  board and senior management maintain a clear and consistent pattern of  planning, monitoring and achieving financial results, and building the strength of  the balance sheet. Capitalization policies and strategies are in place. |
| 4 | The institution has a clear commitment (or policy) to and track record in moving  toward and reaching break-even, thereby generating profits that are capitalized on  the balance sheet. However, it has not done so on a significant level or for a very  long period. It does, however, have interest and support from its parent owner,  and MISFA. |
| 3 | The institution continues to rely primarily on MISFA support, although the board  and shareholder parent have met and exceeded their equity contribution  commitment. The DFI is close to reaching breakeven and is showing consistent  trends in doing so. |
| 2 | The DFI board/parent NGO has made some equity contribution to the institution;  progress toward break-even remains a challenge, but there are some basic  components in place to warrant more time to monitor trends. |
| 1 | The institution continues to incur operating losses, without a clear trend toward  break-even. There is no policy with regards to capitalization; its goal is to obtain a  cash flow surplus. The board and senior management do not have the financial or  managerial capacity to effect change. |
| 0 | There is no interest by the parent shareholder in the financial position of the DFI,  and its over-leveraged position on MISFA debt. The value of the institution’s equity  is being eroded by inflation, high losses, and deteriorating portfolio quality. The  board and senior management are disengaged and unable or unwilling to  recognize the gravity of the situation. |

STANDARD 8

Accounting Treatment of Non Performing Loans (NPLs) & Write Offs

**Purpose and Rationale**

DFI’s treatment of its portfolio at risk can have a major impact on its financial results. Ignoring nonperforming components of the portfolio will mislead stakeholders regarding the DFI’s true financial condition. There is currently no international standard for the treatment of NPLs although local accounting standards and regulatory requirements for the treatment of NPLs often exist. Some minimum standards in the accounting treatment of NPLs, however, are important to ensure greater integrity in financial reporting among DFIs. All DFIs should have a policy for calculating and creating an Impairment Loss Allowance and writing off loans, and must follow a prudent approach when accruing interest on their NPLs.

**Objective**

The objective of this standard is to ensure that DFIs make provisions in their accounts for NPLs to show the fair market value of their financial assets, recognize any losses/ impairments, and provide guidance and direction in accruing interest on NPLs. DFIs subject to DAB regulations shall adhere to those standards.

**Key terms**

Impairment loss allowance, portfolio at risk, rescheduled portfolio, loan loss, write off, NPL, accrual of interest

**Principles**

1) DFIs shall maintain adequate provisions for non-performing loans at all times.

SEMA has provisions in place in regards to late payments, delinquency management, and recovery systems. For more information, please see Credit Policies and Procedures Manual.

2) DFIs shall adjust provisions on a monthly basis.

SEMA adjusts provisions based on information gathered from field and other sources pertaining to loan performance on a frequent and regular basis. For more information, please see SEMA Credit Policies and Procedures Manual.

3) DFIs shall use the following aging schedule for Portfolio at Risk:

a. 0 days

b. 1–30 days

c. 31–60 days

d. 61–90 days

e. 91–180 days

f. 181–365 days

SEMA uses a software program (Loan Performer) with a similar aging schedule. SEMA is fully compliant with this schedule requirement.

4) The minimum provisioning rates are:

a. Current Portfolio — 0%

b. PAR 1–30 days — 10%

c. PAR 31–90 days — 30%

d. PAR 91–180 days — 60%

e. PAR > 180 days — 100%

f. Renegotiated Portfolio — 100%

Most DFIs should have more aggressive allowance rates based on internal risk assessments taking into consideration historical loan loss rate among other factors.

SEMA uses a software program that uses similar provision rates. SEMA is compliant with this requirement.

5) DFIs shall have a written policy on restructuring loans; will disclose all restructured loans in portfolio reporting; and will provision 100% for restructured loans.

SEMA has a policy in place in regards to restructuring loans. SEMA also will disclose all restructured loans in portfolio reporting, and will provision completely for restructured loans. For more information, please see SEMA Credit Policies and Procedures Manual and SEMA Business Plan.

6) DFIs using a group loan methodology shall treat its clients on an individual basis for purposes of provisioning.

SEMA has provision procedures in place for the treatment of clients in groups. For more information, please see SEMA Business Plan and SEMA Credit Policies and Procedures Manual.

7) DFIs shall suspend the accrual of interest on loans where principal or interest payments have been past due for periods exceeding 30 days. The loans will then be placed on non-accrual status and interest income is recognized only upon payment in cash.

SEMA complies with this requirement.

8) DFIs shall have a written write-off policy; will disclose loans written-off; will have a clear operational policies and procedures for managing loan write-offs. DFIs shall write off loans over 365 days late.

SEMA has an existing policy for writing off loans and dealing with defaults. For more information, please see SEMA Business Plan and SEMA Credit Policies and Procedures Manual.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has a formal portfolio classification system broken down by level of  risk and by aging, which is based on a historical analysis of the specific  portfolio classification. Provisions reflect the portfolio classification system  that is broken down by risk. Accounting and reporting practice for the  treatment and disclosure of NPLs are sound and adhere to the principles  of this standard. |
| 4 | The DFI is generally adequate in meeting the standards; inconsistencies  are addressed systematically as policies are updated. Provisions are  adequate and are done on a monthly basis. Loans over 30 days late are  placed on non-accrual status in DFI’s financial statements to MISFA. The  DFI generally writes off loans over 365 days late. |
| 3 | The DFI has a policy with respect to portfolio aging and provisioning for  non-performing loans. The policy does not take into consideration various  levels of risk within the portfolio nor historical analysis. Provisions are  usually adequate, but not always on a regular basis. The DFI does not  systematically place NPLs on non-accrual status or write off loans over 365  days late. |
| 2 | The DFI has a policy with respect to portfolio aging and provisioning for  non-performing loans and the information systems and verifiable historical  data to make proper provisions but does not provide adequately for nonperforming  loans. Disclosure, reporting and accounting treatment is  inconsistent, as staff is not fully aware of expectations. Information  systems have weaknesses in terms of providing regular and reliable  information on the portfolio. The DFI accrues interest on its entire portfolio  including NPLs. Loans over 365 days late appear in DFI’s financial  statements. |
| 1 | The DFI has outdated policies with respect to portfolio aging, provisioning,  accrual of interest, and write-off of non-performing loans. It lacks the  information systems and/or verifiable historical data to make proper  treatment of its NPLs. |
| 0 | The DFI has no policy with respect to portfolio aging, provisioning, accrual  of interest on NPLs, and write-off of non-performing loans and has neither  the information nor the intention of doing so. |

STANDARD 9

Financial Management

**Purpose and Rationale**

A financial services institution’s core business – the outflow of cash in loans and productive assets and the inflow of cash in deposits, loans and capital – seeks to maximize and profit from this management of financial resources. Managing portfolio quality, idle cash, operations, and taking advantage of financing opportunities are the important components of good financial management. The purpose of this standard is to encourage DFIs to have basic financial management strategies and capacity in place to strengthen and build solid balance sheet composition.

**Objective**

The objective of this standard is to provide DFIs guidance and expectations in basic financial management including cash planning and management, liquidity, a financing strategy and investment of idle funds. DFIs subject to DAB regulations shall adhere to those standards.

**Key Terms**

Liquidity, projections, obligations, investments, idle funds, equity subsidies, subordinated debts, cash flow statement

**Principles**

1. The DFI shall prepare cash flow projections that incorporate disbursement requirements (new and repeat loans), estimated repayments, and the payment of expenses, and other obligations to ensure that the institution remains liquid, meets client loan demand efficiently, and forecasts cash shortages well in advance.

SEMA has a plan in place accounting for cash flow projections, that includes disbursement requirements, estimated repayments, and other obligations. SEMA is building capacity to meet expected increased loan demands. The SEMA business plan accounts for possible cash shortages.

2. The DFI shall prepare a cash flow statement with its audited financial statements annually and preferably quarterly for internal purposes to evaluate the sources and uses of financial resources, whether from operations, investing or financing.

Internally, cash flow and all transactions are audited on a monthly basis. From this information SEMA maintains a continual evaluation of resources for operations, investing and financing.

3. The DFI shall strive to maintain liquidity or idle cash of 6 months operating expenses to provide a cushion in the event of difficult times and to minimize the risk of cash shortages. This is defined as cash and other liquid investments maturing within three months /operating expenses.

The Board of SEMA will designate contributions and net income as reserve to meet the liquidity requirements.

4. The DFI shall invest idle funds in short-term bank certificates to optimize these resources if not immediately utilized. Investment terms must be planned and incorporated into the overall cash flow projections to ensure adequate thought and foresight in cash management.

SEMA uses a variety of tools to prudently invest idle cash in bank deposits and other mechanisms. All these investments are part of predetermined plans that are reviewed and monitored by SEMA management team.

5. The DFI shall give consideration to match the maturity of liabilities and obligations with asset maturities and analyze, plan and minimize any gaps, maturity mis-matches, and foreign exchange risks.

SEMA closely monitors the maturity of liabilities and obligations with asset maturities and the business plan minimizes gaps and maturity mis-matches. The business plan is also minimizing foreign exchange risks.

6. The DFI shall develop and give thought to a long term financing strategy to build the capital base of their institution. MISFA funding options include operating subsidies, equity subsidies, loans and subordinated debt. The DFI may also consider long term plan such as deposit mobilization or other external investors willing to invest either debt or equity in the DFI.

SEMA’s long term financing strategy includes building capital by means of securing institutional grants, public donations, and investments. Various means of mobilizing deposits are employed to secure and maximize available capital.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has solid cash management tools in place to analyze and monitor cash  use and demand. Cash flow projections are regularly updated and include both  short-term and medium-term inflows and outflows. The DFI effectively monitors  idle cash position, invests idle cash when possible, and has rarely run into an  emergency cash shortage. The DFI has reached break-even for a year now, and  is looking at using internally generated revenue to build the balance sheet. The  board and senior management have also given strategic thought and developed  relationships to a long term financing strategy that is designed to further  strengthen the balance sheet position, and attract new investors to the  institution. The DFI effectively optimizes MISFA funding opportunities. |
| 4 | The DFI has liquidity and financing policies in place and has made reasonable  progress in implementation. The board and senior management see effective  results of reliable cash planning, investments, and generally sound cash  management. The DFI has a variety of financing strategies in place; they have  received both equity and subordinated debt financing from MISFA, and are  exploring additional funding options. They are nearly at break-even, and are  actively engaged in developing a sound long-term financing strategy. |
| 3 | The DFI has a cash management policy in place, although it is not followed or  utilized very well. However, expenses are somewhat under control, though  informally. Portfolio quality is monitored very well, and performance is gradually  improving. The board and senior management have given thought to diversifying  financing sources, and are taking steps to plan accordingly. Asset and liability  mis-matches are not well understood or provided for. |
| 2 | The DFI has no cash management plan or practice in place, except that  disbursements and collections are well monitored, planned and reported on.  Expenses are controlled to some extent, and the portfolio quality is somewhat  stable. They are timely in submitting requests for cash to MISFA or their head  office, and rarely have a cash shortage. |
| 1 | The DFI has no cash management plan or practice in place. However, it is  reasonably good at projecting disbursement demand and collections, but does  occasionally experience a cash shortage. Portfolio quality is generally poor, and  there is weak practice in monitoring budgets. |
| 0 | The DFI has no cash management plan or practice in place. It frequently runs  short of cash for disbursements and expenses, and bank accounts are  overdrawn from time to time. |

STANDARD 10

Products and Services

**Purpose and Rationale**

Microfinance lending methodologies have been revised, adapted and at times simply replicated for different contexts without careful thought for the needs of clients. Products and services that are market-led and client-oriented will help the DFI differentiate itself in the market from its competitors and attract higher demand for services. The purpose of a standard for product development is to encourage DFIs to engage in a process of product development to increase client satisfaction and loyalty and reduce credit risk.

**Objective**

The objective of a standard on product development is to ensure that DFIs have a basic process or methodology in place for the research, development, costing, testing, piloting, monitoring and evaluation, staff capacity and training and refining of products before rolling out the product broadly in the institution.

**Key terms**

Research, costing, testing, piloting, monitoring and evaluation, refining

**Principles**

1) The DFI shall have a basic process in place for developing a new product or service that incorporates formal or informal research or client feedback.

SEMA has an ongoing evaluation process consisting of informal field research and client feedback used to continually adjust services to its clients and to optimize microfinance performance. The procedures for establishing new products are in place and recorded in SEMA’s Business Plan.

2) The DFI shall adequately consider a product’s cost, pricing, loan tenure, repayment frequency, and other terms and conditions in the development stage.

Due consideration is continually given to the above-mentioned aspects of product offerings.

3) Product costing and analysis shall be clearly segmented, so that arrears by product, crosssubsidization of products and individual product performance is objectively evaluated and clearly understood.

Cost considerations and regular analysis of SEMA’s products are clearly segmented by product and understood by microfinance management personnel in accordance with SEMA’s business plan.

4) The DFI shall test or pilot a new product for a reasonable period, in a given location with informed and aware staff, and evaluate the feedback, results, and issues arising as a result. Product pilot activities shall be tested in a variety of locations so that assumptions for contextual specific successes and features are thoroughly evaluated. The DFI shall submit a report including cost analysis to MISFA following successful completion of the pilot testing of products.

SEMA will pilot new products, managed by competent staff, with evaluation of feedback and results duly noted. A report including cost analysis will be submitted to MISFA at the completion of the pilot program.

5) The DFI shall take adequate measures, plans, and modifications to ensure that client

portfolio systems (manual or automated) are structured to handle new products, and that

staff are aware how to document and record loan schedules and transactions for new

products.

SEMA’s clients’ portfolios will be monitored and managed so as to allow for new products, with software and management staff adequately equipped to document all necessary information regarding new products.

6) The DFI shall use client feedback, monitoring and evaluation to make necessary refinements and changes to the product before broad uptake and implementation.

Client feedback monitoring and evaluation will be used on an ongoing basis.

7) The DFI shall ensure that staff capacity is in place before offering new products through training, on the job experience, previous experience and qualifications, and that only staff who demonstrate proficiency and competence are responsible for new product delivery.

SEMA will ensure personnel capacity and capability for the offering of current and new products

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has a formal system and process for the development of new products  and services, ensuring adequate research, development of terms and conditions  that consider costing and pricing, a pilot or testing period, monitoring and  evaluation. The DFI submits a report including cost analysis to MISFA after  completion of each pilot. The DFI also prepares its staff and MIS for the new  product, and demonstrates success and capacity in rolling out more broadly after  the pilot period. |
| 4 | The DFI has a formal system for new product and service development that  includes research, design, terms and conditions, a test period, and monitoring  and evaluation. It is not carried out systematically, and though some of the  phases have been less formal than on paper, the DFI has reasonably thought  through both the product, staff capacity and MIS needs in the process. |
| 3 | The DFI informally researches and develops new products based on client  feedback, market knowledge and comparison with the competition. Consideration  for costing and pricing is minimal, but the terms and conditions are reasonably  thought through. The DFI conducts an informal test of the new product, takes  client feedback, and makes modifications as needed. There have been some  problems with new products, but the DFI has managed to adapt and recover after  a period, without major loss or damage. |
| 2 | The DFI has no system, process or methodology in place for developing new  products and services. New products are offered without any consideration for the  market demand or adequate analysis on product terms and conditions. The DFI  has informally observed challenges and problems and made attempt to rectify the  situation after some time. |
| 1 | The DFI has no system, process or methodology in place for developing new  products and services. New products have not been developed, but current  product offering have been changed to respond to client feedback and perceived  market demand. Results have been poor. |
| 0 | The DFI has no system, process or methodology in place for developing new  products or services. New products have failed miserably with disastrous results  for clients and portfolio quality. |

STANDARD 11

Credit Policies & Procedures and Credit Risk Management

**Purpose and Rationale**

Sound credit policies and procedures seek to ensure that DFIs deliver appropriate loan products to clients and that clients repay their loans on time. DFIs must carefully consider (a) **who** they lend to, (b) **what types** of loans they make, (c) **how much** they lend to clients, (d) for **how long** the loans are made, (e) **where** they lend (i.e. geographic areas) and (f) **which** business sectors they lend to, among other factors. Policies and procedures should ensure proper assessment, administration, supervision, enforcement, and recovery of loans. Due to the typically short tenor of developmental finance loans, portfolio quality can deteriorate quickly causing severe cash flow problems. Failure to recover non performing loans can lead to erosion of capital and ultimately failure of the DFI.

**Objective**: The purpose of this standard is to ensure that DFIs give due attention to their credit policies and procedures and do not take unnecessary credit risks.

**Key terms:**

Credit management, origination, assessment, supervision, collection, loan utilization check, related parties, unsecured loans, collateral, guarantor, delinquency, risk management

**Principles:**

1) DFIs shall fulfill KYC norms. All DFI borrowers must be residents of Afghanistan, legally able to ‘contract’. DFIs shall verify and track the domicile/business location(s) of all borrowers.

SEMA uses Loan Performer software for tracking and managing loans. For more information, please see SEMA Credit Policies and Procedures Manual.

2) DFIs shall follow local customs and norms when developing and delivering loan products. For example, DFIs should ensure that both the borrower and spouse(s) understand the terms and conditions and obligations under a loan contract with some means of verification.

SEMA will operate the loans in compliance with the laws of Afghanistan. All loans are self-insured. The process of loan issuance includes a thorough training and education of borrower on repayment, administrative fee, and insure.

3) DFIs shall lend to only one borrower per household at any given time.

SEMA shall make every effort to prevent duplicate benefits being given to the same beneficiary or the same beneficiary household (e.g. under the same name of another household member). For more information, please see SEMA Field Operations Manual.

4) DFIs not subject to DAB regulations shall follow these guidelines with respect to maximum loan size:

a. For first time unsecured loans, the maximum loan size shall be up to 100,000 AFN

b. For secured loans, the maximum loan size shall be up to 350,000 AFN

c. For loans > 350,000 AFN, the loan product shall require prior approval by MISFA

SEMA has an existing system for loan disbursement, which follows the guidelines with respect to maximum loan size. For more information, please see SEMA Business Plan.

5) DFIs shall follow these guidelines with respect to proper loan utilization:

a. For unsecured loans, DFIs shall follow their own internal policies and procedures

b. For secured individual loan, DFIs shall carry out a Loan Utilization Check within 15-30 days, based on loan purpose

SEMA has an existing system for loan disbursement, which follows the guidelines with respect to maximum loan size. For more information, please see SEMA Business Plan.

6) DFIs shall not lend to related parties. Related parties include the DFI’s parent organization, shareholders, directors, affiliate companies, subsidiaries, and executive officers. Loans to staff must be segmented and disclosed appropriately. Employee loans shall be distinguished from staff advances that are normally reported as other loans receivable.

SEMA enforces this standard. For more information, please see Conflict of Interest sections of existing SEMA documents.

7) DFIs shall have in place a current credit policy and procedure manual and accompanying training manuals in the vernacular. The personnel developing the credit policy and procedures shall be functionally independent of the management responsible for originating the exposure. MIS systems shall have consistently established over-rides, approval levels and security access to support the credit policies and procedures.

Access to software is password protected and secure. For more information, please see SEMA Credit Policies and Procedures Manual.

8) The DFI shall have in place appropriate, timely and effective credit risk management tools for monitoring delinquency such as management reports and key indicators. DFIs shall also have in place detailed procedures, practices and systematic steps for delinquency management and follow up of late loans, based on the number of days late. These steps shall include group visits, warning letters, client visits, and follow up with guarantors. The DFI shall have a dedicated risk management team or a focused capacity building program, training personnel on risk management tools and techniques.

SEMA uses Loan Management software to manage and mitigate risk, and manage the performance of the loan. For more information, please see SEMA Credit Policies and Procedures Manual.

9) The DFI credit policies and procedures shall have in place adequate segregation of duties, and additional controls if strong segregation is not possible, with respect to handling cash (refer to Standard 18)

SEMA policies and procedures address the handling of cash and segregation of duties. For more information, please see SEMA Credit Policies and Procedures Manual and SEMA Field Operations Manual. Refer to Standard 18.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has formal written policies and procedures for credit management that  have been approved by the DFI’s Board of Directors. The personnel developing  the policies and procedures are functionally independent of the management  responsible for originating the exposure. The policies and procedures cover all  key areas of credit management and are diligently implemented by  management. The policies and procedures follow the guidelines established by  MISFA. The DFI has a strong portfolio classification system which assists them  measure and monitor credit risk. A focused capacity building program, training  personnel on risk management tools and techniques is in place. An internal  review and reporting system that informs the CEO/Managing Director and senior  management of how policies are being carried out and that provides them with  sufficient information to evaluate the performance officers and supervisors and  the overall condition of the loan portfolio. Information presented is both timely  and accurately. Delinquency management procedures and practices are  effective. |
| 4 | The DFI has adequate written policies and procedures for credit management  that have been approved by the DFI’s Board of Directors. Some discrepancies  exist between the written policies and practice. Information is made available to  senior management but it is not always timely or accurate. |
| 3 | The DFI has formal written policies and procedures for credit management but  key areas such as supervision and collection policies and procedures are  inadequate or missing. Serious problems exist in the implementation of the  credit policies and procedure. Delinquency monitoring and management is good  but there are some weaknesses. |
| 2 | The DFI has no formal written policies and procedures for credit management  but some consistency in practice exists. Loan documentation exists but is  generally inadequate. Delinquency management and information is poor. |
| 1-0 | The DFI has no written policies and procedures for credit management. How  loans are originated, appraised, approved, disbursed, monitored, and collected  are inadequate, inconsistent and/or poorly documented. |

STANDARD 12

Administration Policy

**Purpose and Rationale**

Policies, procedures and guidance in procurement, logistics, transportation, security and other administrative matters are important to guide DFI management and staff in the effective and efficient use of resources necessary to accomplish their financial service delivery. They are designed to protect and safeguard assets, to support efficient operations, and enable personnel to focus on meeting the social and financial objectives of the DFI.

**Objective**

The objective of this standard is to provide guidance to DFIs in putting in place primary policies and procedures for administration in procurement, outsourcing, physical security, transportation and general levels of authority.

**Key terms**

Procurement, physical security, outsourcing, tender

**Principles**

1) The DFI shall have basic policies and procedures in place governing procurement, physical security arrangements, outsourcing procedures, transportation and general levels of authority.

SEMA has previously existing policies and procedure in place, governing the aforementioned components. For more information, please see SEMA Field Operations Manual, as well as SEMA Business Plan and SEMA Credit Policies and Procedures Manual.

2) Policies and procedures shall cover the essential components, of budgets, approval levels, efficiency and due care in the use of resources, fixed assets and staff time.

SEMA policies and procedures cover the aforementioned components. For more information, please see SEMA Field Operations Manual and SEMA Credit Policies and Procedures Manual.

3) Fixed assets shall be used for official purposes only, physically secured, and properly

maintained. Maintenance and mileage logs shall be used.

SEMA’s fixed assets are used, secured, and maintained properly and responsibly. Documentation of mileage logs are also used. For more information, please see SEMA Field Operations Manual, as well as Fixed Assets Inventory Report.

4) Outsourced services such as professional work, audit, vehicle rental, and office rental shall be adequately described, tendered through a transparent process, and clearly contracted for delivery of goods and services.

All procedures for procurement follow an existing process in section 4.7 of SEMA Field Operations Manual.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has adequate and effective policies and procedures in place for the  procurement, management and use of assets and resources. Physical security of  staff is very well-managed and all staff is aware of expectations and contingency  plans. Operating efficiencies are strong, and staff is productive and effective in  conducting their work. Tenders, procurement, and asset use are well documented  and processes effective. |
| 4 | The DFI makes reasonable and adequate effort and is generally effective with  administrative policies and procedures. Operating efficiencies are improving;  documentation of procurement and asset management is adequate and  satisfactory. |
| 3 | The DFI relies mainly on informal policies but is not always consistent with  implementation of these procedures. Adherence and compliance is not  consistent, and there is some evidence of poor resource management. Staff  security is not formalized as it should be, although informal means are commonly  used. |
| 2 | The DFI has formal and informal policies in place for administrative management,  but there is little adherence or effectiveness. Staff often complains of  inefficiencies in operations. |
| 1 | The DFI has few administrative policies in place. Waste is high and assets are  frequently mis-used. Staff and asset security are poor. |
| 0 | Management and staff have no respect for efficiency or economy in their  acquisition and use of resources and assets. Operating costs are very high without  any productive value. |

STANDARD 13

Business Continuity & Disaster Recovery

**Purpose and Rationale**

The purpose of a business continuity plan is to ensure that the institution is able to recover quickly and continue business operations in the event of natural disasters (earthquakes, floods, etc.), security interruptions (bombings, armed conflict, restricted movement), and hardware or software failure of information systems or documents, due to virus, fire, theft, electrical interruption or other reasons. An effective disaster recovery plan will enable financial service providers, who rely on information to carry out their core business activities, regain relatively prompt access to information, documents and clients in the event of a disaster.

**Objective**

The objective of the standard is to ensure DFIs have an adequate and practical disaster plan that will enable them to recover from business interruptions and respond with effective and rapid communication, management decisions, and information restoration.

**Key terms**

IT equipment, IT protection, virus, natural disasters, communication strategy, security

interruptions, physical back-ups, and back-up restoration

**Principles**

1) The DFI shall backup data regularly and store it off site.

SEMA has an existing data backup plan. For more information, please see SEMA Field Operations Manual.

2) A disaster recovery plan, including IT recovery, shall be developed by key management with Board input, review and approval.

SEMA has an existing data recovery plan. For more information, please see SEMA Field Operations Manual.

3) The DFI’s IT recovery plan shall be tested and reviewed at least twice a year. Testing shall include a test of backup restoration, although not necessarily a physical move of the office or personnel.

SEMA data backup plan consists of data backup onsite and offsite on a daily basis. For more information, please see SEMA Field Operations Manual.

4) The disaster recovery plan shall include specific management roles, a communications plan, a tested recovery plan (IT), and a plan for security of documents and assets. The disaster recovery plan shall include a basic security protocol that addresses expectations,

management roles, and communication channels in the event of natural disasters or security incidents.

SEMA has an existing disaster recovery plan in place, which has been tested and is reliable due to multiple backups. For more information, please see SEMA Field Operations Manual.

5) DFI staff and management shall be informed and trained in the vernacular on the key

responses to natural disasters, security incidents, and client communications on business

recovery steps.

SEMA has an existing plan in place with expectations made clear. For more information, please see SEMA Field Operations Manual.

6) The Internal Auditor shall review the disaster recovery plan as part of internal audit work, including an audit of responses to business interruptions.

SEMA’s internal auditor will review the disaster recovery plan on a regular basis and include and audit of responses to any business interruptions

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The institution has a documented, tested, and up-to-date disaster recovery plan  for business continuity covering a range of possible problems -- from physical  security for hardware and software, security for staff, documents and assets  due to conflict, fire and natural disasters. Management is clear on its role in  responding to a disaster and staff understands communication channels within  the institution, and key messages to external stakeholders and clients. IT staff  regularly test and review IT disaster recovery plans. IT department regularly  makes data backups and stores it offsite. The Internal Auditor includes business  continuity and disaster recovery risks in its scope of audit area and review. |
| 4 | The institution has adequate documented and tested disaster recovery plans in  place. Management is relatively clear on its role in responding to a disaster and  key messages on communication channels within the institution and to external  stakeholders are visibly posted or readily available. IT staff test recovery  systems from time to time. IT hardware or software incidents are very, very rare,  and there has been minimal information loss or disruption to services. IT  department regularly makes data backups and stores it offsite. |
| 3 | There is a disaster recovery plan in place, with infrequent testing. Data backups  are made, stored off-site, and recovery of data has been reasonably effective.  Minimal information loss has taken place. Documents are physically well  secured in the office. Staff is reasonably aware of procedures, communications,  and processes for security incidents, natural disasters, and fire emergency  plans. Plans are occasionally reviewed and updated. |
| 2 | There is no disaster recovery plan in place for any business interruption to the  DFI. Data backups are made, and stored off-site. The institution has dealt with  some damage to the hardware and/or software systems because of poor  physical security (viruses and electrical). Information recovery has also been a  problem, in spite of back-ups. There has been some information loss take place.  Staff generally is not aware of a communication plan or what do to in the event  of emergency or security incidents. |
| 1 | There is no disaster recovery plan or staff communication or information in  place for any business interruption to the DFI. Data backups are made very  rarely and usually not stored off-site. The institution has dealt with serious  damage to the hardware and/or software systems because of poor physical  security (viruses and electrical). Information recovery has also been a problem,  in spite of back-ups. Documents are physically secured in the office, but not in a  vault or fire-proof storage facility. |
| 0 | No backups of software systems or data are made. There is no disaster recovery  plan or capacity in place. There is no communications or operational strategy in  place for responding to emergencies, crisis or other business interruptions. The  institution has dealt with serious damage to the hardware and/or software  systems because of poor physical security or viruses. Information recovery has  also been a problem. |

STANDARD 14

Management Information Systems

**Purpose and Rationale**

Strong DFI management at all levels is highly dependent on **good** **information**, particularly

financial information and portfolio information. The DFI also needs to ensure that client

information, HR and personnel information and all operating information is clear, well-managed

and available. Data handling must be well processed, controlled and managed in order to ensure

reliable information is extracted. **In order to be useful, it must be relevant, correct, and timely**

and available to all management and staff for operational planning, management and decisionmaking.

Whether automated or manual, information need to meet the following criteria: (a)

**Relevant** – does it provide what is needed? (b) **Used** – does the recipient need all the

information? (c) **Timely** – is it delivered in time to be useful? (d) **Accurate** – is the information

correct? (e) **Distributed** to the correct people – do the reports go to the people who need the

information? (f) **Accessed** by the correct people – is access to the reports limited to the users? (g)

**Well** **formatted** – is it easy to read and understand? (h) **Retrievable** – are reports filed in standard

formats and locations? (i) **Traceable** – is the information on the reports able to be audited?

**Objective**

The purpose of this standard is to ensure that DFIs adequately plan, secure, manage and utilize

IT hardware, software, data, records and documents to produce relevant, accurate and timely

information. This standard is also to ensure that other DFIs operating and personnel information

is well-maintained, relevant and used effectively for planning and monitoring purposes.

**Key term:**

Data, data integrity, information, relevant, reliable

**Principles**

1) The DFI shall maintain controls, systems and procedures to ensure that data is reliable, is relevant, and is entered into the correct periods of operations.

Examples of control procedures:

a. Establish controls over changes to computer programs

b. Limit access to data files

c. Establish security passwords that restrict access and application of various functions, depending on the staff member’s responsibilities

d. Human resource, personnel and payroll documents shall be well-secured

e. Compare internal data with external sources of information

f. Compare cash, security and inventory accounts with accounting and portfolio records

SEMA uses a proprietary software package (Loan Performer) which helps maintain controls and procedures to ensure the collection and analysis of relevant data. Access to data files is limited and regulated. Personnel and payroll documents are well secured. All internal data, including client, loan, personnel and payroll files is monitored externally on a regular basis.

2) The DFI shall ensure that information is processed efficiently, in a timely manner, in a meaningful format, and disseminated and available to users on a regular basis.

This information is reviewed and processed frequently.

3) The DFI shall retain records, documentation and systems to adequately capture operating information, trends, personnel information and trends and ensure that information is used for monitoring and decision-making.

SEMA gathers and reviews this data on a regular basis.

4) The DFI shall (either manually or through a computer database) include individual information about loans: identity of the client, credit history (if a long time customer), amount disbursed, loan terms (interest rate, fees, maturity), repayment schedules (dates, amounts, principal, interest and fee allocations), amount and timing of payments received, amount and aging of delinquency, and outstanding principal balance.

SEMA gathers all of the above-mentioned information and it is reviewed and stored in a secure database.

5) The DFI shall produce the following information for the entire portfolio: outstanding principal balance, delinquency by aging, and amount late. The DFI shall also produce segmented information on the portfolio: by Loan Officer, by Branch and center (if applicable), and by product.

SEMA’s current records are structured to account for all of the above-mentioned data.

6) The DFI shall ensure that adequate reconciliations, balancing and controls are in place to ensure that information in various sources are verified, agree, and are used appropriately in monitoring and evaluation. This review and verification shall be done by an independent person/staff from the one entering or handling data.

Adequate reconciliation, balancing, and controls are verified and monitored frequently by personnel who do not enter original data.

7) The DFI shall have in place special authorizations for write-offs, exceptions, corrections, deletions, report generation, and other matters as a part of database and accounting system processes and user access. (i.e. a hierarchy of access to the databases e.g., read, input, authorization, program changes).

SEMA policies and procedures include provisions that meet all of the above-mentioned requirements. For more information, please see Microfinance Policies and Procedures Manual

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI effectively and efficiently uses its management information systems –  both manual and automated to produce coherent, reliable, timely and useful  reports for all level of management and operations of the institution. The Loan  Portfolio Tracking system is comprehensive, adequate, and well-controlled.  Reports are relevant and made available to all staff on a very timely basis  Human resource records are up to date, well summarized and used effectively  for planning and management. |
| 4 | The DFI has a reasonably strong management information system in place.  Management knows what information is required for planning and monitoring  purposes, and the IT and information systems have made consistent and  regular progress toward effective change and implementation. Information is  generally reliable and reports are increasingly available and useful to operations  team. The HR administration system adequately documents HR data that is  used as part of the information system for planning and monitoring operations. |
| 3 | The DFI has made strides in building a stronger financial management  information system. The loan portfolio tracking system is reasonable, although  some challenges in consolidated reporting still exist. Branch Managers and  CEOs get reports with regularity, though not as much information is provided to  provide for adequate analysis. Changes and improvements have been  consistent in strengthening this aspect in the DFI. |
| 2 | The DFI produces few operating reports and financial reports but with great  difficulty. Reports are always late, and generally not reliable in terms of accuracy  or meaningful presentation. Loan delinquency is still a problem, but loan officers  and supervisors do have the information needed for follow up. However,  consolidating portfolio data and ensuring integrity of information and coherence  with bank accounts and financial reports is still weak. |
| 1 | The DFI’s management information system is very poor, and only a few pieces of  information are extractable and used for managers. Management is aware that  they need more information, but staff and systems are totally inadequate to  consistently and reliably produce the information. Loan officers have a basic  idea which clients are late, but managers are unable to monitor effectively and  manage delinquency. |
| 0 | The DFI’s management information system is chaotic, inaccurate and totally  unreliable. Management has no idea of what is happening with operating  activities, and no basis for planning or monitoring. |

STANDARD 15

IT Systems Management

**Purpose and Rationale**

Reliable, sound and timely information is the “nerve center” of financial service delivery.

Automated information systems require protection, control and sound management of IT

hardware and software. Since the loss of information, particularly for a long period of time can be devastating to an institution, IT systems management is a critical, but often neglected area of DFI management.

**Objective**

The purpose of this standard is to ensure that DFIs adequately plan, secure, manage and utilize IT hardware, software, network servers, virus protection and other internal and external threats, updates and changes, and backups of IT systems.

**Key terms**

IT hardware, software, records, viruses, network server, back-ups

**Principles**

1) The DFI shall ensure IT hardware is physically secured, labeled, and in an environment free of dust, excessive humidity, cold or heat. Physical access and security of the server room shall be in place.

SEMA has made sure that all IT hardware is physically secured, labeled, and in an environment conducive to optimal technical performance. Server security is in place.

2) The DFI shall include provisions for the continuous supply of power, a plan for interruptions in power supply, and the processing capacity of systems.

SEMA’s office provides for a continuous supply of power and adequate processing capacity for computer systems.

3) The DFI shall ensure regular back-up and off-site storage are followed at least daily or as appropriate.

Daily data backups are conducted in both onsite and offsite locations.

4) The DFI shall have in place a robust and constantly updated anti-virus, firewall and antispyware for the network and/or all computers in all locations.

SEMA’s computer system uses a good and frequently updated anti-virus system and also uses a firewall for its network.

5) Employees of the DFI using the IT system and internet shall be aware of the risks of downloading other software, phishing and other virus risks from the internet.

SEMA’s personnel are made aware of the above-mentioned liabilities.

6) The IT department shall ensure that the network computers are password protected, that passwords meet reasonable security requirements, are kept sufficiently secret, documented, and changed regularly.

SEMA’s IT staff take the above mentioned security measures for the computer system.

7) The IT department shall ensure adequate internal controls related to authorization, dual

control, segregation of duties, user access, support, and documentation of the IT system. This includes documentation of procedures and operating manuals.

SEMA’s present operating procedures and internal control meets the above-mentioned requirements. For more information, please see Field Operations Manual.

8) The DFI IT department shall adhere to procurement procedures for hardware and software purchases, ensuring adequate support is available, price structures have been investigated, and warranties and updates are available, and that capacity is adequate to deal with expanded growth and expansion.

SEMA’s IT personnel will ensure adherence to the above-mentioned items to provide fully functional capacity for its computer system.

9) The DFI IT department shall ensure that operating systems (such as Windows) and software licenses are legitimate, duly registered and regularly updated as available.

The proprietary software used by SEMA is fully legitimate, registered and updated.

10) The DFI shall adequately plan, test, monitor and implement system changes to ensure the system is free of errors. The system shall be both robust and flexible to handle expanded growth, changes in the DFI’s strategy, geographic expansion (networks, etc.) and changes in products and services.

A system is in place (Quickbooks and Loan Performer) that continually tests and monitors each others accuracy.

11) The DFI shall have a succession, back-up plan in place for key IT personnel and functions.

SEMA has a succession backup plan in place for key personnel and IT systems.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has adequate and effective policies, procedures and systems in place to  support a robust, well-managed and secure IT environment. Hardware is well  secured and protected. Software upgrades, anti-virus and firewall protection, user  access, skilled personnel and effective database management characterize the  institution’s IT environment. There are minimal and very short-term internal or  external threats in the IT environment, and shortages and gaps are addressed  rapidly and effectively. Systems applications and controls regularly reveal fraud or  loss exposure, although actual losses have been minimal. The IT system has an  audit trail of user access and use. |
| 4 | The DFI has sound policies, procedures and systems in place to manage a  dependable IT environment. Hardware management is fairly good. Software  management, upgrades, use, protection, and server application are reasonable  and usually well applied. There have been no significant losses and recovery of  information, losses and fraud has been responsive and fairly quick. |
| 3 | Policies, procedures and practices are in place, and adhered to with a reasonable  degree of rigor or discipline. Backups are made regularly, documented, and stored  off-site. There is quite strong adherence to good practice of protecting, securing  and managing both hardware and software. Anti-virus protection and server  management has improved greatly. There have been some losses of information  due to theft, fraud and viruses, but recovery has been made, though not as  efficiently as possible. |
| 2 | Formal policies and procedures are generally weak, inadequate and not adhered  to regularly or consistently in managing the IT environment. Informal procedures  and practices on backups and off-site storage are there. Software updates,  protection, access and use of software is not particularly strong, but has shown  signs of improvements. |
| 1 | The DFI has no policies and procedures to protect and manage IT hardware and  software. There are informal practices in place for anti-virus and backups.  However, nothing is applied consistently, and there have been incidences of  breakdown, loss and fraud due to lack of information. |
| 0 | The DFI has no informal or formal policies, procedures or practices in place to  protect and manage IT hardware and software. The system if rife with viruses,  breakdowns, information loss and exposure to fraud is high and has been  frequent. |

STANDARD 16

Documents & Record Keeping

**Purpose and Rationale**

Transaction and operational records are fundamental tools of tracking activities and economic events in a DFI. They form the audit trail and the basis of tracking and summarizing financial activity into meaningful information and reports. They record information about clients, loans, and personnel. In some cases, documents are readily convertible to cash, and therefore must be secured and controlled to prevent loss or abuse.

**Objective**

The objective of this Standard is to provide guidance to DFIs in the handling, preparation and recording of documents and records that track the financial and operating transactions between the institution, and its customers, vendors, employees and other stakeholders. The purpose is to provide a clear audit trail of events and activities and to demonstrate transparent, consistent and timely entry into the accounting system that will generate reports based on the transactions.

**Key Terms**

Audit trail, documents, paper or electronic trail, records

**Principles:**

1) DFIs shall use preprinted, serially pre-numbered, multiple copy source documents to

document transactions. Examples include cash receipt forms, vouchers, bank cheques,

requisition or purchase order forms. Reference numbers shall be used in all transactions to establish an audit trail of all and any receipts and disbursements of the institution.

SEMA’s primary investors have established a prudent finance and internal control process to ensure that all source documents are properly prepared; all transactions are recorded and reported in compliance with Generally Accepted Accounting Principles.

2) DFIs shall regularly print out hard copy reports (accounting, finance, payroll, portfolio), file them sequentially and by month, and make them available for scrutiny by management, internal or external audits. If a DFI uses electronic or magnetic transactions or reporting, all reports should be produced on a regular basis, and saved on media (such as server, CD or magnetic drive) with no ability to write-over, copy or destroy the reports. Such media shall be both well-secured and accessible for management, internal or external audits.

SEMA will generate hard copies of all payroll and other expense records together with related financial reports monthly to be available for management review, internal and external audit.

3) All files shall be clearly documented, complete, stored systematically and secured in order to protect the confidentiality of client information. Access to all files, including client files shall be restricted to authorized personnel.

All financial and other records and documents are properly stored and access is restricted only to authorized personnel and management.

4) The DFI shall maintain controls, systems and procedures to ensure that records are controlled, reconciled and secured.

**Examples of control procedures:**

a. Limit access to records and documents

b. Human resource, personnel and payroll documents shall be well-secured

c. Maintain and review control accounts and trial balances

d. Compare internal data with external sources of information

SEMA has internal control policy and procedure, which includes segregation of duties, to ensure that records are controlled, reconciled and secured.

5) Personnel files of the DFI shall record work history, the staff resume and application, performance review, vacation and leave records and other relevant communication. All personnel files will be physically secured and accessible only to authorized personnel.

SEMA maintains personnel files including the above mentioned items and are physically secured and accessible only to authorized personnel.

6) The DFI shall retain documents, reports and transaction summaries for a statutory period of 6 years by the DFI.

SEMA retains documents and reports for a minimum of 7 years.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | Documents and records are well secured, organized and used throughout the  DFI. Physical access to confidential documents and “high risk” documents  (those readily convertible to cash such as purchase orders, receipts, or petty  cash vouchers) is restricted and their use is well managed and controlled. A  strong paper trail and audit trail exist and are useful for management, internal  and external auditors and documents are retained as per the statutory  requirements. The DFI also utilizes electronic media for audit trail securely and  effectively. |
| 4 | The DFI is acceptably strong in its control and management of documents,  records, audit trail and paper trail. Documents are well secured and managed.  The audit trail is quite strong and adequate for audit purposes. Some  deficiencies are noted, and have been experienced, but the DFI has addressed  these responsibly. |
| 3 | The DFI’s document management and record keeping is reasonable. The audit  trail and paper trail are acceptable, although there are some weaknesses  noticed from time to time. There has been consistent improvement in these  areas. Preventive controls against loss and fraud are strong. There have been  delays in corrections due to problems, but things are improving. |
| 2 | The DFI has made improvements in its document and record keeping recently,  and is committed to improving controls and management. Generally, documents  and record-keeping are still not acceptable. The audit and paper trail is  improving, but still generally weak. |
| 1 | The DFI’s paperwork, documentation, paper trail and audit trail are scattered,  poorly organized, and carry high risk to loss and fraud. Management and staff  are not committed or aware of their responsibilities to adequately organize and  manage documentation. |
| 0 | There is no respect for documents, their order, security and confidentiality  throughout the DFI. The audit trail is virtually impossible to trace and there is a  complete lack of paper trail. The DFI is totally exposed to fraud, information  misuse and loss, and un-auditable. |

STANDARD 17

Internal Controls

**Purpose and Rationale**

An internal control system is described as a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) effectiveness and efficiency of operations, (b) reliability of financial and operational reporting, (c) compliance with applicable laws and regulations, and policies, and (d) safeguarding of assets and resources. It includes all policies, procedures, systems, records, processes and activities established and maintained by the managers of an entity to help ensure, as far as is practical, the orderly, efficient and profitable conduct of its business.

**Objective**

The objective of this standard is to ensure DFIs have in place basic internal control culture and systems that management implements to safeguard assets and resources, assure reliable reporting, comply with laws, regulations, and promote the achievement of developmental and financial objectives.

**Key Terms**

Internal control, assurance, effectiveness, efficiency, adequate, fraud, abuse of office, manipulation of data, conflict of interests, misrepresentation of clients, audit trail, paper trail, segregation of duties

**Principles**

1) The Board of directors and senior management shall set the tone of the control environment by their **overall attitude, awareness, and actions** towards the internal control system and its importance. This will be accomplished by the Board’s approval of DFI policies, providing leadership to strategic direction, understanding and monitoring risks, monitoring budgets and financial performance, and giving oversight to the internal audit function.

SEMA senior management and Board of Directors provide strategic direction for SEMA. Furthermore, SEMA complies with the other operational principles. For more information please refer to Field Operations Manual.

2) The Board of directors, senior management and DFI staff shall adhere to the code of conduct, be committed to integrity, ethical values and professional competence.

All SEMA staff and employees possess such attributes.

3) The DFI shall develop and implement an anti-fraud and whistle blowing policy. The policy should clearly define “fraud” and spell out the consequences of fraudulent cases. It should also encourage employees to raise concerns or report suspicious cases in a correct and controlled manner. The DFI shall be structured so that authority and responsibility are appropriately delegated and assigned, and that managers and staff are held accountable through regular reporting, monitoring, and feedback mechanisms.

SEMA has in place a comprehensive anti-fraud and whistle blowing policy with procedures to report and counter reported cases of suspected and confirmed fraud. Employees are informed of the structure in place to use if necessary, and are encouraged to make use of this provision when needed. Anti-fraud and whistle blowing policies are explained in full in SEMA’s Code of Conduct document.

4) The DFI shall have policies and procedures in place for all operational activities, including credit operations and accounting, which provide guidance to staff and management for the consistent, correct and effective discharge of responsibilities. Policies and procedures shall be simple, understood, relevant, and available to staff who understand their role in the internal control process. All policies of the DFI will be adopted by the board of directors. However, the procedures of the organization shall be adopted by the relevant senior management committee within the DFI - so that they own the procedural guidelines within their purview.

SEMA complies with this principle. For more information please see SEMA Field Operations Manual and SEMA Credit Policies and Procedures Manual.

5) The DFI shall appoint and hire motivated, committed, skilled and qualified persons to key positions who effectively fulfill their responsibilities with due care, competence, and professionalism.

SEMA complies with this principle.

6) Segregation of duties shall be in place for all areas of the DFI’s activity, particularly for cash handling, accounting functions, system data entry, credit operations, banking, and reporting. Segregation of duties ensures that the approval, recording, and handling of a business process are not carried out by the same individual. Have different persons “Approve”, “Record” and “Do”. If segregation of duties is not possible, verification and review by supervisors and managers shall be in place.

SEMA complies with this principle. For more information please see SEMA Field Operations Manual.

7) The DFI is recommended, where appropriate and possible, to send selected staff on mandatory annual leave for a reasonable time and require another person to take over

his/her function. This will allow DFI to find any issue of concern (if any) related to the area/s of his/her responsibilities.

As part of internal control and internal audit, SEMA complies with this principle.

8) The DFI shall design and use adequate documents and records for internal record-keeping, including serially pre-numbered documents (receipts and vouchers), multiple copies, document registers, contracts, client files, journals, log books, and ledgers. The DFI shall ensure that documents are physically secured, and that a document control register tracks all issuance and return of serially pre-numbered documents in stock.

SEMA complies with this principle.

9) Transactions and activities shall be properly authorized and approved by the designated personnel.

SEMA complies with this principle.

10) The DFI shall require its directors/employees to declare any potential conflict of interest while discharging their duties. There is a potential for un-desirable transactions being conducted at the DFI.

SEMA complies with this principle. For more information please see SEMA Employee Handbook.

11) The DFI shall have in place security and controls over the application, updates, changes, continuity and backup of computer systems, databases and software to protect from viruses, data entry abuse, electrical disruption, and systemic failure. This includes system administration of passwords, levels of access, and back-ups.

All accounting and operation transactions are securely controlled and backed up in multiple locations.

12) Independent checks and review of activities and performance shall be a regular part of supervision and monitoring through daily operations and accounting activities. This includes loan portfolio spot-checks, reviews of all reconciliations, review of bank deposits, checks for compliance, surprise cash counts, and other critical aspects of operations.

SEMA complies with this principle.

13) DFIs shall incorporate dual controls on decision-making, approvals or bank accounts where at least two employees are involved in a specific activity. Examples include, a Credit Committee approving loans, two signatories on bank accounts, two persons accessing the cash vault, and a level of review before an approval of expenditure.

The internal control and segregation of duties policies require that the procurement and transactions are requested, approved, processed, and booked by different individuals.

14) Reconciliations shall be a part of accounting and transaction controls in the DFI’s financial management information system. This includes, daily cash reconciliations, weekly receipt reconciliations, weekly disbursement reconciliations, monthly bank reconciliations, monthly general ledger reconciliations to subsidiary ledgers (staff advance, accounts receivable, accounts payable), particularly the loans receivable account captured in the client portfolio tracking system. Control accounts – minimum monthly – preferably daily and weekly.

SEMA’s internal control procedures have weekly review, and monthly oversight on all above transactions.

15) The DFI shall outline limits of authority to its management related to the approval of purchases, legal contracting, bank transactions, cash on hand, and budgetary parameters.

SEMA Board of Directors has established limits on approval and check signing authority for each level of management.

16) The DFI shall establish controls over fixed assets including physical security and control, maintenance, inventory, accounting, identification and use of fixed assets.

SEMA complies with this principle. For more information please see SEMA Field Operations Manual.

17) The DFI shall have an “audit trail” that links source documents to journals, to summaries, and to monthly or cumulative financial information in the general ledger. Transactions must be traceable in the financial management information systems of the DFI.

SEMA complies with this principle. All transactions are audited by third party independent auditors.

18) The DFI shall have in place an adequate “paper trail” of documentation that supports accounting transactions, entries and reports. This includes orderly, timely and sequential filing of vouchers, journals, general ledgers, portfolio reports, delinquency and aging reports, loan collection reports and loan disbursement reports. Where the paper trail will result in excessive hard copy, database reports shall be generated in soft copy and systematically saved, stored and labeled on electronic media.

SEMA will generate hard copies of all payroll and other expense records together with related financial reports monthly to be available for management review, internal and external audit. SEMA also keeps a softcopy backup of transactions for future review.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The institution’s board and senior management set a strong culture of internal  control through example, oversight and monitoring of activities, and establishing  strong planning, monitoring and reporting mechanisms. The institution’ Board  approves all policies that are documented and updated as needed. All  organization procedures are adopted by the relevant senior management  committee within the DFI. They have been communicated to personnel who use  them in their day-to-day activities. The incentive system is well aligned with the  institution’s targets and its policies and procedures. Human resource policies  attract competent and committed personnel. The institution’s accounting and  client portfolio tracking system has optimal controls and its control policies and  procedures are comprehensive and effective, as measured by the rarity of  instances of fraud, financial misstatements, and damage to or theft of the  institution’s assets. The DFI has an anti-fraud and whistle blowing policy. The  internal audit function is both competent and independent. External auditors are  independent, abide by professional standards and practice, and produce  constructive Management Letters. |
| 4 | The institution’s key policies and procedures are documented, updated – usually  approved by the board, and fairly consistently applied by personnel. The  institution’s financial management information system has good controls and its  control policies and procedures are adequate. Fraud, financial misstatements,  and damage to or theft of assets has been minimal. The internal and external  audit functions are generally adequate. |
| 3 | Most of the institution’s key policies and procedures are documented in manuals  and have been updated. Personnel are, for the most part, aware of these  manuals and use them in their day-to-day operations. The incentive system and  human resource recruitment and administration have some deficiencies as do  the institution’s accounting system and control policies and procedures. The  institution has had to deal with a few incidences of fraud, misstatements, and  damage to or theft of assets. The internal and external audit functions exhibit  some deficiencies. |
| 2 | The institution has policies and procedures by which it operates in the key areas,  but these have not been documented. Personnel have varying interpretations of  these policies and procedures. The HR administration and incentive system have  serious deficiencies. The institution’s accounting system and control policies and  procedures have deficiencies. The institution has dealt with numerous  incidences of fraud, misstatements, and damage to or theft of assets. The  internal audit function is nonfunctional and external auditors are inadequate. |
| 1 | The adequacy of policies, procedures and processes and their application within  the institution are weak. No internal audit function exists. Human resource  policies and procedures are weak and do not attract qualified and motivated  staff. The external audit work in inadequate and does not add value. Weak  controls have resulted in incidences of fraud. |
| 0 | There is weak board oversight and management is not held accountable. There is  no adherence or application of policies and processes within the institution. No  internal audit function exists and management supervision of operations is weak.  Important deficiencies exist with the external audit. Weak controls have resulted  in serious incidences of fraud. |

STANDARD 18

Accounting Policies & Cash Management

**Purpose and Rationale**

**Policies** are the written guidelines that indicate the direction of the operations. Accounting policies include guidelines on the treatment, classification and recording of financial transactions. Cash handling policies outline issues on the treatment and security of cash. **Procedures** are the written instructions that tell how to implement and follow the policies. The results of effective accounting policies and procedures will support the preparation of reliable and consistent financial reports, enhance internal and external audit work, serve to guide and train new staff and provide meaningful information on the DFI’s operations. Effective and appropriate cash handling policies and procedures will protect the assets of the DFI and instill a culture of care and due diligence.

**Objective**

The objective of this standard is to provide guidance to DFIs in establishment and implementation of accounting policies and procedures at all branches, locations and head office. This standard also provides guidance in the handling of cash in order to minimize loss and theft.

**Key terms**

Accrual, double-entry accounting, prudence, business entity, IFRS, IAS, materiality, going concern, business entity concept, historical cost principle, conservatism, substance over form, classification, summarization, dual control, deferred revenue, capitalization

**Principles**

1) In order to be effective, DFI policies and procedures shall be a) written; b) simple/clear; available; c) understood; d) relevant; and e) implemented.

SEMA policies and procedures are written with the characteristics listed in mind. For additional information, please see SEMA documents such as Field Operations Manual and Credit Policies and Procedures Manual.

2) DFI accounting policies and procedures shall be laid out in a policy manual that is developed by management and staff and approved by the Board of Directors. Detailed operating procedures explain underlying controls and define who does what, where, when, how, and in what sequence.

SEMA’s Field Operations Manual is in compliance with this principle. For additional information, please see Field Operations Manual.

3) Accounting policies and procedures shall adhere to IFRS and IAS accounting standards and with local Afghan laws and regulations binding on the institution.

SEMA accounting principles are in compliance with IFRS and GAAP and adhere with local Afghan laws and regulations binding on the institution.

4) DFI accounting policies and procedures shall be based on the accounting conventions and norms including a) business entity concept b) historical cost principle (other measurements where applicable) c) going concern concept d) consistency principle e) matching principle f) conservatism or prudence g) substance over form h) materiality.

SEMA accounting policies are in compliance with the GAAP which in complies with the above mentioned points.

5) The DFIs shall use the accrual accounting method and a double entry accounting system to record transactions.

SEMA uses the accrual accounting method as well as double entry accounting system to record transactions.

6) DFI management shall be responsible to disseminate, train, update and implement the policies and procedures including: a) manuals are kept up to date and set out the procedures that must be followed in the operation of the system; b) sufficient copies of the manual are available to authorized persons; c) the Finance Manager recommends updates to the manual through the Executive Director as often as necessary; and d) amendments to the manual are properly authorized and communicated.

SEMA complies with this principle.

7) Accounting policies and procedures shall be reviewed and updated periodically to reflect the requirements of day to day operations, changes in legal requirements, or changes in IFRS and IAS. Procedures to incorporate changes shall be made explicit.

SEMA complies with this principle.

8) In order to produce reliable financial statements and reports, accounting procedures shall incorporate the following controls for validity, completeness, and valuation maintained by independent checks and segregation of duties within the accounting function:

a) Transactions shall be valid;

b) Transactions shall be properly authorized;

c) Transaction records shall be complete;

d) Transactions shall be properly valued;

e) Transactions shall be properly classified;

f) Transactions shall be recorded at the proper time;

g) Transactions shall be properly posted to the general ledger (master files) and correctly summarized and aggregated; and

h) All transactions must be supported by adequate and appropriate documents that justify and support the payment.

SEMA follows the above mentioned principle. SEMA uses Loan Performer for tracking loans, and Quickbook Pro software to conduct all financial and accounting transactions. For more information please refer to the Field Operations Manual.

9) The DFIs specific policies shall include the minimum items to consider prescribed by MISFA. (This includes policies for capitalization of fixed assets, depreciation, accounting treatment of non-performing loans, staff advances, donated capital for loan portfolio, operating subsidies, or restricted purposes, deferred revenue, prepaid expenses, etc.)

SEMA complies with this principle. For more information please refer to the Field Operations Manual and Credit Policies and Procedures Manual.

10) No cash shall be received from anyone without the issuance of an official receipt from the DFI.

SEMA complies with this principle.

11) The DFI shall have a locked and bolted safe for maintaining cash in the office. Access to the safe shall be under dual control.

SEMA complies with this principle.

12) Cash on hand will be counted and reviewed on a periodic basis, but not less than once a week.

Cash at hand is reviewed on a daily basis.

13) The DFI shall set a limit to the level of cash maintained at any branch, center or Head Office. Cash in excess of these amounts will be deposited in the bank.

SEMA complies with this principle.

14) Cash receipts from client repayments shall be deposited to the bank, and receipts balanced and verified to bank deposit slips on a regular basis. The DFI shall determine appropriate levels of verification and independent review depending on its operation modality and levels of decentralization.

SEMA complies with this principle.

15) The DFI shall ensure adequate segregation of duties in the handling and recording of cash transactions.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The institution’s accounting policies and processes are documented and  updated as needed. They have been communicated to personnel who use them  in their day-to-day activities. The accounting system has optimal controls and its  control policies and procedures are comprehensive and effective, as measured  by the rarity of instances of fraud, financial misstatements, and theft of the  DFI’s cash. External auditors produce constructive Management Letters  addressing items that are generally not urgent or critical in nature. |
| 4 | Generally, the institution’s accounting policies and procedures meet the  standard. The system has reasonable controls; there are adequate and effective  policies on the handling of cash. Fraud, financial misstatements, and damage to  or theft of assets have been minimal. |
| 3 | Most of the institution’s accounting policies and procedures are documented in  manuals and have been updated. Deficiencies exist but are being systematically  addressed. The institution’s incidences of fraud, misstatements, and theft of  cash are diminishing. Cash controls are fairly strong, well-understood and  applied, and improving in effectiveness. |
| 2 | The institution has informal accounting policies and procedures by which it  operates in the key areas, but these have not been documented. Personnel  have varying interpretations of these policies and procedures and application in  accounting systems and report preparation is generally inconsistent. There have  been some recent improvements. The institution has dealt with incidences of  fraud, misstatements, and damage to or theft of cash. Management letters of  external auditors report numerous accounting weaknesses. |
| 1 | There are weak and inadequate accounting policies and procedures in place.  Reports are highly questionable, though minimum reporting is in place. External  auditors struggle with the production of external accounts, and engage in report  preparation most times. Policies and procedures are not adhered to or enforced  by management. Cash handling and controls are very weak, and fraud is  frequent. |
| 0 | There is no uniformity in the application of accounting policies and procedures  within the institution. Reports are unreliable, inconsistent and not meaningful.  Financial reports are virtually unauditable. There are no policies or procedures  for cash handling and there have been numerous and significant incidences of  fraud due to cash theft. |

STANDARD 19

Internal Audit

**Purpose and Rationale**

The Institute of Internal Auditors defines internal auditing as “…independent, objective

assurance and consulting services designed to add value and improve an organization's

operations. It helps an organization accomplish its objectives by bringing a systematic

disciplined approach to evaluate and improve the effectiveness of governance, risk

management, and control processes.”

**Objective**

The objective of this standard is to encourage the effectiveness of the internal audit function in microfinance institutions to provide independence assurance on the achievement of DFI objectiveness, the adequacy of risk management and internal controls, and the reliability of financial and operational financial reports.

**Key terms**

Competence, Objectivity, Resources, Process, Scale, Independence, Fraud, risk, control processes, CIA, ACCA, CA, CAT

**Principles**

1) The DFI shall have in place an Internal Audit charter or policy that outlines the purpose, scope, authority and work of the internal audit department.

SEMA has in place an internal audit policy that monitors all aspects of the institution on a monthly basis.

2) The Internal Auditor(s) shall have appropriate professional qualifications such as CIA, ACCA, CA or CAT, prior years’ practical experience, impeccable character and judgment, excellent verbal and oral communication skills, and the maturity and judgment to evaluate relevant and meaningful observations and recommendations to management.

SEMA’s relevant personnel are fully qualified and possess many years of experience. They have exercised good judgment in ongoing monitoring and evaluation of SEMA’s operations.

3) The Internal Auditor shall have a direct reporting function to the audit committee of the board to ensure independence, with an administrative and functional reporting line to management for coordination, communication and effective discharge of its responsibilities. The board of directors and/or the audit committee has responsibility for employment decisions related to the internal auditors.

SEMA is fully in compliance with the personnel and reporting functions required.

4) The internal auditor shall have unlimited and direct access to all areas of the financial institution for purposes of assessing the existence and effectiveness of internal controls.

SEMA is fully in compliance in this regard.

5) The Internal Auditor shall report to the board on a quarterly basis at a minimum.

SEMA’s Internal Auditor reports to the board on a quarterly basis.

6) The Internal Auditor shall develop a risk based annual audit work plan to ensure all aspects of operations are included in timely and relevant audit work. The work plan shall be approved by the audit committee. The Internal Auditor shall also have adequate time and resources available for unplanned audits, special assignments and investigations, training and personal development and management of field audit staff.

The auditor monitors risk monthly concerning SEMA operations. The auditor will perform unannounced audits and spot check investigations, and also conduct training for continuing development of management skills for field staff. SEMA’s business plan is periodically reviewed and approved by the audit committee. \*\*Define SEMA Audit Committee internally. Set up if need be\*\*

7) The Internal Auditor shall make follow up of recommendations previously issued and report to the board the status and risks of outstanding matters on a periodic basis.

The Auditor and SEMA management have followed up on recommendations issued by Loan Performer assessment conducted in 2013.

8) The Internal Auditor shall support the DFI’s board and management in its risk identification and management program, and evaluate the effectiveness of risk mitigation and internal control systems in achieving the objectives of the entity.

The Auditor closely coordinates with SEMA’s board in management in identifying and mitigating risk and enforcement of internal controls to achieve SEMA’s objectives.

9) The Internal Auditor shall be a key independent contributor to the communications and information flow that is critical to the functioning of a strong internal control system.

The Auditor is an integral partner in communications and management of all internal controls.

10) The Internal Auditor shall have no operating or management responsibilities.

SEMA’s auditor is not in a managerial role.

11) The internal audit resources shall be adequate to support the DFI’s activities in scope, size and geographic breadth.

SEMA’s audit resources fully monitors and supports the institution’s activities in the required ways.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | An internal audit function exists, is adequately resourced, and is both competent  and independent. Audit conducts regular review and engages on all aspects of  DFI operations. The internal audit risk-based as identified by the board and  management. The DFI has a Board-approved Internal Audit Charter or Internal  Audit Policy that outlines scope, responsibilities and authority of the internal  audit function. An Internal Audit Manual outlines audit procedures, conduct and  management of the function. The Internal Auditor is a qualified professional with  prior year practical experience. The Internal Auditor reports functionally to the  audit committee or the board, or a board appointed representative(s) who review  and approve the annual plans, receive audit reports, and monitor audit  recommendations with management. The work performed by audit, its  documentation, reports and recommendations are of high quality. The audit  function includes follow-up on issues raised in reports, follow up of  recommendations, next steps. Issues of fraud have been detected by audit and  management has adequately addressed these issues. |
| 4 | An internal audit function exists and is adequate despite some limitations in  resources, skills and experience, and or focus. The DFI has a Board-approved  Internal Audit Charter or Internal Audit Policy that outlines scope, responsibilities  and authority of the internal audit function. An Internal Audit Manual outlines  audit procedures, conduct and management of the function. The work performed  by audit, its documentation, reports and recommendations are generally  adequate. The internal audit function includes detecting and preventing fraud.  Internal audit follow up on recommendations could be improved. |
| 3 | The DFI has an internal audit function but it has some deficiencies in the areas  outlined above due to a lack of resources, skills and qualifications and or focus. |
| 2-0 | The internal audit function is seriously deficient, nonfunctional, or does not exist  at all. |

STANDARD 20

External Audit

**Purpose and Rationale**

An external audit lends credibility to financial statements and other management reports for the board and other stakeholders. It provides assurance of accountability and identifies weaknesses in internal controls and systems. The purpose of appointing an external audit is to obtain an opinion to whether the financial statements at a given date and for a given period express fairly the financial position and performance of a DFI.

**Objective**

The objective of this standard is to promote and encourage professionalism, independence and timeliness in the conduct and quality of DFI external audits.

**Key terms**

External audit, chartered accountant, terms of reference, opinion, qualified report, engagement letter, management letter, assurance

**Principles**

1. Management is responsible for the preparation of financial statements according to IFRS and for the implementation of internal controls to prevent and detect fraud.

SEMA’s Internal control mechanisms are fully in place according to IFRS standards and implemented on an ongoing basis for fraud detection and prevention.

2. The DFI shall outsource an external audit each financial year end.

An external audit conducted by a fully qualified auditing firm is conducted each year.

3. An external auditor shall be engaged by, and ultimately responsible to, the board. This can be done by an audit committee of the board, or in smaller DFIs, by a single director with financial expertise.

An external auditor has been engaged, approved by the Board, in consultation and agreement with the audit committee.

4. The accounts of a DFI for each accounting year end shall be audited by one or more auditors who are chartered accountants within the meaning of the International Accounting Standards Board (IASB).

SEMA’s accounting structure is fully in compliance with this principle.

5. The auditor or auditors shall be appointed for such terms and on such remuneration as determined by the Board of Directors for the institution to pay. Once appointed, the auditors shall not be removed before prior approval of the board. No auditor shall serve as external auditor of a DFI consecutively for more than 5 years. The DFI is required to notify MISFA when they appoint or remove the external auditor/s from their service.

The auditors are engaged at the discretion of the Board of Directors; change of auditors can occur only with approval of the Board. SEMA will notify MISFA regarding the auditors engaged, and any change of auditors.

6. The DFI shall provide to the auditors its financial statements and other accounts, related vouchers, books of accounts and documents for examination and review. In addition, any directors or officers of the institution shall be available for interview and discussion throughout the course of audit work.

SEMA provides to the auditors all the above-mentioned statements for review during the course of regular audit work.

7. The auditors shall report to the Board of Directors of the DFI on the annual accounts and balance sheet and in their report they shall state whether, in their opinion, the financial statements are properly drawn up so as to give a true and fair view of the state of affairs of the DFI.

Auditors report to the Board of Directors regarding annual accounts and balance sheets along with any findings.

8. The audited financial statements shall be published within three months of close of its financial year, facilitated by DFI financial management. This shall include the management letter with the response from management.

SEMA’s audit financial statements are published within three months of close of its financial year, including a letter with the response from management.

9. The DFI shall submit a copy of its audited financial statements to MISFA.

SEMA will supply a copy of audited financial statements to MISFA on an annual basis.

10. The DFI shall determine a scope of work that will form the basis the terms of reference for the engagement generally approved by the full Board. The scope of an external audit may include the following.

**Common External Audit Services**

|  |  |  |  |
| --- | --- | --- | --- |
| **Service** | **Purpose** | **Activities** | **Output** |
| Annual financial  statement audit | To confirm that the  financial statements are  free from material  misstatement | Audit, on a test  basis, key account  balances and  underlying evidence  or procedures | Audit report, including  an opinion, financial  statements, and  notes |
| Management  letter | To obtain constructive  comments that  management can use to  improve operations or  internal controls | By-product of the  annual financial  statement audit | Management letter |
| Special purpose  audit | Generally to audit  compliance with donor  requirements, including  use of funds | Review of specific  issues as requested  by the clients, usually  on behalf of the  donor | Special audit opinion  and report |
| Agreed-upon  procedures | To obtain detailed results  of specific testing  procedures for selected  transactions or account  balances | Performance of  agreed-upon  procedures | Report of results of  procedures without  opinion. Users draw  their own conclusions. |

Audit Timetable

1. Appointment of auditor by Board of Directors not later than January 31 of each year;

2. Signing of formal engagement letter not later than February 15 of each year;

3. Confirmation to MISFA of appointment of auditors and copy of engagement letter not later than February 28 of each year;

4. Performance of year end audit procedures of auditors on or around March 31 each year;

5. Initiation of audit field work not later than April 20 each year;

6. Issuance of initialled financial statements for approval of Board of Directors not later than June 5 of each year;

7. Meeting of Board of Directors for approval of financial statements not later than June 15 each year;

8. Filing of income tax return based on audited financial statements not later than June 20 each year;

9. Submission of signed audited financial statements, including the Auditors management letter and the DFI’s response, to MISFA not later than June 30 each year;

SEMA is in compliance with the scope of work and terms of reference as approved by the Board included in the standards and principles below.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI outsources an external audit each financial year end. The Board is actively  engaged in its responsibility to approve external audit terms of reference, auditor  communications, and managing the process through an audit committee or  qualified and informed Board member with relevant skills to understand and take  on this responsibility. The DFI notifies MISFA when they appoint or remove external  auditors. External auditors are independent, abide by established professional  standards, and produce constructive Management Letters. Audit work and reports  are issued on a timely basis. |
| 4 | In general, the DFI meets most characteristics of the standards for external audit  delivery. DFI outsources an external audit each financial year end. The Board is  engaged in the process. External auditors are independent, abide by established  standards, and produce Management Letters, but they are not always timely or  relevant. |
| 3 | The DFI outsources an external audit each financial year end. The Board is engaged  in the process. External auditors are independent, and abide by established  standards, and produce Management Letters. The external audit function exhibits  some deficiencies as outlined below. |
| 2 | Serious deficiencies exist with the external audit. The external auditors have very  little experience with developmental finance institutions. The external audit process  takes too long and absorbs DFI management and staff time. Issues examined are  not particularly material to the main risks in the business. The board does not take  responsibility for leading this process. |
| 1-0 | An external audit is conducted only because it is mandated or not at all. It has no or  little relevance to the operation of the DFI. |

STANDARD 21

Transparency, Disclosure & Reporting

**Purpose and Rationale**

Regular and transparent reporting of the operational and financial state of developmental

finance institutions is a professional, ethical and industry norm. Stakeholders, investors,

regulators, and other supporters of financial institutions expect full, transparent and fair

disclosure of the financial position of the DFI. International Financial Reporting Standards are the international standard for financial reporting, and DFI’s are expected to report accordingly. Therefore, clear and transparent reporting strengthens the DFI’s reputation, and ability to attract support and investment.

**Objective**

The objective of this standard is to outline the expectations and characteristics of DFI operational and financial reporting.

**Key Terms**

Disclosure, transparency, general ledger, integrated, subsidiary ledger

**Principles**

1. Financial reporting and disclosures shall be transparent and in accordance with IFRS.

SEMA reporting follows an existing set of standards, compliant and in accordance with IFRS. For audit purposes, SEMA is also in compliance with Generally Accepted Accounting Principles (GAAP).

2. The responsibility of disclosure and reporting shall lie with the senior management.

SEMA reporting follows an existing set of standards, with responsibility of disclosure and reporting designated to senior management. For additional information please refer to SEMA Field Operations Manual Section 5 as well as SEMA Credit Policies and Procedures Manual.

3. The DFI shall commit to a sense of professional and ethical responsibility in all reporting and shall honestly and openly disclose all material or relevant information to MISFA. This includes any activity that might have a significant impact on the DFI or other related entities.

SEMA Code of Ethics and Conduct applies to reporting and is committed to transparency between organizations. Reporting information can be found in SEMA Field Operations Manual Section 5 and SEMA Credit Policies and Procedures Manual, while Codes of Conduct and Ethics can be reviewed in Standard 3 as well as in SEMA Field Operations manual, specifically Section 8.15 & 8.16.

4. The presentation and disclosure of all reporting activity should present a true and fair view of all the business activity. In case of more than one business segment, the DFI shall report the activity as a whole and also as a distinct segment.

SEMA complies with these requirements.

5. The DFI shall submit ongoing financial and operational reports to MISFA as agreed to by contract, but no more than 1 month after the period end.

SEMA will comply with these requirements.

6. The accounting system and the loan portfolio tracking system shall be linked and integrated, even if operated with two software systems. The general accounting system shall record transactions in journals and general ledger balances shall be used as a basis to prepare financial and MISFA reports. The loan portfolio management system shall record all client transactions and shall act as the subsidiary ledger for the loans receivable control account in the general ledger

SEMA complies with these requirements. The existing accounting practice of

SEMA follows the same protocol as defined above.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI reports regularly to MISFA in a timely, transparent, consistent and  meaningful manner. Financial reports are prepared according to IFRS.  Operational reports are useful and together with financial report provide a fair  and true picture of the state of the institution. Management takes full  responsibility for reporting. |
| 4 | The DFI is consistent and regular in its financial and operational reporting. IFRS  is complied with for the most part. Management has improved in their ability to  interpret results and provide full disclosure. |
| 3 | The DFI adequately reports on IFRS basis the financial and operational results  of its activities. Staff capacity is reasonably strong and reporting is improving  and generally timely. Full disclosure of the operations and activities is adequate,  though some questions remain from time to time. |
| 2 | The DFI has improved in its reporting, although there are still inconsistencies.  Reports are usually late and are often filled with errors. However, management  is genuinely attempting to improve in reporting, and makes attempts to provide  verbal updates on any gaps. |
| 1 | The DFI is usually late in reporting and has weak capacity to report fully and  consistently. Management is weak in its understanding, interpretation and  presentation of financial and operating results |
| 0 | The DFI is consistently late in reporting and management takes no responsibility  in this activity. Reports are not prepared in accordance with IFRS, and partial  and mis-construed information is provided. |

STANDARD 22

Training and Staff Development

**Purpose and Rationale**

The DFI needs to have a training and staff development program for every level of staff of the DFI in order to maintain professional levels of performance. A training program that guides staff and provides measuring tools to track their productivity will ensure employees understand tasks, expected results and targets. This will result in improved supervision and monitoring for outputs, staff confidence and improved performance for the institution. Career development programs emanating from performance appraisals and increasing opportunities to perfect and develop skills will permit HR to attract and retain experienced personnel and ensure that personnel are regularly upgraded to meet the demands of the tasks. Attractive merit based incentive systems linked to DFI targets that are achievable due to training. The DFI has a satisfied team and a staff that is performing well.

**Objective**

The objective of this standard is to outline the expectations and characteristics of training and staff development.

**Key Terms**

Training, career development, merit based incentives, productivity, performance appraisal, terms of reference, skills upgrade.

**Principles**

1. The DFI shall ensure that there are documented training programs that are flexible, diversified and respond to the individual needs of staff at all levels of the organization. A comprehensive induction training program to explain Development Finance and the Code of Conduct is provided to all staff at the time of joining the DFI.

SEMA may encourage the development of its staff through participation in pre-approved seminars and workshops that SEMA will deem to be directly related to an employee’s work within SEMA and will positively impact the employee’s job knowledge or performance. For additional information, please refer to SEMA Employee Handbook, specifically Section 6.14 and SEMA Field Operations Manual, specifically Section 10.

2. As soon as there is scale, the DFI will ensure there is a dedicated Training Department separate from Human Resources with personnel that is experienced in training and ensures head office and field training and refresher courses are systematic and evolve with the needs of the personnel. The department maintains a strategic training plan for the DFI that is presented to the board as part of the business plan and disseminated to the organization.

SEMA does not have a department however the core structure of business has embedded the culture of employee development and training. For example, as the major investor, SFL executive team and technical personnel will provide frequent training for the staff of SEMA. Moreover SEMA is a member of AMA, who provides frequent training for its members. SEMA will take advantage of the available staff training and development provided by AMA.

3. The DFI will ensure Supervision and Monitoring methods and tools measure results of staff performance as linked to the results of using the training provided.

SEMA shall make use of Employee Evaluation Form in order to measure performance. Please see SEMA Employee Evaluation Form.

4. The DFI will ensure targets and benchmarks for staff productivity are in relation to the training obtained.

SEMA staff members will each have a clearly defined scope of work and job description, which are the basis for their performance review. For additional information please see Employee Handbook and Employee Evolution Form.

5. The DFI will ensure there is a personnel performance appraisal system is linked to the training, the tasks and the results of the tasks for each staff member.

SEMA has a currently existing Performance Appraisal and Reward Systems. For more information, please see SEMA Field Operations Manual, specifically Section 10.3 & 10.5.

6. The DFI will ensure there is a career development plan for each staff member that is integrated into the performance appraisal system. Skills upgrades requirements and support for technical staff is included in the plan.

SEMA has a currently existing Performance Appraisal system that will evaluate the employees’ performance and responsibilities as well as potential improvement. For more information please refer to Employee Evaluation Form.

**Assessment**

|  |  |
| --- | --- |
| **Scale** | **Range** |
| 5 | The DFI has established a dedicated Training Department with specialized staff  dedicated to developing training modules and educating staff on a regular  basis. The Training Strategy and objectives is well documented, has been  approved by the Board and is disseminated through the organization. The  training department has the necessary budget, staff and technology to  implement institution wide trainings. The DFI has established documented  training program that are flexible and respond to the individual needs of staff at  all levels of the organization. All employees undergo a complete structured  induction process sufficient for an understanding of development finance,  organizational mission and vision, code of conduct as well as day to day tasks  well defined in updated Terms of Reference for each position. Performance  Appraisals are conducted annually and are linked to productivity targets and  results as well as a career development program for each staff. The incentive  system is well aligned with the DFI’s operational targets and the staff has  received the training to be able to achieve the targets. |
| 4 | The DFI has a dedicated Training unit, and is generally able to produce materials  that train the staff. A strategic training plan has not been developed yet. The  training results are monitored by supervisors that have tools to measure staff  productivity as a result of improved methods of work resulting from training. All  employees undergo a complete structured induction process sufficient for an  understanding of development finance, organizational mission and vision, code  of conduct as well as day to day tasks. Documentation including training  materials are relevant and available in local languages. The incentives are  linked to DFI targets and employees get training to achieve increased  productivity towards the targets. |
| 3 | The DFI has an HR Department that has a Training person part time. No  strategic training plan is being considered, because training is a part of HR.  Training modules for basic development finance knowledge (delinquency,  indicators, loan analysis) are provided in printed format to Supervisors to use at  will. The training and induction processes are at times inadequate. A Code of  Conduct, Incentive systems and performance appraisals exist, but they are  deficient in many ways. The DFI is aware and is making efforts to remedy these  training and development issues. |
| 2 | The DFI has a weak HR Department and no training personnel. There is no plan  to train or support staff. Upon recruitment, staff members are provided with  brief description of their tasks and shadow other staff as training. There is no  Employee Handbook and no Induction training. No targets or incentives are  placed in the terms of reference. Terms of Reference are incomplete and out of  date. No career development or performance appraisals exist. |
| 1 | The DFI does not have a training program. Staff implements their tasks as best  they can. There is no plan for training nor does Management understand the  need for training. |
| 0 | The DFI does not have a training program. Management takes no responsibility  in this activity. Staff have no Job Descriptions or Terms of Reference and only  have a general knowledge of what is expected from them. |

ANNEXURE 1

Glossary of Terms

**Term** **Definition** **Standard**

Abuse of office means improper treatment or use of a position, rank 17 or power and used for wrong, personal or illegal purposes; the abuse of the power inherent in superior rank, with the view that rank-based abuse underlies many other forms of mismanagement and conflict of interests.

ACCA means Association of Chartered Certified Accountants 19 the global body for professional accountants.

Accrual or realization principle, means that revenue must be 18 recognized in the accounting period it is earned, and expenses be recognized when they are incurred, rather than when there is collection or payment of cash.

Adequate means enough; sufficient in quality or quantity to meet 17 a need or qualify for something.

AISA means the Afghanistan Investment Support Agency 1 charged with the responsibilities of registration, licensing and promotion of all new investments in Afghanistan.

Articles of Association means the basic document of a registered DFI 1 explaining its internal organization.

Assessment or appraisal, means the part of the credit management 11 process undertaken by the DFI to determine whether a borrower is credit worthy, i.e. whether the borrower meets the criteria established by the DFI for receiving a loan.

**Term** **Definition** **Standard**

Assurance means reliability, confidence or certification. 17, 20 Assurance services in auditing have been defined 'Independent Professional Services that improve information quality or its context'. Assurance services reduce the information risk; risk that the information provided is incorrect, on more than just financial data. The major purpose of assurance services is to provide independent and professional opinions that improve the quality of information to management as well as other decision makers of the DFI.

Audit trail means all source documents, vouchers and registers are 16,17 physically traceable, referenced, or linked through the hard copy or electronic records and documents in an accounting or record keeping system of a DFI.

Back-up restoration means the process undertaken by a DFI to replace or 13 reconstruct lost or damaged data in its database.

Back-ups means the same as physical back-ups defined for 15 Standard 13.

Balance sheet structure means the relative composition of the balance sheet, 7 specifically the amount and relationship of debt to equity. A strong equity base is necessary to cushion the DFI from losses or unexpected events, but can also be an expensive resource. Equity is also used to leverage debt, a cheaper source of capital to fuel growth of a DFI.

Budgeting means the process of establishing a forecast of the 6 expected revenue and expenses incurred over a period typically undertaken on an annual basis. It provides a tool for the DFI to predict with reasonable accuracy whether the expected operational performance will result in a profit, a loss or will break-even for a given period and to measure actual financial performance against the forecast.

Business entity means every business and DFI is a separate entity, 18 distinct from its owner and from every other business. Therefore, the records and reports of a business should not include the personal or business transactions or assets of either its owner(s) or those of another business.

CA means Chartered Accountant. 19

Cash Flow Statement in financial accounting, also known as statement of 9 cash flows or funds flow statement, means a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents. A cash flow statement breaks down the flows of cash in and out of the DFI into operating, investing, and financing activities. The statement captures both the current operating results and the accompanying changes in the balance sheet.

CAT means Certified Accounting Technician. 9

**Term** **Definition** **Standard**

Chartered accountant means the first accountants to form a professional 20 accounting body over 150 years ago in Great Britain. They were granted a royal charter almost from their inception. The title is an internationally recognized professional designation.

CIA means Certified Internal Auditor, awarded by the 19 Institute of Internal Auditors, and abiding by International Professional Practice of Auditing.

Classification means transactions must be entered into the journals 18 with the proper account categories according to the chart of accounts in order to generate consistent and comparable information.

Code of Conduct means a set of rules outlining the responsibilities of 3, 5 or proper practices for an individual or organization, as a DFI. Related concepts include ethical codes and honor codes.

Code of Ethics means a set of guidelines which are designed to set out 5

acceptable behaviors for members of a particular group,

association, or profession. Many organizations govern themselves with a code of ethics when they handle sensitive issues like money, people, and particularly low-income people. A code of ethics can increase confidence in a DFI by showing that they are committed to following basic ethical guidelines in the course of doing their work.

Collateral means a borrower's pledge of specific property to a 11 lender, to secure repayment of a loan. The collateral serves as protection for a lender against a borrower's risk of default - that is, any borrower failing to pay the principal and interest under the terms of a loan obligation. If a borrower does default on a loan, the borrower gives up the property or assets pledged as collateral and the lender becomes the owner of that collateral.

Collection means the part of the credit management process 11 undertaken by the DFI to enforce repayment of all loan amounts that is ideally systematic and progressively stronger. The process should be accompanied by reports that detail problem loans and courses of action.

Committees means any of a select group of members of the Board 2 of Directors with a defined scope of responsibility, e.g. members of the Board charged with specific duties relating to the oversight of financial reporting and disclosure, and dealing with the internal and external auditors - often referred to as an Audit committee.

Communication strategy means, in the context of a DFI's administration policy, 13 the channels and means used to inform staff in the event the DFI needs to implement its disaster recovery plan.

**Term** **Definition** **Standard**

Competence means the ability to do something well, measured 19 against a standard, especially ability acquired through experience or training. Competence is the ability to perform a specific task, action or function successfully.

Conflict of interest means any relationship that is, or appears to be, not in 17 the best interest of the organization or DFI. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.

Conservatism means when presented with a choice, accountants 18 should choose procedures and methods of recording transactions that ensures that assets, revenues and gains are not OVERSTATED, and that liabilities, expenses and losses are not UNDERSTATED. This principle is intended to result in the fair presentation of information of the DFI.

Control processes means the policies, procedures, and activities that are 19 part of a DFI’s control framework, designed to ensure that risks are contained within the risk tolerances established by the risk management process.

Costing means the process undertaken by DFIs as part of the 10 product development cycle to determine the full cost of delivering products and services. Costing exercises may have various purposes but they are generally conducted to determine whether to modify the pricing of existing products, accept and implement new products, and to determine how to price new products. There are two product-costing methodologies, namely, Allocation Based Costing and Activity Based Costing.

Credit management or credit risk management, means the process 11 undertaken by DFIs to ensure that it delivers appropriate loan products to borrowers and that borrowers repay their loans. It includes the assessment, administration, supervision, enforcement, and recovery process for all loans.

DAB means Da Afghanistan Bank and all of its constituent 1 parts including its branches in the country.

Data means raw facts. Data relating to DFI operations are 14 typically stored electronically through computers.

Data integrity means the condition that exists when data is unchanged 14 from its time of creation and has not been accidentally or intentionally modified, altered or destroyed so that it is considered reliable and accurate.

Deferred revenue means DFIs or organizations that receive grants or 18 donations in lump sum advance installments apply the accrual accounting method and will record the amounts as deferred revenue when received. They are only transferred to revenue as the related project expenses are incurred (generally one entry at the end of the reporting period).

**Term** **Definition** **Standard**

Delinquency means the failure of a client or company to pay a debt 11 or other financial obligation. Failure of a DFI to cure a delinquent payment can ultimately result in repossession or foreclosure of pledged assets. Accounts that are not current are also known as delinquent accounts.

Director means any person occupying the position as a member 2 on the Board of Directors (Supervisors, or equivalent) of a DFI and includes sponsor, nominee and alternate director or by whatever name called.

Disclosure means the giving out of information, either voluntarily 21 or to be in compliance with legal regulations or workplace rules. In accounting and reporting, disclosure refers to a DFI or company's disseminating information about its past financial performance, future forecasts, current operations, and anything else stakeholders and investors may be interested in.

Documents means all vouchers, bills, promissory notes, bills of 16 exchange, contracts, application forms, receipts, records, securities for advances, legal documents for claims by or against the DFI and other record supporting entries in the books of the DFI.

Double-entry accounting means an accounting approach whereby any given 18 transaction will affect a minimum of two accounts within assets, liabilities, or equity (including revenue and expenses). If the accounting equation is to remain in balance, any change in the assets must be accompanied

by an equal change in the liabilities or equity, or by an equal but opposite change (increase or decrease) in another asset account.

Dual Control means a backstop to decision making or approvals that 18 has at least one other employee check or approve a transaction. For example, checks should always be signed at least by two or more approved employees.

Effectiveness means the adequacy to accomplish a purpose, objectives 17 or goals; producing the intended or expected result: effective internal controls that minimize risk.

Efficiency means accomplishment of or ability to accomplish a 17 job with the minimum expenditure of time, resources and effort; without wasting resources; productive use of resources: the degree to which something is done well or without wasted energy.

Engagement letter means a document that defines the legal relationship 20 (or engagement) between a professional firm (e.g., law, investment banking, consulting, advisory or accountancy firm) and its client(s). This letter states the terms and conditions of the engagement, principally addressing the scope of the engagement and the terms of compensation for the firm.

**Term** **Definition** **Standard**

Equity means, as defined by IAS, the residual interest in the 7 assets of an institution after deducting all its liabilities. It also means the sum of all equity accounts (e.g. paid-in-capital, donated equity, retained earnings, reserves, other equity accounts, etc.) net of any equity distributions such as dividends, stock repurchases, or other cash payments made to shareholders.

Equity Subsidies means grants or donations that are given to a DFI for 9 the purpose of building its equity or capital base.

Ethical means the moral standards by which people judge 3 behavior. These include values such as honesty, integrity, respect, loyalty, fairness, openness, and transparency.

External audit means independent, professional audit who adheres to 20 international practices in the profession of auditing, for the purpose of expressing an opinion on whether the statements express the true and fair position of the organization.

Fiduciary responsibility means the legal or ethical relationship of confidence or 2 trust between two or more parties, most commonly known as a fiduciary and a principal. In a fiduciary relationship, one person, in a position of vulnerability, justifiably reposes confidence, good faith, reliance and trust in another whose aid, advice or protection is sought in some matter. In describing the fiduciary responsibility of a DFI toward its clients, it requires the DFI to act at all times for the benefit and interests of the client, with loyalty to those interests.

Founder means a natural person or legal entity listed on the 1 DFI's organizational documents that is responsible for the establishment of the DFI.

Fraud means any illegal act characterized by deceit, 19 concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

General ledger means the place where all information about changes 21 in an asset, liability, equity, revenue, or expense item is recorded.

Going concern means the records and balance sheet of a DFI or a 18 business are developed with the assumption that the business will continue to operate indefinitely, and that the assets used in conducting business and operations will not be sold, and the liabilities will be paid as recorded.

**Term** **Definition** **Standard**

Governance means, according to the Institute of Internal Auditors, 2 the combination of processes and structures implemented by the board in order to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

Guarantor means one who guarantees an obligation and has a 11 legal duty to fulfill it. DFIs may require guarantors to provide collateral or security to client's loans.

Historical cost principle means general past practice to record assets at their 18 actual, historical cost valued at the time of recognition in the accounts.

IAS means International Accounting Standards 18 established and set by the International Accounting Standards Board for accounting and reporting of financial performance to make such information comparative, consistent and transparent in the global economy.

Idle Funds means funds that are not invested in loan portfolio 9 or in revenue producing investments; some idle funds are necessary to be available for operating expenses and demand for disbursements in a DFI.

IFRS means International Financial Reporting Standards, a 18 number of pronouncements issued by the IASB on accounting and reporting issues. More broadly, IFRS refers to the entire body of the Board’s pronouncements, including standards (IAS) and interpretations of the standards.

Impairment loss allowance means the estimated amount of future losses expected 8 on the loan portfolio of a DFI, thereby a prudent and conservative approach to balance sheet presentation. The allowance is created by an accounting entry, usually based on an aging schedule of portfolio delinquency, that charges provision for loan losses to the income and expense statement, and creating a contra-account to the gross loan portfolio, called the impairment loss allowance (or in some cases the loan loss reserve). The result is that net loan portfolio is reported on the DFI's balance sheet.

Incentive schemes means a structured motivational plan that measures and 5 rewards performance of increased results, outputs, or quality of activities. Incentives are usually monetary,

but may also include other forms of reward, recognition or appreciation.

Independence means the freedom from conditions that threaten 19 objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

**Term** **Definition** **Standard**

Information means data that are processed, organized, structured or 14 presented in a given context so as to make them useful.

Integrated means bringing together processes or functions that are 21 normally separate, but must work together in order to function effectively.

Integrity means the concept of perceived consistency and 3 coherence of actions, values, methods, measures, principles, expectations and behavior.

Internal control according to the COSO framework, means a process, 17 effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance for the achievement of an entity's objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

Internally-generated means growth in equity and capital due to the 7 capitalization generation of profits; this is in contrast to the capital generated through external investors, the sale of shares, or contributions from parent shareholders or other investors of the DFI.

Investments means the commitment of money or capital to purchase 9 financial instruments or other assets in order to gain profitable returns in form of interest, income, or appreciation of the value of the instrument. An investment usually has some risk of principal loss beyond the control of the owner. If DFIs do have idle cash not needed for investment in loan portfolio, they will invest in low-risk instruments to generate some investment income.

IT Equipment means information technology software and/or 13 hardware and accessories used for business purposes of the DFI including communication and the processing and storing of data electronically.

IT Hardware means the physical components (e.g. mechanical, 15 magnetic, electronic, and electrical ) making up a computer system.

IT Protection means the processes and measures undertaken by the 13 DFI to prevent or deter unauthorized access or deliberate or accidental threats to the DFI information technology hardware and software.

Leverage in finance, also known as gearing or levering, means 7 the use of debt to supplement investment. Financial leverage takes the form of a loan or other borrowings (debt), the proceeds of which are (re)invested with the intent to earn a greater rate of return than the cost of interest.

**Term** **Definition** **Standard**

Liquidity means being in cash or easily convertible to cash; 9 debt paying ability; the ease with which an investment can be converted to cash without substantially affecting the asset price.

Loan loss means a non-cash expense to account for future losses 8 on loan defaults of the DFI. DFIs and banks assume that a certain percentage of loans will default or become slow-paying and enter a percentage as an expense when calculating their pre-tax incomes. This guarantees solvency and capitalization if and when the defaults occur. The loan loss provision expense is related to the risk evaluation of the DFI's delinquent portfolio.

Loan utilization check means the process undertaken by the DFI to ensure that 11 the proceeds of the loan are used for the stated purpose by the borrower.

Management letter generally accompanying an external audit, means the 20 auditor’s vehicle for providing a variety of financial information to the DFI. The information might include an evaluation on internal control weaknesses, changes in Accounting Standards, or other relevant information.

Manipulation of data means a misuse or misapplication of statistics, 17 information, or records in order intentionally misrepresent information and results. Informally called "fudging the data," this practice includes selective reporting and even simply making up false data.

Materiality means that financial statements should disclose all 18 items which might influence the decisions of the users of financial statements if they had knowledge of the same. Disclosure, notes to the financial statements, and errors or misstatements in the financial statements all affect the issue of materiality.

Misrepresentation of means inaccurate, under- or over-stated facts and 17 clients information about DFI clients.

MOA means Memorandum of Association, a legal document 1 that records the agreement of the founder(s ) and/or sponsor(s) to form the DFI and that sets out the relationship between the DFI and the outside. It is typically accompanied by the Articles of Association.

Monitoring and Evaluation means the process undertaken by the DFI as part of the 10 product development cycle to track, collect, and analyze relevant information to determine the value of a product to the DFI in terms of profitability and customer satisfaction. It is an ongoing process that forms part of both the development of new products and refinement of existing products.

Natural Disasters means an event such as an earthquake, flood, landslide, 13 etc. that is outside of human control that results in financial, environmental, or human losses.

**Term** **Definition** **Standard**

Network servers means any combination of hardware or software 15 designed to provide services to an interconnected group of computers and other electronic office equipment.

NPL means Non-Performing Loans, the commercial 8 terminology for loans that are not current in their obliged repayment schedule.

Objectivity means the ability to view things, perceive or describe 19 something without being influenced by personal emotions, prejudices or the opinions of others. It is referred to as the quality of being accurate, unbiased, and independent of individual perceptions.

Obligations means a contractual commitment, usually referred to 9 as a liability or a payable.

Opinion means a statement issued by either an internal auditor 20 or an independent external auditor as a result of an internal or external audit or evaluation performed on a legal entity such as a DFI. The report is subsequently provided to a “user” (such as an individual, a group of persons, a company, a government, or even the general public, among others) as an assurance service in order for the user to make decisions based on the results of the audit.

Origination means the part of the credit management process by 11 which a borrower applies for a new loan, and the DFI processes that application. It generally includes all the steps taken by the DFI from loan application through disbursement of funds to the borrower (or the rejection of the application).

Outsourcing means the transfer of a business function of the DFI to 12 a third party service provider. It may include for example professional work, audit, vehicle rental, office rental, etc.

Paper or electronic trail means a written or electronic record, history, or 16, 17 collection of evidence; the records left by a person or organization in the course of activities; A record of transactions in an information system that provides verification of the activity of the DFI's system.

Performance evaluation means a structured process of setting up performance 5 systems plans and objectives, providing monitoring and feedback and a review process that helps staff know what is expected of them in their job. The system is designed to enable staff to recognize their strengths and weaknesses while developing a plan with management to meet their individual and DFI organizational goals.

Physical back-ups means a copy or copies of data from the DFI's database 13 stored in some other location, whether on disk or some offline storage that can be used to reconstruct that data in the event of loss or damage to the original data.

**Term** **Definition** **Standard**

Physical security means the measures used to prevent or deter 12 unauthorized access or deliberate or accidental threats to the facilities, resources, or stored information of the DFI. It includes a variety of physical measures including locks on doors and safes, electrical surge protectors and anti-virus software, as well as measures that ensure the safety of staff.

Piloting means the same as testing in this context. 10

Portfolio at risk means non-performing or delinquent loans in 8 relationship to the entire portfolio of the DFI. It looks not only at the amount of principal that is late, but the entire balance of the late loan in relation to the entire portfolio outstanding.

Process means the set of actions and steps followed to produce 19 a specific objective. Process management is the application of knowledge, skills, tools, techniques and systems to define, visualize, measure, control, report and improve processes with the goal to more effectively meet the financial and social objectives of the DFI.

Procurement means the acquisition of goods and/or services at the 12 best possible price, in the right quality and quantity, at the right time, in the right place and from the right source for the direct benefit or use of the DFI.

Projections means the estimated future financial performance of 6, 9 the DFI based on an underlying set of realistic assumptions and presented typically over a period of not less than three years.

Prudence or conservatism, means to use good judgment to 18 consider likely consequences and act accordingly in managing resources. It also means to be careful in managing resources so as to provide for the future.

Qualified report means an audit statement issued when the auditor 20 encountered situations where reporting does not comply with generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS); a qualified report usually states that the financial statements are fairly presented with noted exceptions or misstatements.

Records means ledgers, daybooks, cash books, supporting 15, 16 documents and all other manual or magnetic/electronic records used to document transactions and activities in the business of the DFI.

Recruitment means the process of attracting, screening, and 5 selecting qualified people for a job or position in the DFI.

**Term** **Definition** **Standard**

Refining means the process undertaken by the DFI as part of the 10 product development cycle to move from a product concept to a product that is ready for pilot testing. It also refers to the process of introducing changes to products following pilot testing and/or changes to existing products and services based on qualitative and quantitative assessments.

Registration means the act of signing up or registering for the right 1 to engage in the business of developmental financial services with the proper authority (DAB, AISA, etc.) including the completion and filing of all required paperwork and payment of fees.

Related parties means individuals or entities connected to the DFI 11 which typically include the parent company or NGO, shareholders, subsidiaries, affiliate companies or organizations, directors, executive officers, senior managers and any close relative to any of the preceding.

Relevant means pertinent, connected or applicable to a given 14 matter.

Reliable means conforming to fact and therefore authentic and 14 worthy of belief.

Remuneration means the act of paying for goods or services; it 5 generally includes base salary or fees, bonus and commission earnings, allowances, benefit packages and other payments offered as part of an employment or service package.

Rescheduled portfolio also renegotiated or restructured portfolio, means 8 loans that have been delinquent for one reason or another, and then had a new repayment schedule and agreement renegotiated with the client.

Research means the systematic approach to the development and 10 refinement of developmental finance products and services consisting of analysis of the DFI's target market, competition and clients as well as analysis of the DFI's environment including political, social, economic and technological factors. It also refers to the process used to test new products, new marketing materials, etc.

Resources means human, technological, physical, skills-sets, 19 financial or capital or pool of assets that can be invested and leveraged to produce value or revenue for the DFI.

Risk means the possibility of an event occurring that will 19 have a negative impact on the achievement of DFI objectives. Risk is measured in terms of impact and likelihood.

**Term** **Definition** **Standard**

Scale means the achievement of growth and the economies 19 of scale in a DFI. An institution can realize significant cost advantages due to expansion; “economies of scale” is a ‘long run” concept and refers to reductions in unit cost as the size of an institution, or scale, increases.

Security interruptions means an event such as a bombing, armed conflict, or 13 other manmade occurrence that results in the restricted movement of staff due to risk of injury or death.

Segregation of duties means that the approval, recording, and handling of a 17 business process in an organization or DFI are not carried out by the same individual. Different persons should “Approve”, “Record” and “Do” the activity.

Senior Manager means a role within the DFI at a high enough level that 4 the person's primary responsibility is the oversight of an entire department or function whether audit, credit operations, human resources, finance, management information systems, etc.

Shareholder capital means capital owned by the shareholders through sale 7 of shares or contribution to the DFI.

Software means written computer programs or procedures or 15 rules and associated documentation pertaining to the operation of a computer system.

Sponsor means one or more DFI founders that is a source of 1 financial and governing strength for the institution. A sponsor should be a legal entity, or an individual with significant successful experience in the provision of developmental financial services, as evidenced by recent relevant experience.

Stakeholders means those with direct interest, involvement or 3 investment in the DFI. This includes the board, management, employees, stockholders, donors, funders, vendors and clients of the DFI.

Strategic planning means a formal process undertaken by the DFI that 6 considers all aspects of the business including its vision, mission and goals for the purpose of setting clear, achievable objectives and measurable ways to achieve them. The process should include an assessment of how resources (financial and human) will be allocated and result in a written plan and set of financial projections to aid the internal decision-making and provide a roadmap for achieving the DFI's objectives.

Subordinated debts means debt with inferior privileges to senior debt in 9 case of the bankruptcy of a DFI. Subordinated debt will carry higher interest rates than senior debt, to compensate for the added risk, and will typically have features in the contract allowing the debt to be converted to equity.

**Term** **Definition** **Standard**

Subsidiary ledger means records used for any general ledger account 21 that records numerous detailed transactions. DFI subsidiary ledgers are used to reduce the size and complexity of the general ledger, and enable the general ledger account to serve as a control account. Subsidiary ledgers serve an important role in controlling the integrity of data and providing the current status of a loan or savings balance.

Substance over form means the accounting treatment and presentation of 18 transactions should be governed by their substance and not merely by their legal form. This has further application for more advanced accounting topics and for specific issues related to amalgamations, special agency relationships or sophisticated investment vehicles.

Succession planning means a process for identifying and developing internal 5 personnel with the potential to fill key or critical DFI positions. Succession planning ensures the availability of experienced and capable employees that are prepared to assume these roles as they become available. It involves leadership development, talent development and staffing planning and development.

Summarization means transactions shall be properly posted to the DFI 18 general ledger (master files) and correctly summarized and aggregated. Whether the accounting system is manual or automated, adequate controls must be in place to make sure that classification, posting and summarization is correct.

Supervision means the part of the credit management process 11 undertaken by the DFI to determine whether a borrower will be able to continue to meet her obligations under the loan. It involves due oversight of the activities of credit staff to gain adequate knowledge of the borrower's affairs over the lifetime of the loan to ensure timely and adequate repayment.

SWOT analysis means the critical part of the strategic planning process 6 that considers internal Strengths and Weaknesses of the DFI and the Opportunities and Threats that the DFI faces in its operating environment particularly in relation to the objectives and goals of the DFI.

Tender means a formal process undertaken by a DFI to receive 12 quotations for the purchase of a specified good or service at a specified price.

Terms of reference means a written document that outlines the 20 expectations of the DFI with respect to the scope of audit work to be covered by the external auditors or other contracted service providers.

**Term** **Definition** **Standard**

Testing means the process undertaken by DFIs on a limited 10 scale and scope as part of the product development cycle to determine whether a new product or service (or refinement to an existing product) is worthy of a broader rollout. By pilot testing a new product before rollout, DFIs can avoid errors on a large scale that could be corrected based on the lessons learned from the limited test.

Training means organized activity designed to impart and build 5 participant knowledge, information, attitudes and skills to improve the participants ability and performance.

Transparency means the lack of hidden agenda or conditions, and 3, 21 full, open and available disclosure of both DFI and client information that is unrestricted for verification and review.

Unsecured loan means a loan that is not backed by collateral. 11 Unsecured loans are based solely upon the borrower's credit rating, character assessment or informal credibility. As a result, they are often much more difficult to get than a secured loan, which also factors in the borrower's income. DFIs generally target clients who do not have collateral for secured loans; the developmental finance sector is known for its character-based lending approaches.

Vacancies means unoccupied, budgeted employee positions to be 4 filled by the DFI for which recruitment actions should be taken.

Virus means a software program that can copy itself and is 13, 14 usually capable of causing great harm to files or other programs on the same computer.

Write off means to charge an asset amount to an expense or 8 loss in order to reduce the value of that asset and earnings. DFIs will write-off off loans that are considered uncollectible which means they will remove them from the accounting records; operationally, the DFI may still have a plan or strategy for pursuing collection efforts.

ANNEXURE 2

Additional Resources

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