Promoting Professionalism in Accountancy

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

GUIDELINES FOR AUDITING TIER IV FINANCIAL INSTITUTIONS

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Purpose

These Guidelines are designed to assist accounting firms in the audit of Tier IV institutions in Uganda. These institutions vary in size and complexity, and there is often a public interest element to them. This, combined with the specialist requirements that must be met, increases the risks to auditors when carrying out the audit of such institutions. The ICPAU Quality Review (ICPAU QR) team regularly reviews audits to ensure that the specialist aspects have been properly addressed and often finds that these are not approached in a consistent manner. These Guidelines aim to assist accounting firms in the consideration of particular areas of interest, including developing an understanding of Tier IV institution related risks; compliance with laws and regulations; appropriately tailored engagement letters; and auditors' reports. These Guidelines provide a simplified demonstration to assist the auditors to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.

Disclaimer

These Guidelines are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in International Standards on Auditing. The Guidelines are not intended to be comprehensive or to deal with all situations that might be encountered, i.e. they are supplementary to and not a substitute for the International Standards on Auditing (ISA) and the relevant laws and regulations, which should be regarded as the primary source of guidance for auditors. Each practitioner is encouraged to apply professional judgment in guidance provided herein after. ICPAU disclaims any responsibility or liability that may occur, directly or indirectly, as a consequence of the use and application of the Guidelines.

ABOUT ICPAU

The Institute of Certified Public Accountants of Uganda (ICPAU) was established in 1992 by the Accountants Act, Cap 266. This has now been repealed and replaced by the Accountants Act, 2013.

The functions of the Institute, as prescribed by the Act, are to regulate and maintain the Standard of Accountancy in Uganda; and to prescribe and regulate the conduct of accountants and practising accountants in Uganda. Under its legal mandate, the Institute prescribes professional standards to be applied in the preparation and auditing of financial reports in Uganda.

Vision

To be a world class professional accountancy institute.

Mission

To develop and promote the accountancy profession in Uganda and beyond.

Core Values

1) Professional Excellence
2) Accountability
3) Integrity
4) Innovation

International Affiliations

The Institute is a member of the International Federation of Accountants (IFAC) and the Pan African Federation of Accountants (PAFA).

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

GUIDELINES FOR AUDITING TIER IV FINANCIAL INSTITUTIONS

1.0 INTRODUCTION

The purpose of this Paper is to assist the auditor to develop an approach to the audit of the financial statements of microfinance institutions and money lenders with particular focus on those operating under the Tier 4 Microfinance Institutions and Money Lenders Act 2016 and the Tier 4 Microfinance Institutions and Money Lenders Regulations 2018. Microfinance generally can be defined as the provision of banking services such as savings, credit, insurance and payment products to low income clients, including the self-employed. Microfinance services are designed to be more affordable to the poor and socially marginalized people to help them become more self-sufficient. Microfinance in Uganda started gaining ground in the mid-1990s, mainly as donor funded projects. The Ministry of Trade, Industry and Cooperatives reported more than 1,500 registered SACCOs as of the end of 2015[1].

This Guidance paper has been prepared by the Institute of Certified Public Accountants of Uganda (ICPAU) in consultation with the Uganda Microfinance Regulatory Authority (UMRA) to guide the audit of institutions that provide microfinance services.

The Paper is based on the provisions contained in the International Standards on Auditing (ISAs) as well as Microfinance Institutions laws and regulations in effect as at March 2019. These include:

(a) The Tier 4 Microfinance Institutions and Money Lenders Act 2016 (the Act)
(b) The Tier 4 Microfinance Institutions and Money Lenders Regulations 2018 (the Regulations)
(c) Relevant rules, guidelines and codes issued by the UMRA and the international accounting and auditing standards.

Best practice auditing norms have also been adopted and incorporated under particular areas. Every care has been taken in its preparation. However, the legislation itself is the sole authority of the law and these Guidelines should be used in conjunction with the legislation.

[1] Clark Heather (2016): RIF Mapping: Uganda, AMFIU, 2016.

2.0 REGULATORY BACKGROUND

As per the requirements of the Act, all Tier 4 microfinance institutions and money lenders are required to be licensed and managed by the Uganda Microfinance Regulatory Authority (UMRA). Such institutions comprise of;

a. SACCOs
b. Non-deposit taking microfinance institutions
c. Self-help groups
d. Community based microfinance institutions

The auditor would need to be familiar with the regulatory background of these institutions, in particular the requirements of the Act and the Regulations as well as the rules, guidelines and codes issued by UMRA and the accounting aspects of their operation before commencing the audit.

The main functions of UMRA are to:

(a) License tier 4 microfinance institutions
(b) Promote programmes and interventions that are necessary for the development of tier 4 microfinance institutions
(c) Protect the interests of the members and beneficiaries of tier 4 microfinance institutions including the promotion of transparency and accountability by non-prudential standards.
(d) Promote the stability and integrity of the financial sector through ensuring the stability and security of tier 4 microfinance institutions
(e) Ensure the sustainability of the microfinance sector with a view to promote long term capital development
(f) Ensure and enforce standards of sound business and financial practices for tier 4 microfinance institutions
(g) Collect and publish statistics related to the operations of tier 4 microfinance institutions
(h) Manage a savings protection scheme and stabilization fund for tier 4 microfinance institutions
(i) Advise the minister on matters relating to the development and operation of tier 4 microfinance institutions
(j) Prescribe performance indicators for tier 4 microfinance institutions
(k) Establish a mechanism of reporting by tier 4 microfinance institutions to the Credit Reference Bureau
(l) Prescribe minimum capital requirements
(m) Regulate and supervise self-help groups and commodity based microfinance institutions
(n) Supervise, control and administer the assets of the Authority in such a manner and for such purposes as is best to promote the purpose of this Act

(o) Perform any other activity necessary to facilitate the discharge of its functions and for giving full effect to this Act.

3.0 UNDERSTANDING TIER 4 FINANCIAL INSTITUTIONS IN UGANDA

Majority of the Tier 4 Institutions are now concentrating on mobilization of savings and advancing loans to members on a commercial basis. This arose a need for government to regulate the operations of these entities so as to protect the interests of the members. The Act provides that

i. No microfinance institution shall carry on business of financial services unless it's a registered society and licensed under the Tier 4 Microfinance Institutions and Money Lenders Act 2016.
ii. Tier 4 microfinance institutions are required to furnish UMRA with periodic reports of operations of the institutions.
iii. Microfinance institutions are obliged to keep proper books of accounts which may be inspected by the Authority at any time.
iv. A Tier 4 microfinance institution that intends to operate Islamic microfinance ought to have approval from UMRA along with proof of compliance of proposed dealings and transactions with the Sharia

The Act further provides for specific requirements for the respective Tier 4 Microfinance Institutions, for example:

a) SACCOS are required to:
   i. Pay a prescribed annual fee in respect of the license
   ii. Maintain the minimum equity that is set by UMRA.
   iii. Have a credit policy which shall include the terms and conditions of repayment, the maximum amount that may be borrowed and acceptable forms of security for loans. SACCOS shall then provide credit according to the terms and conditions prescribed in the credit policy of the SACCO.
   iv. Maintain the following;
      - A reserve fund comprising 10% of the annual surplus from the operations of the SACCO.
      - A share transfer fund to which not more than 5% of the surplus if any will be transferred.
      - Contribution to the Education Fund which shall be 1% per year of its turnover
      - Any other reserve(s) as may be approved by members in the general meeting
   v. maintain
      - A stabilization fund intended to provide financial assistance to SACCOs in distress. The monies advanced to the fund shall be annual contribution from each SACCO equivalent to 0.5% of the SACCO's average total assets and money realized from assets purchased from a SACCO in the process of dissolution

- A savings protection fund. The annual contribution to be made by each SACCO shall be determined by UMRA or as appropriated by Parliament

vi. invest or deposit funds only in-

- A registered cooperative bank
- Any registered society, company or statutory corporation approved in writing by UMRA
- Any bank or financial institution incorporated in Uganda
- Securities allowed by law for the investment of trust funds
- Such other mode as specified by the byelaws of the society and approved by UMRA

vii. Pay dividends or bonuses or bonuses or distribute any part of its accumulated funds without the prior written consent of UMRA.

b) Non-Deposit Taking Microfinance Institutions

These institutions shall be licensed annually by UMRA to assist in the development of micro, small and medium sized businesses as well as expanding access to micro loan resources to individuals for the promotion of their businesses, livelihoods and land holdings.

The Act prohibits them from

- Raising monies in form deposits from individuals
- Acting as a surety for the obligations of the shareholders of the non-deposit microfinance institution or third parties
- Lending loan insurance funds
- Providing collateral for its members or third parties
- Disposing of institution's assets that results in a 10% reduction of the book value of the assets without the approval by UMRA.

In regard to audit and general management accounts, the Act requires non-deposit taking institutions to

- Submit annual report to UMRA within 3 months after the end of a financial year.
- Prepare an annual report shall containing audited financial statements, structure of management any other information as UMRA may from time to time.
- Keep proper books of account which may be inspected by the Authority at any time. These books of accounts shall be kept for at least 7 years

Typical financial statements for non-deposit taking institutions shall comprise of:

- Voluntary property contributions by one or more promoters
- Donations and charitable contributions from third parties

- Grants and non-repayable special purpose financing from a local government or Government
- Earnings from the activities of the non-deposit microfinance institution including micro lending and
- Loans and credits among others.

c) Self-help groups

A self-help group is a group registered for the purpose of developing the economic interests of group members and may provide services including savings and credit, revolving fund, fundraising, rotational group farming or barter trade. Self-help groups should;

i. Comprise of members with a common bond. These groups are required to;

- mobilise and manage its own savings
- provide interest bearing loans to members
- offer a limited form of insurance to members
- share out member equity at least once a year in proportion to the savings
- Be time bound.

ii. In order to offer the above services, the self-help groups ought to;

- Be registered for the purpose of developing economic interests of the group members.
- Comply with UMRA's operational guidelines for establishing financial stabilisation mechanisms
- Have a governance committee responsible for the day to day management of the self-help group.

d) Commodity based microfinance institutions

These institutions provide microfinance services in the form of goods and services. Recipients of commodities from these institutions are required not liquidate the commodity acquired or assign or transfer the commodity except with the approval of UMRA.

4.0 THE AUDIT OF MICROFINANCE INSTITUTIONS

Auditing a microfinance institution is almost similar to auditing a conventional financial institution. However the weak internal control systems makes the audit of these institutions high risk engagements. The microfinance and money lenders engagements may vary in size and nature, many can be small and low risk in comparison to other clients, yet it is crucial that they are allocated sufficient time and that they are approached with the same rigor and professional skepticism as other audits. All in all, the engagement is likely to require the auditor to express an opinion on whether the financial statements present fairly in all material respects, the microfinance institution's financial position in conformity with generally accepted accounting principles. The audits of microfinance institutions, just like other engagements are performed and reported in line with the International Standards on Auditing (ISAs) as well as compliance with the Tier IV Microfinance Institutions and Money Lenders Act 2016 and the Tier IV Microfinance Institutions and Money Lenders Regulations 2018.

4.1 Compliance with the Tier IV Microfinance Institutions and Money Lenders Act 2016 and Regulations 2018

ISA 250 (Revised) - Consideration of Laws and Regulations in an audit of Financial Statements, states that those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The provisions of these laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in the entity's financial statements. In Uganda, Tier IV Microfinance Institutions are subject to the Tier IV Microfinance Institutions Act 2016 and the Tier IV Microfinance Institutions and Money Lenders Regulations 2018 in addition to other laws such as the Anti-Money Laundering Act 2013, the Income Tax Act and the Labor Laws in Uganda. Assessment of an entity's compliance with relevant laws and regulations therefore forms a very important aspect of the audit of Tier IV Microfinance Institutions and Money Lenders. The key areas of compliance are:

a) Licenses

Tier IV Microfinance Institutions and Money Lenders have to be licensed in accordance with section 78 (3) of the Act. The license should be in writing and it should be issued by the Uganda Microfinance Regulatory Authority (UMRA). These Institutions are then obliged to display their licenses at all premises in which they transact their business in such a manner as to be readily visible to the public. The licenses are renewable after every 31st of December.

b) Management

A money lender shall not change its management except with written authorization of the UMRA.

c) Credit Policy

Tier IV Microfinance Institutions and Money Lenders are supposed to have a credit policy which include the terms and conditions of payment, the maximum amount that may be borrowed and an acceptable form of security for loans. Credit shall then be provided according to the terms and conditions of that policy.

d) Surplus

- A SACCO shall create a reserve fund comprising 10% of the annual surplus from the operations of the SACCO.

- A SACCO shall maintain a Share Transfer Fund and shall allocate annually out of its surplus, if any, an amount to be determined by the Authority from time to time, not exceeding 5% of the SACCO's share capital.
- Every SACCO shall subscribe to the SACCO Stabilization Fund which shall be managed by UMRA and shall then make an annual contribution of 0.5% of the average total assets of the SACCO plus money realized from assets purchased from a SACCO in the process of dissolution.
- A share transfer fund to which not more than 5% of the surplus if any will be transferred.
- Contribution to the Education Fund which shall be 1% per year of its turnover.

e) Financial Year

SACCOs shall maintain a financial year of a 12 months period ending on 31st December.

f) Anti-Money Laundering Considerations

Tier IV institutions and money lenders ought to adhere to all the provisions of the Anti-Money Laundering Bill. Therefore the auditor ought to look out for suspicious transactions or business relationships. This may necessitate an audit of the institution or money lender's 'know your customer' policies. The auditor will then have to report any suspected or actual incidences identified. In this regard, the auditor will also look into the entity's policy on record keeping of information regarding transactions.

g) Tax and Labor Laws

The auditor will also look into the client's human resource policies and tax records to ensure compliance with the Income Tax and Labor laws in the country. Employees should be treated lawfully, NSSF remittances made as well as corporate taxes paid along with the filing of the required tax and NSSF returns. Evidence of compliance should be tested.

5.0 DETERMINING MATERIALITY

ISA 320 Materiality in Planning and Performing an Audit requires the auditor to determine materiality for the financial statements as a whole when establishing the overall audit strategy. A materiality level is a threshold above which potential errors are considered problematic. If the aggregate of uncorrected misstatements identified during the audit exceeds the materiality level, the auditor may not be able to render an unqualified audit opinion.

In line with ISA 250 (Revised), Consideration of Laws and Regulations in an audit of Financial Statements, the auditor will set a qualitative materiality in line with compliance with the relevant Tier IV Institutions and Money Lenders laws and regulations. Any non-compliance will become a material issue as this is always associated with fines and penalties which may affect the existence of the institution or money lender.

6.0 OBTAINING AUDIT EVIDENCE

ISA 500 Audit Evidence states that the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from the audit procedures performed during the course of the audit. Audit procedures to obtain audit evidence can include inspection of records or documents, observation of processes or procedures being performed by others, obtaining external confirmation from a third party, recalculation to check the mathematical accuracy of documents or records, analytical procedures and inquiry

> In practice, some practitioners seem not to give much attention to documentation of audit evidence. Whereas a practitioner may have performed all relevant procedures in respect to ascertainment of an account balance, if such work is not documented, it's as good as not having been performed.

7.0 REPORTING

7.1 AUDIT REPORT

After all the tests have been conducted and evaluated, and an assessment has been made of whether the financial statements have been prepared in accordance with an acceptable financial reporting framework, the auditor shall then make a written opinion on the financial statements as a whole. The auditor shall form an opinion in relation to the audit evidence obtained and shall then make a report in accordance with ISA 700 requirements. The Tier IV microfinance institutions are required to furnish UMRA with periodic reports of operations. UMRA is then mandated to satisfy itself of:

a) Compliance with capital requirements of Tier IV microfinance institutions;
b) The composition of assets and liability items;
c) The quality of the earning assets;
d) Financial risks, operational risks, business risks and event risks; and
e) Any other matter which in the opinion of the Authority is relevant to the discharge of its supervisory function under this Act.

7.2 MANAGEMENT LETTER

A byproduct of the audit process is the identification of concerns or weaknesses that became apparent during the audit and the provision if constructive recommendations that management can use to better manage operations or solidify internal controls. These concerns are communicated to those charged with governance of the entity through a management letter.