

What are the microfinance services?

[Finance](#)



1. 0 Background Context

In the last couple of decades, Microfinance has become a very diverse and emergent industry. There are hundreds of institutions in Uganda providing Microfinance services; these institutions vary from grass root self-help groups and Non-Governmental Organisations (NGOs) to commercial banks that provide financial services to small and medium enterprises and low-income rural households. These MFIs receive support and services from donor agencies, investors, lenders, banks, charity organisations, and a series of other specialised businesses.

As MFIs are growing rapidly and are getting global recognition they must now maintain a certain industry-wide standard when they are reporting to the donors, lenders, and investors, so that their reports are acceptable and also comprehended by the recipients. As overseas financial transactions are now evitable, it is very important that a uniform standard of reporting is adopted in order to avoid confusion and misinterpretation. For this purpose, The SEEP Network[1] in 2005 developed a framework to provide Microfinance institutions and practitioners with a way to prepare financial statements and reports so that these reports can be analysed and strictly monitored and to also they are compliant with International Financial Reporting Standards (IFRS). However, according to a SEEP Report (2008) “ even after the establishment of a framework, some MFIs find it difficult to abide by, and many financial terms and indicators considered “ standard” continue to differ in name and content among MFIs. This leads to confusion among practitioners and analysts and causes considerable distortions when comparing MFIs”. Further more the report also provided an example saying

that the word ' delinquency' is usually used to signify arrears or portfolio at risk. However, arrears and portfolio at risk are two different accounting items; arrears measure the sum of all past due payments, whereas portfolio at risk is the total value of loans outstanding that have one or more past due payment. Therefore the use of certain terminology can lead to confusion.

As mentioned above, MFIs also find it hard to comply with the International Financial Reporting Standards completely. For example, MFIs normally follow a mixed accounting system where the accrual method of accounting is used for expenses and the cash method is used for interest earned on loans. Although the cash method of accounting may be acceptable for internal management reports, according to IFRS and International Accounting Standards (IAS) an adjustment for accrued interest is required.

2. 0 Introduction

It is often difficult for cross-border investors to comprehend financial statements that Microfinance institutions prepare following their respective nation's accounting principles. This statement is further supported by Zeghal and Mhedhbi (2006) stating that financial information prepared according to a national accounting system may no longer satisfy the needs of users whose decisions are more and more international in scope, this according to Murphy (2000, p. 471) is due to the expansion of foreign trade and cross border financial flows. As international borders are opening up, institutions, which are limiting themselves to purely domestic information, can prove to be a handicap for its own businesses development and as well as to investors who may have interest in the business. Research done by Gannon

and Ashwal (2004) suggests that there is a clear trend toward adopting IFRS as the single body of internationally accepted financial reporting standards. The research also revealed inconsistencies in national and international accounting practices. As a result many governments, accounting regulators and other governing bodies such as the SEEP Network and CGAP[2] for Microfinance Institutions coordinated to provide Microfinance practitioners with a means to develop reporting standards so that those reports can be used for meaningful analysis and monitoring and are in accordance with International Financial Reporting Standards (IFRS).

According to Ebbers and Flower (2002), the fundamental accounting issue faced by organisations operating globally is the difference in national accounting systems. Gebhart (2000) further added that accounting information for globalising companies, are a vital means of internal and external communication between managers, employees and foreign stakeholders from different national backgrounds. A unified financial reporting system meets the need of a common international language of accounting (Whittington, 2005) and enables companies to position themselves against competitors (Street, 2002).

As Microfinance is an emerging market, they are the targets of the worlds leading investors who operate in Western countries. To be effectively involved in this sector however, they must adopt international accounting standards that suit their needs (Zeghal and Mhedhbi, 2006). An important question that arises is whether reporting standards in a developed country can be effectively applied to a developing country. In this particular study, the developing country of focus is Uganda. According to the research <https://assignbuster.com/what-are-the-microfinance-services/>

conducted by Kinsey (2006) the differences in the culture and business environment in developed and developing countries are so vast that no one set of standards can be useful to both kinds of countries. But on the other hand, a report published by FASB (1999) argues that if international accounting standards are flexible enough to allow for differences in culture and business practices across nations, then one set of accounting regulations may be useful to developed and developing countries alike. The objective of this study is to assess whether the Microfinance sector in Uganda is converging towards developed country accounting and reporting standards (International Accounting Standards and/or IFRS) and the extent to which they have complied with such standards.

2. 1 Project Aim

The aim of this study is to establish the extent to which the Microfinance Sector in Uganda have adopted and complied with International Financial Reporting Standards (IFRS) and to ascertain the differences between the resulting financial statements and reports in comparison to IFRS.

2. 2 Project Objective

The objective of this study is to examine the accounting standards adopted by various organisations and institutions in the Ugandan Microfinance sector and to identify and analyse the organisations that have adopted IFRS.

2. 3 Research Questions

Have Ugandan MFIs adopted IFRS

To what extent have Ugandan MFIs complied with IFRS

2. 4 Structure of the Study

As seen above, the study first introduces the subject by providing background information on the problems faced by MFIs during the process of IFRS convergence. This chapter was then followed by a brief description and outline of the recognition of IFRS globally. The third chapter will carry out an extensive review of the relevant academic literature and will provide the theoretical background of the study as gathered from secondary sources. The fourth chapter explains data collection methods, and contains detailed information about the research methods that will be used for the study and in addition, includes an explanation as to how the chosen research methods will help answer the research questions. Chapter five consists of the discussion on the findings. The final chapter will contain a summary of the results and conclusions.

3. Literature Review

Research addressing the convergence or harmonisation of international accounting standards is both growing and becoming more empirical in nature; the studies mainly focus on the implementation or adaptation of the accounting standards (Zeghal and Mhedhbi, 2006; Goodwin and Ahmed, 2006; Larson and Street, 2004). The large public accounting firms and the World Bank conducted most other prior studies addressing convergence of IFRS and national standards. Limited studies have been conducted by the SEEP Network and CGAP on the reporting standards of the Microfinance sector. When the International Accounting Standards Board (IASB) announced the use of IFRS to address the reporting requirement it became an important opportunity for institutions from different sectors in developing countries, to

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be recognised and acknowledged by the developed world through their financial statements and annual reports. Uganda and its Microfinance sector is no exception.

As mentioned above, very limited studies have been conducted on the effect of IFRS in the Microfinance sector, therefore this study will assess whether the Microfinance sector in Uganda is converging towards international accounting and reporting standards and the extent of its compliance.

3. 1 International Accounting Harmonisation

International Accounting harmonisation is needed due to the globalisation of businesses and services and the increase in cross-border investments and borrowing. Harmonisation will help reduce the differences in financial reporting practices among countries involved in international trade. Nobes et al. (2008) define harmonisation “...as a process of increasing the compatibility of accounting practices by setting bounds to the degree of variations”. Murphy (2000, p. 472) also provided a similar definition stating that harmonisation is concerned with reducing the diversity that exists between accounting practices in order to improve the comparability of financial reports prepared by companies from different countries. However McLeay and Neal (1999) argued in their paper that the universal application of a uniform accounting method does not necessarily enhance comparability. They also clarified the fact that it is the availability of alternative accounting treatments and the use of the appropriate standards that produces financial statements to be more comparable.

3. 1. 1 The theory of International Accounting Harmonisation

McLeay and Neal (1999) described harmony as a situation where the odds of selecting a given method are not conditional on the country in which a firm operates. According to them, harmony does not depend on being a general acceptance of a uniform method but rather implies a movement towards a similarity in the choice between alternative accounting treatments. Doupnik and Perera (2007, p. 75) shared similar views stating, “ standardization implies the elimination of alternatives in accounting for economic transactions and other events whereas harmonization refers to the reduction of alternatives while maintaining a high degree of flexibility in accounting practices”.

Fuertes (2008) later came up with a reasonable difference between harmonisation and standardisation. He suggested that the main difference between harmonisation and standardisation lies in the degree of accuracy of the accounting standards. He further mentioned that harmonisation involves a reduction in accounting variations, while standardisation entails moving towards the eradication of any variation.

The following are the benefits of International Accounting Harmonisation noted by Zeghal and Mhedhbi (2006):

Harmonisation of international accounting enhances the quality of financial information;

It improves the comparability of accounting information in the international milieu;

It facilitates financial operations on an international scale, and thus

contributes to a better globalisation of capital markets;

It contributes considerably, especially for developing countries, to strengthening integration and competitiveness in financial markets.

3. 1. 2 Steps taken to Harmonise International Accounting Standards

For several decades, companies in many key industries have increasingly encountered more worldwide competition. They have responded to this challenge with strategies of globalisation. As Gebhardt (2000, p. 341) states, globalisation strategies involve increasing financing activities and are not restricted to operating and investing activities only. He also stated that for companies operating globally, accounting information plays a crucial role in the decision making process. Aware of this reality and the necessity to adapt a standardised accountancy to the dynamic business environment and to make sound decisions, accounting regulating authorities have taken initiatives to have a coherent set of accounting standards and practices that provide national and international institutions with a relatively homogenous information product that is comparable and reliable (Zeghal and Mhedhbi, 2006). To meet this objective, the International Accounting Standards Board (IASB) has prepared and published International Accounting Standards (IAS). Later IASB continued to develop its standards calling the new standard IFRS.

3. 2 Convergence to IFRS

According to Larson and Street, (2004, p. 91) many countries are intending to adopt International Financial Reporting Standards (IFRS) or are in the process of making the country's national accounting regulation converge

with IFRS. This convergence as stated by Jermakowicz and Gornik-Tomaszewski (2006, p. 191) “ would affect the country’s reputation as modern, organized and well regulated place to do business”. This means that both developed and developing or emerging countries will gain legitimacy in the business world. This was argued in a working paper by Ramanna and Sletten (2009) that powerful countries are less likely to adopt IFRS, according to them this is because powerful nations are less willing to surrender their standard setting authority to an international body. In their recent study in 2011, they concluded that there is a network benefit in the adoption of IFRS and this is enabling countries to shift away from their local accounting standards despite the unwillingness of developed countries to adopt IFRS. To attain these network benefits Judge et al. (2010) concluded that the institutional pressures within an economy are also a key driver of IFRS adoption.

After the establishment of International Accounting Standard Board (IASB) in 2001, according to Pickard (2006, p. 36) its main aim was to develop “ a single set of global financial reporting standards that will be both understandable and enforceable”. IFRS has extensively publicised the advantage of uniform global accounting standards, the features encouraging IFRS includes reduction of information risk and cost of capital, increasing transparency, facilitating cross-border investing, and enabling economic growth. Holthausen (2009, p. 447) later argues that the goal of uniformity in accounting standards will not be fully realised unless the primary institutional and economic conditions of the countries are also similar. He also stated “ if the underlying institutional and economic factors do not

become similar across countries over time, then the goal of similar financial reporting outcomes is not likely to be a desirable economic outcome”.

Moreover, evidence from research has shown that, even for countries that have claimed adoption of IFRS, complete convergence has not yet been achieved (Barth et al., 2008; Djatej et al., 2008). This means that deeply rooted political and economic factors vary from country to country, and these factors are likely to influence the complete convergence of IFRS in a given country.

3. 2. 1 Legal and Cultural influences in IFRS convergence

The legal and cultural need in different countries causes variations in accounting systems (Radebaugh et al., 2006). This means that the differences are not only between developed and developing countries but also between countries in the same region or that share a similar culture. According to Prather and Kinsey (2006, p. 142) due to vast differences in culture and business environment between developed and developing countries, one set of standards cannot be useful for both types of countries. They further argued that if international accounting standards are flexible enough to allow for differences in culture and business practices across nations, then one set of accounting regulations may be useful to developed and developing countries alike. Therefore, it is very important that the implementation of IFRS should not be driven entirely on maintaining a strict standard but should also consider the diversity of cultural and legal factors.

3.3 The Case of Uganda

3.3.1 Country context

Uganda occupies an area of 241, 038 sq km[3] in the heart of East Africa, with a total of over 34. 6 million (July 2011 est.)[4]. Approximately 94 percent of the poor live in rural areas where about 75 percent of the population lives (CGAP, 2004) and depend on Agriculture, which contributes about 36. 1 percent of the Gross Domestic Product (GDP).

Uganda's financial system is characterised by the co-existence of formal and informal financial markets. The formal financial markets, which mainly comprise of commercial banks, development banks and credit institutions mainly exist in urban areas and offer a narrow range of financial services. They concentrate on providing working capital mainly to medium and large-scale enterprises. Furthermore, the formal financial institutions are inflexible in their operations, with respect to the needs of the small-scale enterprises and the poor people in the rural areas who may not have collateral or well-written feasibility studies to solicit for loans. As such, the rural areas, where the majority of poor people live remain either under-banked or served by informal financial institutions.

3.3.2 Overview of the Accounting System in Uganda

The Institute of Certified Public Accountants of Uganda (ICPAU) is the only statutory licensing body of professional accountants in Uganda. It was established by the Accountants Statute, 1992, but did not commence operations until 1995. The ICPAU is empowered by the statute to establish accounting standards and to act as a self-regulatory organisation for

professional accountants, which includes requirements for practising as a professional accountant in Uganda.

The functions of the Institute, as prescribed by the Act, are:

To regulate and maintain the standard of accountancy in Uganda;

2. To prescribe or regulate the conduct of accountants in Uganda.

The objectives of the Institute include the regulation of accounting practice and the provision of guidance on standards to be used in the preparation of financial statements. As with most developing countries, and in cognisance with developments in the area of accounting at a global level, the ICPAU in 1999 adopted International Accounting Standards (IAS) without any amendments (Dumontier and Raffournier, 1998).

Prior to the adoption of IAS, there had been a proliferation of approaches to the preparation and presentation of financial statements in Uganda. One of the more obvious approaches to the presentation of financial statements was based on references to Generally Accepted Accounting Standards (GAAS) and firm regulations (Samuel Sejjak, 2003). A report from World Bank and IMF (2003) suggests that the accounting and financial system of Uganda is fundamentally sound and resilient and poses no threat to the macroeconomic stability of the country.

3. 3. 3 Adaptation of IFRS in Uganda

IFRS is a principle based set of 37 accounting standards. As the need for consistent worldwide reporting standards grows, the goal is to provide a general financial reporting guidance for public companies. Within the

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European Union (EU), companies with securities listed on stock exchange must adopt IFRS for their consolidated financial statements starting in 2005. Many other countries worldwide require IFRS as the leading reporting standard. Over 100 countries are currently using IFRS. There are many reasons for implementing IFRS. Most important is the comparability of financial statements worldwide. For investors and auditors the IFRS provide a cohesive view of the consolidated financial statements[1].

Since 1998, the Council of ICPAU has adopted International Financial Reporting Standards (IFRSs, IASs, SIC and IFRIC Interpretations) as issued by the International Accounting Standards Board (IASB), without amendment, for application in Uganda. International Financial Reporting Standards set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements.

The adoption of IFRS in Uganda to a larger extent is influenced by external factors such as foreign investors, international accounting firms, and international financial organisations amongst others. However, unless a country opens its doors to these institutions, there is little they can do to politicise the adoption process. The implication is that the more a country is open to the international environment, the higher the possibility that the country will be coaxed into following International Financial Reporting Standards.

3. 4 Overview of the Microfinance sector in Uganda

3. 4. 1 Microfinance

According to Marguerite Robinson (2001), “ Microfinance refers to small scale financial services for both credits and deposits that are provided to people who perform agricultural activities; operate small and medium enterprises in developing countries, in both rural and urban areas”.

Microfinance means transactions in small amounts of both credit and saving, involving mainly small-scale and medium-scale businesses and producers.

Microfinance Institutions (MFIs) set up centres in targeted areas with group members. These group members consists of 25 – 40 members per group but this number varies with different MFIs. The loans are normally disbursed to two or three of the members of self-selected groups (mostly female groups) and the whole group becomes responsible for the repayment by their fellow members. The other members only get their loans when the initial borrowers pay their installments regularly. Members have to attend regular meetings, usually weekly, to repay their loans.

The history of Microfinance is often associated with the rise of NGOs providing microcredit services to the poor and the development of a handful of microfinance banks. In the early 1990s, standards began to emerge calling for stronger financial management of microcredit providers, particularly in their delinquency management and reporting. At the same time, credit unions and banks involved in micro lending developed stronger monitoring techniques for their microcredit portfolios. As the Microfinance industry grew in capacity and outreach, the competition also started to increase. Therefore, it became important for the industry to introduce a reporting standard that

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would increase transparency, facilitate comparability, improve decision-making, and increase investment by making it easier to observe and understand an MFI's financial health.

MFIs in Uganda consist of moneylenders, micro-finance agencies, NGOs, rural farmers' schemes and savings societies that provide savings and/or credit facilities to micro and small-scale business people who have experienced difficulties obtaining such services from the formal financial institutions. Their range of activities include; deposit taking, savings schemes, small-scale enterprises, agriculture, real estate, group lending, retail financial services, giving advice on financial matters and training in business management.

The Microfinance industry in Uganda is in its advanced stage of evolution. Since the 1990s, Uganda has created a success story by developing the market for Microfinance services, which has been considered a role model for Africa and even other regions (Goodwin-Groen et al. 2004). Its growth and development will be a function of the support and effort of practitioners, donors and the Government working together to create an enabling environment for its development. It is readily apparent that the Government is committed to economic and financial reforms. In addition to the other reforms being implemented through its economic policy framework, the Government has shown its commitment to reforming the financial sector. Operationalisation of the Microfinance Policy and the legal and regulatory framework indicates renewed efforts and commitment to improving the financial system. The Government is acutely aware of the limitation of the traditional banking sector's ability to mobilise savings from and extend credit

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to poor people in rural and urban areas. These sections of society have a weak financial resource base and are in dire need of financial services that cater for its unique circumstances.

3. 4. 1 Regulatory Structure for Microfinance in Uganda

The current financial sector policy in Uganda aims primarily at systemic safety and soundness as a supporting bedrock for orderly growth. The policy, drafted by the Bank of Uganda and approved by the Government following multiple bank failures of the late 1990s, was significantly informed by the bitter lessons learnt from these failures and by incidences of fraudulent organisations that fleeced the public. The role of the Bank of Uganda, the financial sector regulator, is to ensure systemic safety, soundness and stability of the whole financial sector, and protection of public deposits in the regulated financial institutions.

The Bank of Uganda issued a policy statement in July 1999 that established a tiered regulatory framework for Microfinance business within the broader financial sector. The policy established four categories of institutions that can do micro-financing business in Uganda:

Tier 1: Commercial banks

Banks are regulated under the Financial Institutions Act revised in 2004.

Since these are already sufficiently capitalised and meet the requirements for taking deposits as provided for in this Act, they are allowed to go into the business of Microfinance at their discretion.

Tier 2: Credit Institutions (CIs)

These institutions are also regulated under the Financial Institutions Act 2004. A number of them offer both savings and loan products but they can neither operate cheque/ current accounts nor be part of the Bank of Uganda Clearing House. Like banks, they are permitted to conduct Microfinance business since they are already sufficiently capitalised and meet the requirements for taking deposits provided for in the Act.

Tier 3: Microfinance Deposit Taking Institutions (MDIs)

This category of financial institution was created following the enactment of the MDI Act. Originally doing business as NGOs and companies limited by guarantee, these institutions transformed into shareholding companies, changed their ownership and transformed/ graduated into prudentially regulated financial intermediaries. They are licensed under the MDI Act and are subjected to MDI Regulations by the Bank of Uganda. Like Tier 1 and 2 institutions (banks and CIs), the MDIs are required to adhere to prescribed limits and benchmarks on core capital, liquidity ratios, ongoing capital adequacy ratios (in relation to risk weighted assets), asset quality and to strict, regular reporting requirements.

Tier 4: All other financial services providers outside Bank of Uganda oversight

This category has SACCOs and all Microfinance institutions that are not regulated; such as credit only NGOs, Microfinance companies and community based organisations in the business of Microfinance. These institutions have a special role in deepening geographical

and poverty outreach, and in other ways extending the frontiers of financial services to poorer, remote rural people.

3. 4. 2 Microfinance Reporting Standards

Microfinance as an industry does not have a central body or mechanism to address compliance or updates to financial reporting standards. MFIs worldwide do not follow standards, and are only now beginning to use tools like International Financial Reporting Standards (IFRS) (SEEP report, 2009). According to Tulchi (2009) Microfinance reporting is gaining momentum with lots of new activity, including a standards adoption process adapted from the International Accounting Standards Board (IASB). According to a working paper by Helms (2002), MFIs have trouble producing accurate and meaningful reports about their financial and social performance. The reason for this is highlighted in a Survey conducted by Elisberg (2009) from SEEP Network that, showed that most of the Microfinance institutions have their own tool for financial reporting and their motivation for reporting standards varied. Elisberg further added that most of these reports were mainly for internal management and operational control. This means that reports for donors often leave out the key institutional indicators needed to manage an MFI, to judge its performance, and to compare it with others.

Since 1990, MFIs have grown in size, type, number, and complexity (Bank of Uganda report, 2005). At the same time, more emphasis has been placed on financial accountability, management, and viability. A growing acceptance of standards for Microfinance has emerged since the early 1990s. In 1995, The SEEP Network produced a monograph, Financial Ratio Analysis of MFIs, which became the standard set of 16 ratios that Microfinance institutions

monitored. Then, in 2002, Microfinance institutions, The SEEP Network, rating firms and donor agencies jointly developed Microfinance Financial Definitions Guidelines: Definitions of Selected Financial Terms, Ratios, and Adjustments for Microfinance, known as the Financial Definitions Guidelines.

4. 0 Methodology

4. 1 Introduction

The research involves analysing the index and the quality of the annual reports of the Microfinance industry. Therefore, the focus of this study is to analyse quality of the annual reports and financial statements of the sampled MFIs in Uganda with IFRS and to observe the degree of compliance of the published accounting information with IFRS.

4. 2 Research Technique

The work of this study will be based on desk research only. A desk-based research technique involves gathering data and information that already exists either from internal sources of the client; publications of governmental and non-governmental institutions, free access data on the internet; in professional newspapers and magazines; in annual reports of companies and commercial databases. The reason for selecting a secondary research method is because of a lack of funding and the large amount of information that is readily available. Since this study is mainly to analyse the quality of the annual reports of Microfinance institutions compared to IFRS, a primary study is not be required.

Issues during the study were that the annual reports were not current and the information that was available was very limited. Also the sample size was very small thus eradicating MFIs not listed and working at the village level. Another important issue were that the financial statements that were analysed had all been audited and this therefore does not provide us with a complete picture of whether the MFIs have successfully adopted and complied with IFRS.

This research technique has been introduced because to establish a vital link between theoretical frameworks and empirical observation. The study will mainly focus on the comparative examination of the annual Financial Reports of MFIs in Uganda registered by the Bank of Uganda (BoU) with the IFRS guidelines. To conduct the study, I first identified the largest 10 MFIs in terms of portfolio size registered under the BoU. The sample consists of the top 10 performing MFIs in Uganda, which are rated and ranked by the Microfinance Information Exchange (or the MIX), a not-for-profit private organisation that aims to promote information exchange in the microfinance industry[1]. The selections of the MFIs are based on the ranking provided by the MIX market[2].

Previous studies have shown that the case study approach has been undertaken to investigate the effects of IFRS implementations (Albu, 2011, Kholeif 2008, Sucher 2004). Other studies indicate the use of comparative analysis technique to understand the effect of IFRS implementation (Djatej and Gao, 2011). The study conducted by Dunne et al. (2008), which examined the implementation of IFRS and its effect, content analysis, was used as the research technique to analyse the annual reports. Content

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analysis has been used in numerous other accounting and finance research studies (Jones and Shoemaker, 1994; Gray et al., 1995; Dunne et al., 2003). The present analysis has taken into account the previous work on content analysis, especially the framework developed by Dunne et al. (2008).

According to Stake (1978, p. 5) the case study method is very down to earth and attention-holding method; however, he also mentioned that it is not a suitable method for generalization. Furthermore, Gallier (1992) mentioned that data collection and data analysis processes in case study research are both subject to the influence of the researchers characteristics and background and rely heavily on the researchers interpretation of events and documents. This may limit the validity of the research findings of the present study.

Comparative analysis is best described by Jochen (2004) as a research method that aims to make comparisons across different cultures, countries and companies. However he also states that the data sets in different countries and institutions may not use the same categories, or may define categories differently. As this study is not focusing on any comparisons between organisations and cultures comparative analysis method will not be appropriate. The study mostly focuses on the degree of compliance of IFRS in the micro finance institutions in Uganda; therefore, no comparison will be required of the past and present trends in this study.

This chapter examines the effects of IFRS on the annual reports and accounts of a sample of top 10 performing MFIs in Uganda. In particular, a content analysis is used to explore and identify the level of compliance in the

magnitude and nature of IFRS related disclosure evident in these documents. The study conducts this method of analysis for all IFRS related disclosure, as well as for different categories of information. In addition, the analysis is performed for a particular industry sector and a limited selection of institutions.

4.3 Content Analysis

This method is used in order to collect data on the magnitude and nature of disclosures relating to IFRS implementation provided in a sample of 10 Micro finance institutions annual reports. More details relating to the specific application of the technique in the present study are provided later in this chapter. However, this section provides a brief overview of the content analysis method and its appropriateness in the present study.

Content analysis has been defined as a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding (Berelson, 1952; Krippendorff, 1980; and Weber, 1990). Content analysis enables researchers to sift through large volumes of data with relative ease in a systematic fashion. According to Weber (1990) content analysis can be a useful technique for allowing one to discover and describe the focus of individual, group, institutional, or social attention. Thus, Weber (1985) explained that content analysis is a method of codifying the text (or content) of a piece of writing into various groups (or categories) depending on selected criteria. The implication is that a larger volume of disclosure for a particular category suggests that the category is important to authors or readers of the text or document. In essence, it is a qualitative method of determining characteristics of interest based on grammatical

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structure, word content, and other fundamental characteristics of communication. Content analysis has been used to describe the content of stock analyst reports where financial and operating data is most often cited as indicating determinants of interest.

There are two general categories of content analysis: conceptual analysis and relational analysis. Conceptual analysis can be thought of as establishing the existence and frequency of concepts, most often represented by words or phrases in a text. In contrast, relational analysis goes one step further by examining the relationships among concepts in a text[3].

4. 3. 1 Conceptual Analysis

Traditionally, content analysis has most often been thought of in terms of conceptual analysis. In conceptual analysis, a concept is chosen for examination and the number of its occurrences within the narrative. Because terms may be implicit as well as explicit, it is important to clearly define implicit terms before the beginning of the counting process. To limit the subjectivity in the definitions of concepts, specialised dictionaries are used. As with most other research methods, conceptual analysis begins with identifying research questions and choosing a sample or samples. Once chosen, the text must be coded into manageable content categories. The process of coding is basically one of selective reduction, which is the central idea in content analysis. By breaking down the contents of materials into meaningful and pertinent units of information, certain characteristics of the message may be analysed and interpreted[4].

4. 3. 2 Relational Analysis

Relational analysis, like conceptual analysis, begins with the act of identifying concepts present in a given narrative. However, relational analysis seeks to go beyond presence by exploring the relationships between the concepts identified. In other words, the focus of relational analysis is to look for semantic, or meaningful, relationships. Individual concepts, in and of themselves, are viewed as having no inherent meaning. Rather, meaning is a product of the relationships among concepts in a narrative text[5].

4. 4 Measurement Techniques

In order to act as an effective research tool, content analysis must incorporate key characteristics; in particular, the process must be reliable and valid (Krippendorff, 1980; 2003). Reliability is one of the distinguishing characteristics of content analysis,

in contrast to other techniques that are often used when describing or analysing the content of communication (Krippendorff, 2003). Validity is the standard of having a good measurement that incorporates the criteria of reliability, accuracy and precision (Neuendorf, 2002). Neuendorf mentioned four types of measurement techniques for content analysis: Reliability, Validity, Accuracy and Precision. Neuendorf further mentioned that a measure could not be valid if it is not reliable, accurate and precise whereas on the other hand, a measure that is reliable, accurate and precise may still be invalid. Reliability can be defined as the extent to which a measuring procedure yields the same results on repeated trials (Neuendorf, 2002). According to Jones and Shoemaker (1994) validity narrates to how sound the results of a study mirror reality; in order to improve validity one needs to

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develop a coding scheme that guides coders in the analysis of content (Krippendorff, 2003). Accuracy is the extent to which a measuring procedure is free of bias and non-random errors (Neuendorf, 2002). Precision signifies the finesses of distinction made between categories or levels of a measure (Neuendorf, 2002).

4.5 Advantages and Disadvantages of the Content Analysis method

According to Kabanoff, Waldersee and Cohen (1995) content analysis offers an important technique for the study of organisations. Content analysis has several more advantages, which are summarised by Brymen and Bell (2007):

Content analysis is useful when researching sensitive issues. In context of this study, analyzing the annual report of the micro finance institutions can be complex. For example most MFIs operate with a dual bottom line objective, which is to make profit as well as provide service to the poor, this issue can be very sensitive towards the MFIs.

Content analysis is used to conduct studies because it provides valuable insights into the data.

Content analysis provides a discreet means of analysing interactions

Content analysis provides valuable historical/cultural insights over time through analysis of the texts

Content analysis can be used for qualitative and quantitative study

Content analysis allows the author to gain access to information that is usually difficult to obtain.

Content analysis has some limitations according to Brymen and Bell (2007):

Content analysis alone cannot provide the answer to “ why” research questions. However as this study only seeks to get an insight to the degree of IFRS compliance, the technique is appropriate.

It proves to be very time consuming

4. 6 Data and Analysis

Within the present study, content analysis is viewed primarily as a qualitative research method, although the quantitative nature of the data collected in the process is acknowledged. The content analysis initially requires the selection of the institutions to be included in the investigation and the main focus of the research involves an analysis of the annual reports of the institutions. The aim of this element of the research was to examine the effect of IFRS on the financial reporting practices of a sample of micro finance institutions in Uganda. This analysis focused on the non-financial statement sections and the financial section, which includes Income Statement/Profit & Loss Account, Balance Sheet, Cash Flow Statement, notes to the financial statements, and Reconciliation Statement provided in the annual reports.

The annual reports of the 10 MFIs that were considered were used as the principal focus of the content analysis, primarily because accounting regulations and IFRS in particular are aimed at the accounting treatments and disclosures provided in these documents. According to Gray et al. 1995, the annual report is usually viewed as the main form of corporate communication. The emphasis has been mainly on the interpretation of the Balance Sheet and Income Statement and also to the explanatory notes that accompany these statements.

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The analysis of the Income Statement was done according to the revenues and expenditures whilst in the Balance Sheet the information relating to fixed assets, current assets, liabilities and equity were examined.

4. 7 Results

The analysis of the results of the content analysis is divided into the following sections:

Whether IFRS is disclosed in the annual reports of the sampled MFIs. The way and the format of presenting accounting information in the published Financial Statements.

A breakdown of the information provided in the Financial Statement into three categories: a) Balance Sheet; b) Income Statement; c) Cash Flow Statement

4. 7. 1 Disclosure of IFRS in the Annual Report

According to McLaughlin and Sa? eddine (2008) information irregularity can be reduced by disclosure regulation. However, Bushee and Leuz (2005) suggested that implementation of disclosure regulation can prove to be very costly and thus institutions should find more information on alternative ways to affect the firm's transparency. From Brennan and Marston's (1999) point of view, there are a number of perspectives from which financial disclosures can be considered. These perspectives include recognition, measurement in the context of disclosure, and finally purposes of disclosures. They further stated that categorization of items in financial statements is a form of disclosure as well as recognition. The result in this study shows that six of the sampled MFIs complied with disclosure and all of the MFIs use

appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Ugandan Companies Act (Cap 110) and Financial Institutions Act, 2004.

Table: 1

Institutions IFRS Disclosure

Centenary Bank Strong

Equity Bank Strong

BRAC Strong

Financial Trust Strong

Finca Strong

Opportunity International Strong

Pride Fair

Micro Enterprise Development Network (MED) Fair

Micro Uganda Limited (MUL) Fair

Silver Upholders Ltd Poor

4. 7. 2 Presentation of the Accounting Information

As a requirement of the Ugandan Companies Act (Cap 110) the institutions are required to prepare financial statements for each financial year that gives a true and fair view of the state of the institutions as at the end of the financial year. The true and fair view is applied in ensuring and assessing whether accounts do indeed portray accurately the business' activities.

However, Kirk (2006) argues that the concept of true and fair view is very

competing but not mutually exclusive in legal or professional standards for financial reporting quality.

The Act further requires the institutions to keep proper accounting records, which disclose, with reasonable accuracy, the financial position. The analysis suggests that the Micro Finance Institutions are preparing a fair presentation of the financial statements according to IAS 1 except for one MFI. The analysis further states that 9 out of 10 MFI's prepared financial statements are free of material misstatements, and the institutions have undertaken appropriate accounting policies; and are making accounting estimates that are reasonable in the circumstances.

Table: 2

InstitutionsIAS 1

Centenary Bank?

Equity Bank?

BRAC?

Financial Trust?

Finca?

Opportunity International?

Pride?

Micro Enterprise Development Network (MED)?

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Micro Uganda Limited (MUL)?

Silver Upholders Ltd?

4. 7. 3 Analysis of the Financial Statements

After the examination of the annual reports of 10 Micro finance institutions, the empirical findings are presented in this section. This section mainly concentrates on the effect of IFRS adoption, in the way and the form of disclosing accounting information to the published Financial Statements. According to Arvidsson (2011, p. 278) the financial statements in the annual report is a good proxy for the level of disclosure a company provides. On the other hand Birgul et al. (1999) argued that whether the information released by financial analysts can act as a substitute for the deficiency of the quality of the firm's own disclosure policy. As all the financial statements in the annual reports examined in this study are audited, therefore Holt and Todd (2009) suggested that stakeholders who are provided with an audit report have more confidence in financial reporting reliability. The following is the breakdown of the financial statement of the micro finance institutions and the analysis presenting the degree to which the institutions have complied with the IFRS regulations.

4. 7. 3. 1 The Balance Sheet

Property, Plant and Equipment: According to IAS 16 all institutions should account for its property, plants and equipment. This will help the institutions to recognize the assets; to determine the amounts they are carrying and to charge depreciation and impairment losses. An item of property, plant and equipment that qualifies for recognition, can be evaluated either by Cost

model (asset shall be measured at its cost) or by Revaluation model (measured at its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses).

After analyzing the 2009 annual reports of the micro finance institutions in Uganda the result suggests that most MFIs property, plants and equipment are stated at cost and one MFIs used both cost and valuation method, less accumulated depreciation and accumulated impairment in value.

Depreciation: Reflecting back to IAS rules, the depreciation method used by the institutions should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The depreciation method that is applied to an asset should be reviewed at the end of each financial year and if there are any significant changes in the expected future economic benefit of the asset, the depreciation method should also be changed to reflect the changed pattern. Depreciation is calculated using two methods namely the Straight-line method and the Reducing Balance method. All the sampled micro finance institutions calculate depreciation according to the IAS standards, all MFIs in the sample used the straight line method and only one used straight line as well as the reducing balance method at annual rates estimated to write off the carrying value of assets over their expected useful life.

Intangible Assets: According to IAS 38 an intangible asset is an identifiable non-monetary asset without physical a substance. This means that the specific entry includes only the cost for purchasing and installing software programmes and establishment charges, rights, trademark and licenses and also the goodwill that arises from the acquisition of a company. The analysis of the 10 institutions revealed that only 60% of the MFIs disclosed

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information of intangible assets in the annual report.

Incorporate Transactions: IAS 24 suggests that the relationships between parents and subsidiaries should be disclosed irrespective of whether there have been transactions between those related parties. It further suggests that an entity should disclose the name of the entity's parent and if different the ultimate controlling party. Also it is required to disclose the transactions between the associated parts (subsidiaries, affiliated companies, Board of directors, member and shareholders), either in separate balance sheet or in the explanatory notes. All though most of the MFIs taken into consideration for this study are multi-nationals and operates globally, no related party disclosure are mentioned in the annual report financial statement. This may be because these institutions operate independently from the parent organization and may not have any transaction between the related parties.

Provisions: IAS 37 defines provisions as liabilities of uncertain timing or amount. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure. Provisions are made by all MFIs in the sample for loans and advances and there is an overall general provision. The percentage of provision differs from institution to institution.

Table: 3

Institutions IAS 16

Depreciation

IAS 38

IAS 37

Centenary Bank?

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Equity Bank?

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BRAC?

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Financial Trust?

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Finca?

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Opportunity International?

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Pride?

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Micro Enterprise Development Network (MED)?

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Micro Uganda Limited (MUL)?

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Silver Upholders Ltd?

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4. 7. 3. 2 The Income Statement

Revenue: According to IAS 18 revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. Revenue should be measured at the fair value of the consideration received or receivable.

According to IAS 18 revenue recognition and classification are as follows:

Sales (goods or products)

Rendering of services

Revenues from interest and rights

Revenue from dividends

As most of the revenue in a micro finance institution comes from interest income therefore, according to IAS 39 when applying the effective interest method, an entity generally repays any fees, points paid or received, transaction costs and other premiums or discounts included in the

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calculation of the effective interest rate over the expected life of the instrument. According to the annual reports 8 out of 10 MFIs has completely disclosed the use of effective interest rate. Even though the calculation is shown but a proper disclosure in the notes are not available.

The effects of Changes in Foreign Exchange rates: IAS 21 states that a foreign currency transaction should be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of transaction. The regulation also states that at the end of subsequent reporting periods foreign currency monetary items should be translated using the closing rate. The financial statements of the institutions are presented in Uganda Shillings, which is the functional currency.

Transactions in foreign currencies are initially recorded at the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. Only two MFIs have prepared their financial statement using US dollar and the functional currency. But all institutions dealing with foreign currency have mentioned in their annual report.

Accrual Basis: According to the IAS 1 framework, financial statements should be prepared on the accrual basis of accounting. This means that the effect of transactions and other events are recognized when they occur (and not as cash or its equivalent is received or paid) and the transactions are recorded in the accounting records and report in the financial statements of the period to which they relate. The analysis shows that 6 MFIs have disclosed in their

annual report that they follow the accrual basis while calculating income from interest. The other remaining institutions failed to mention the use of accrual basis accounting to prepare their financial statements.

Table: 4

Institutions IAS 39

IAS 21

IAS 1 (Accrual)

Centenary Bank?

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Equity Bank?

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BRAC?

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Financial Trust?

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Finca?

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Opportunity International?

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Pride?

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Micro Enterprise Development Network (MED)?

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Micro Uganda Limited (MUL)?

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Silver Upholders Ltd?

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4. 7. 3. 3 Cash Flow Statement

According to IAS 7 statement of cash flow should report cash flows during the period classified by operating, investing and financing activities. It also states that cash flows arising from the above mentioned activities should be reported on a net basis, which means a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short. Ninety percent of the MFIs prepared the cash flow statement and disclosed it in the annual report whereas one MFI did not disclose the cash flow statement.

4. 7. 3. 4 Explanatory Notes

IAS 10 is responsible for the explanatory notes or “ events after the reporting period adjustments”. These adjustments arises when both favourable and un-favourable events occurs between the end of the reporting period and the date when the financial statements are authorized for issue. Two types of events are identified by IAS 10 a) adjusting events after the reporting period; b) non- adjusting events after the reporting period. All MFI comply with the disclosure of the explanatory notes, even though one MFI failed to comply completely.

4. 7. 4 Disclosure and Presentation of Risk Management

According to IFRS 7 an entity should disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period. After analyzing the reports 7 MFIs disclosed detailed information on risk management, 2 MFIs discussed briefly in their annual report and one MFI did not disclose any information on risk management.

Risk associated with micro finance institutions are as follows:

Credit Risk: The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Only 7 MFIs disclosed and presented the credit risk analysis of their institution.

Currency Risk: The risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Only 30% of the institutions did not disclose the currency risk factor in the annual report and the rest of the institutions complied with it and presented in the form of Market risk factor.

Interest Rate Risk: The risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk management was complied by 7 MFIs and the remaining MFIs failed to disclose any form of market risk factor.

Liquidity Risk: The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The liquidity risk management was disclosed by 7 MFIs.

Table: 5

Institutions
Credit Risk

Currency Risk

Interest Rate Risk

Liquidity Risk

Centenary Bank?

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Equity Bank?

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BRAC?

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Financial Trust?

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Finca?

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Opportunity International?

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Pride?

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Micro Enterprise Development Network (MED)?

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Micro Uganda Limited (MUL)?

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Silver Upholders Ltd?

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5. 0 Discussion:

When comparing the annual reports we noted that 2 institutions are commercial banks providing micro finance services and falls under the tier 1 regulatory structure, 2 institutions are credit institutions which categorizes as tier 2 entities, 2 institutions are termed as Micro finance Deposit taking Institution (MDI) and they regulates under tier 3 rules and regulations and the remaining 5 institutions are registered as micro finance institution under the tier 4 regulatory system.

As shown in the analysis in the previous chapter more then half of the sampled entities providing micro finance services comply completely with <https://assignbuster.com/what-are-the-microfinance-services/>

IFRS whereas, rest are still struggling to comply. It's been noticed that institutions under tier 1, 2 & 3 and couple under the tier 4 regulatory system have complied with the IFRS procedures. This may be due to the fact mentioned by Paananen and Lin (2008, p. 10) that adoption of IFRS can be a major challenge due to its complexity, high cost, and the lack of implementation guidance. This means that adoption and implementation of IFRS is very expensive and cannot be afforded by all. Referring to the annual reports the following table shows the total assets of the sampled institutions and how they have complied with IFRS:

Table: 6

Institutions Total Assets in ?

IFRS Disclosure

Centenary Bank 137, 323, 355

Strong

Equity Bank 36, 469, 058

Strong

BRAC 11, 536, 870

Strong

Financial Trust 8, 797, 683

Strong

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Finca7, 851, 906

Strong

Opportunity International5, 808, 912

Strong

Pride1, 581, 298

Fair

Micro Enterprise Development Network (MED)1, 384, 223

Fair

Micro Uganda Limited (MUL)624, 984

Fair

Silver Upholders Ltd96, 095

Poor

The above table clearly shows the level of IFRS disclosure varies with the capacity of the institutions. Even though all the organisations have adopted IFRS, they did not comply with the standard completely. IFRS has been developed with the goal to make the financial markets more efficient.

Forsberg (2010) mentioned in his paper that even though the implementation of IFRS is expensive but the benefit which will derive from more efficient financial markets is bigger than the cost of adopting IFRS. As mentioned in the literature review Radebaugh et al. (2006) argued the fact <https://assignbuster.com/what-are-the-microfinance-services/>

that increasing harmonization of accounting standards contradicts the interest of the domestic institutions. The results in this study almost verify both these arguments; because implementing IFRS into the IT system of MFIs and also developing human resource to support it requires a considerable amount of investment and hence domestic institutions find it difficult to maintain a low cost structure. This investment is very questionable for most of the MFIs since they operate as an NGO in the rural areas and rely heavily on foreign donations.

Expanding the reach of the micro finance sector and entering the cross border markets for attracting foreign investment and recognition, IFRS needs to be facilitated. Doupnik and Perara (2008) in their book stated that international accounting standards are essential in order to eliminate the obligation to follow the financial reporting requirements of foreign countries for the institutions seeking to increase foreign investments. Based on the findings of this study micro finance institutions are adopting IFRS and this has proven to be very beneficial for the institutions, donor agencies and investors. This adoption has enhanced the comparability, transparency and reliability of the financial statements and also created an opportunity for the information users to have an access to the right information.

Despite the institutional differences between the MFI samples, the findings suggest that all the micro finance institutions generally share a similar insight of the meaning of the phrase 'true and fair view'. The findings also show that even though the institutions are providing a true and fair view of their financial affairs it does not completely associate itself with the compliance of IFRS. This means that it is not necessary to completely comply

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with IFRS to present a true and fair view of the financial statements. This statement however contradicts the study done by Laswad (1998) where he concluded that true and fair view is linked with the technical than the qualitative aspects of financial reporting. As the sample size is very small for this study further research is required to explicate this difference.

As mentioned earlier that institution with low financial capacity finds it difficult to comply with IFRS entirely. Other reasons for this non-compliance may include lack of education level, existence of a financial market and cultural membership factors (Zeghal and Mhedhbi, 2006, p. 384). In the study carried out by Sejjaaka (2003), it was mentioned that the compliance of IAS in Uganda is very low and this was due to the fact that financial institutions