RISK IN THE CONTEXT OF MFIS

1.1.1 The Concept of Risk

Risk is a fundamental fact of life and may mean different things to different people. Risk is usually vulnerabilities that exist in our systems, processes and facilities. However, their existence creates potential financial consequences. Risks are either internal or external to the organization, making it possible or impossible to control respectively.

There are situations that demand risk taking in order to accomplish worthy and meaningful goals. This is especially true in microfinance for example where loan officers take risks every day by lending money to people without credit histories, without business records and often without collateral.

Like all financial institutions, microfinance institutions (MFIs) face risks that they must manage efficiently and effectively to be successful. If the MFI does not manage its risks well, it will likely fail to meet its social and financial objectives. When poorly managed, risks begin to result in financial losses. In addition, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, an MFI is not able to meet its social objective of providing services to the poor and quickly goes out of business.

1.1.2 What then is Risk?

Risk could be defined as “the threat or probability that an action or event will adversely or beneficially affect an organization's ability to achieve its objectives”. We can therefore adapt the definition of risk to MFIs as “the possibility of certain events happening due to our operational activities which may adversely affect the achievement of organizational objectives and goals.
Risk connotes uncertainty and uncertainty is about the future. It therefore implies that every activity undertaken in the present with future implications has an element of uncertainty and therefore risk. Every activity undertaken within an MFI therefore has an element of risk.

1.1.3 Sources of Risk

Risks can exist, emerge or emanate from the external or internal environment in which the MFI operates. The internal risks are inherent in the MFI’s operations or they exist due to the nature of business and business model being operated. Risks emanating from the external environment are as a result of the MFIs interaction with the external environment as it carries out its operations. Whereas an MFI has greater control over the risks emanating from the internal environment, the same cannot be said for risks emanating from external environment. The level and type of risk will however, vary from institution to institution depending on factors such as business model, level of automation, quality of personnel and geographical location among others.

MAJOR RISKS IN MFIS

1.2.1 Introduction

The session presents the major categories of risk faced by MFIs. It also discusses other challenges MFIs are exposed to with implications for risk including rapid growth and expansion, management succession and new product development.

1.2.3 Major Risk Categories

Risk, as noted is an integral part of an MFI's operations and comes in different forms. There are different ways of grouping the various risks faced by MFIs. This is based mainly on sources of the risk (whether external or internal environment) and the business functional areas giving rise to the risk. The three categories considered in this module for MFIs are:

1. Financial Risks;
2. Operational Risks; and
3. Strategic Risk.

These risks are reviewed in the light of: the MFI's potential exposure to loss; the quality of internal risk management and information systems, and the adequacy of capital and earnings to absorb both identified and unidentified potential losses. Each category of risk has different risk types as presented in table 1.

Table 1: MFI Risk Categories

FINANCIAL RISK	OPERATIONAL RISK	STRATEGIC RISK
Credit Risk • Transaction Risk • Portfolio Risk **Liquidity Risks** **Market Risks** • Interest Rate Risks • Foreign Exchange Risks • Investment Portfolio Risks	**Transaction Risk** Human Resources Risk • Information & Technology Risk **Fraud (Integrity) Risk** **Legal & Compliance Risk**	**Governance Risk** Ineffective Oversight Poor Governance Structure **External Business Risks** • Business Risk • Event Risks • Reputation Risk

1.2.4 Financial Risks

The MFI is engaged in financial intermediation entailing mobilizing savings, securing loan facilities and equity from shareholders on one hand and extending these as loans to clients as well as pursuing other business objectives. The financial intermediation places high levels of uncertainties on both sides of the equation even as financial liabilities (including savings, loans and shareholders' funds) are used to generate financial assets (loans and investments) with the expectation that financial assets will generate adequate earnings to pay for the cost of the financial liabilities and eventually retire liabilities when required.

An MFI is therefore required to manage the risks associated with the financial intermediation function. The financial risks an MFI is required to focus on are:

a) Credit risks,
b) Liquidity risks, and
c) Market risks.

i. Credit Risks

Credit risk is an inherent risk in an MFI's lending operations and is faced by providers who give credit. It is the uncertainty that earnings will reduce due to a loan client's late and or non-repayment of loan obligations (principal and interest payments). Credit risk includes both:

Transaction Risks and Portfolio Risk

Transaction Risk	Transaction risk refers to the risk within individual loan transactions. This involves risk of non-repayment of loan due to the inability of the MFI to appropriately screen loan clients and issues concerned with loan application, processing, monitoring and repayment. It is usually mitigated through borrower screening techniques, guarantor system technique, and quality procedures for loan disbursement, monitoring, and collection.
Portfolio Risk	Portfolio risk refers to the risk inherent in the overall loan portfolio. This relates to developing and serving clients with appropriate loan products which are suitable for them – e.g. loan sizes, loan duration, moratorium duration and repayment frequency. This is usually mitigated by diversifying types of businesses being funded and setting of concentration limits, maximum loan size, loan types and loan structures.

ii. Liquidity Risks

Liquidity risk is the possibility of the inability of MFIs to meet current cash obligations and the inability of management to adequately anticipate and plan for changes in funding sources and cash needs. It is important to note that, liquidity risk of an MFI goes beyond the absence of adequate funding to meet current cash obligations to include availability of funding to meet growth and expansion needs. This leads to negative effect on the growth of owners, customers and other stakeholder's interests. Liquidity risk could seriously affect the ability of MFIs to meet savings withdrawals of clients, meet loan disbursement schedules and pay back funds obtained for on-lending among others.

- To efficiently and effectively mitigate liquidity risk, management must maintain sufficient cash reserves on hand (to meet client withdrawals, loan disbursements and to fund unexpected cash shortages) while also investing the appropriate amounts in the appropriate instruments and client loans to maximize earnings.

- MFIs must be able to honour all cash payment commitments as and when they fall due and meet customer requests for new loans and savings withdrawals. These commitments can be met by drawing on cash holdings, using current cash flows, borrowing cash, or converting liquid assets into cash.

Liquidity management is not a one-time activity in which the MFI determines the optimal level of cash it should hold. Liquidity management is an ongoing effort to strike a balance between having too much cash and too little cash. If the MFI holds too much cash, it may not be able to make sufficient returns to cover the costs of its operations, resulting in the need to increase interest rates above competitive levels. If the MFI holds too little cash, it could face a crisis of confidence and lose clients who no longer trust the institution to have funds available when needed.

iii. Market Risk

Market Risk includes:

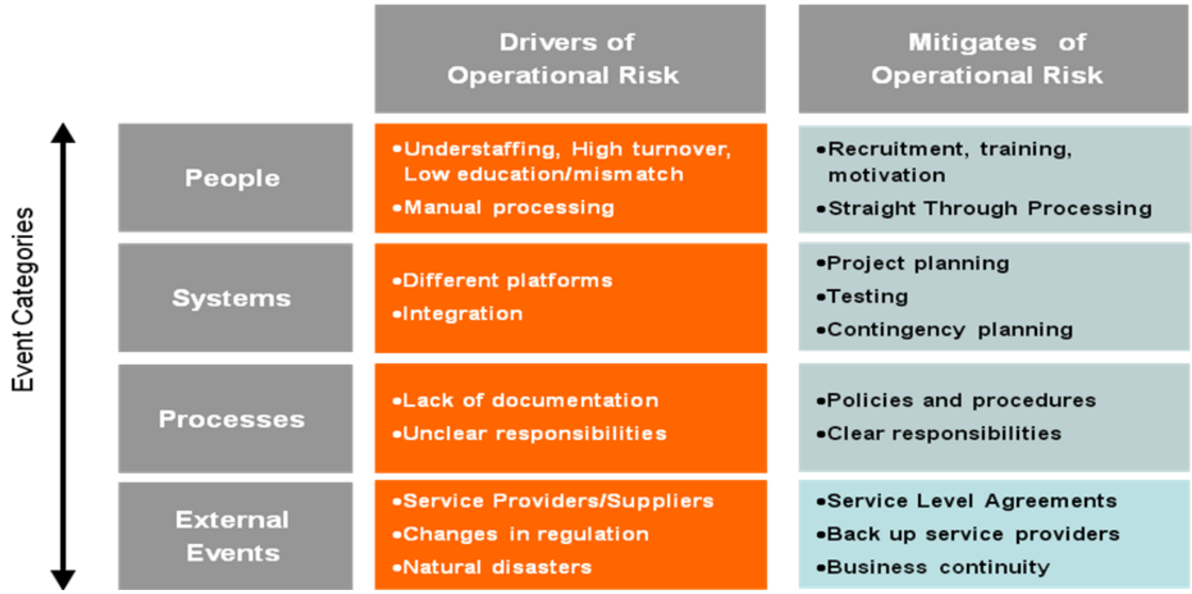
- Interest Rate Risk (asset liability management),
- Foreign Exchange (Currency) Risk, and
- Investment Portfolio Risk.

Interest Rate Risk (Asset Liability Management)	Interest rate risk relates to the uncertainties in the MFIs earnings (or net margin) due to a change in interest rates on the market. It results from mismatch in asset and liability repricing characteristics and maturity. For example, when an MFI uses savings (liability) to finance loans (asset) and expects that the savings at interest rate of 8% per annum will be available to finance a loan which attracts an interest rate of 24% thus yielding a spread of 16 points. Where savings clients are likely to withdraw their savings earlier than expected especially before loan maturity and the MFI will have to borrow or raise new savings at an interest rate higher than 8%, then we have the potential for interest rate risk. This will be arising either because of changes in interest rates or the different maturity period called maturity mismatch. Addressing Interest rate risk is a critical treasury function, in which MFIs match the interest rate, maturity schedules and risk profiles of their funding sources (liabilities) to the terms of the loans and investment they are funding (assets). Interest rate risk has implications for MFI profitability and eventual sustainability.
Foreign Exchange (Currency) Risk	Foreign exchange risk is the potential for loss of earnings or capital resulting from fluctuations in currency values. MFIs often experience foreign exchange risk when they borrow or mobilize savings in one currency and lend in another. For example, a Ghanaian MFI borrows concessional on-lending funds denominated in US$ or Euro (€) and then use it to grant loans in local currency (GHC). There is currency risk – i.e. if the value (exchange rate) of GHC weakens against the US$ or Euro (€), the Ghanaian MFI is exposed to currency risk. Alternatively, if the GHC strengthens against the US$ or Euro (€), the Ghanaian MFI experiences a financial gain.
Investment Portfolio Risk	The investment portfolio represents the source of funds for reserves, for operating expenses, for future loans or for other productive investments. Investment portfolio risk refers mainly to longer-term investment decisions rather than short term liquidity or cash management decisions. The risk of losing on the interest over time as well as the value of the currency is known as investment portfolio risk.

1.2.5 Operational Risks

Operational risk arises from operational activities such as human or computer error within daily product delivery and services. There are various definitions of operational risk. For example, The Basel Committee defines operational risk as: **"The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events."** Operational

risk therefore transcends all divisions, products and services of MFIs. This risk includes the potential that inadequate technology and information systems, operational problems (absence and inadequacy of policies, and procedures), insufficient or incompetent human resources, or breaches of integrity (i.e. fraud) will result in unexpected losses.
The key drivers of operational risk with their mitigating practices are presented below. The intensity of the various event categories will differ for the respective MFIs.



Under operational risk the focus will be on Transaction and Fraud Risk.

i. Transaction Risk

Transaction risk exists in all products and services. It is a risk that arises on a daily basis in MFIs as transactions are processed and is triggered by a combination of people, systems and processes. Transaction risk is particularly high for MFIs that handle high volume of small transactions daily. When traditional banks make loans, the staff person responsible is usually a highly trained professional and there is a very high level of cross-checking. MFIs make many small, short-term loans and this same degree of cross-checking is not cost effective, so there are more opportunities for error and fraud.

The loan portfolio usually accounts for the bulk of the MFI's assets and is thus the main source of operational risk. As MFIs expand their operations by offering additional financial products, including savings and insurance, the operational risks multiply and should be carefully analyzed. The continuous use of mobile bankers by many MFIs especially in the area of savings mobilization without adequate and appropriate training; clear basis of savings and clients targets; market zoning; employee status (whether permanent or contract staff); effective follow up and monitoring give rise to transaction risks that have to be managed.

Transaction risks can be categorised into:

1) People (human resource) risks; and
2) Systems (management information systems) risks.

a. People (Human Resource) Risks

As a service industry, the delivery of microfinance products is just as important as the products themselves. An MFI can dramatically reduce its transaction risk if it has well trained and motivated employees. This is accomplished through a three pronged strategy:

- Hiring of Staff.
- Training of Staff.
- Rewarding staff.

***Hiring and engagement practices**:* MFIs should identify sources of prospective staff members with high moral integrity and recruit new staff from these sources. In addition, MFIs should use staff screening mechanisms, like personality tests and employee references, to ensure that they are hiring individuals who meet the organisation's specifications. Background and police verification checks are highly recommended.

***Training and development*:** A critical aspect of bringing on new recruits is to indoctrinate them into the institution's culture of risk management including zero-tolerance for fraud. This is the ideal opportunity to promote the organization's core values of honesty and integrity, and demonstrate the zero-tolerance policy by making examples of employees who succumbed to temptation and suffered the consequences. Employee hand books should be given to staff so that they remain conversant with their roles and responsibilities and what is expected of them and what is not. Training often focuses on the tasks of the job, but to serve as an effective control, training should impart much more than just technical skills. For new staff, orientation is the time to immerse them into the institutional culture, cultivate their commitment to the missions and values of the organization. Reorientation and ongoing training programmes should also be organised across the organisation to ensure staff are well versed in policies and procedures put in place.

***Compensation*:** Employees should have a strong incentive to perform their job in a responsible and competent manner. Employees who do not feel sufficiently compensated will be much less likely to carry out their responsibilities with the needed thoroughness and attention to detail.

1. Systems (Management Information Systems) Risks.

The management of information involves much more than installing a computer system in an MFI. A management information system is the processes and actions involved in capturing raw data, processing the data into usable information, and disseminating the information to users. As such, MIS includes all the systems used for generating the information that guides management in its decisions and actions. By transforming data, or unprocessed facts, into information through a systematic process, management information systems provide tools for identifying, controlling and monitoring key risks within an organization. The better the information, the better the MFI can manage its risks.

MFI's management needs to decide what reports they need to be able to make appropriate management decisions and to provide reports to stakeholders—board, investors, regulators, etc. To enable the top managers to have the reports they need, information must be properly collected, recorded, and input into the system.

Key attributes of good information in MFIs should meet the following criteria.

- **Relevant** — Does it provide what is needed?
- **Used —** Does the recipient need all the information?
- **Timely —** Is it delivered in time to be useful?

- **Accurate —** Is the information correct?
- **Distributed to the correct people —** Do the reports go to the people who need the information?
- **Accessed by the correct people —** Is access to the reports limited to the users?
- **Well formatted —** Is it easy to read and understand?
- **Retrievable —** Are reports filed in standard formats and locations?
- **Traceable —** Can the information on the reports be audited?

ii. Fraud Risk

Fraud or integrity risk is the risk of loss earnings or capital as a result of intentional deception by an employee or client or a combination of both. The most common type of fraud in an MFI is the direct theft of funds through suppression of savings, repayments and diversion of loans by staff acting alone or with clients. Other forms of fraudulent activities include the creation of misleading financial statements, bribes, kickbacks, and ghost loans. Module 4 discusses details of fraud risk and measures to be adopted by MFIs in curtailing fraud risk.

iii. Regulatory and Legal Compliance Risk

Compliance risk arises out of violations of or non-conformance of MFIs with laws, rules, and regulations, prescribed practices, or ethical standards. The costs of non-conformance to norms, rules, regulations or laws range from fines and lawsuits to the voiding of contracts, loss of reputation or business opportunities, or shut-down (withdrawal of licenses) by the regulatory authorities. With the recent introduction of regulations for the microfinance sector by the Bank of Ghana, MFIs in Ghana will be more scrutinized than before.

In managing regulatory and legal compliance risk, MFIs need to establish a good working relationship with the regulatory authorities. Regardless of its formal regulatory status, an MFI should encourage open communication with regulators to ensure their full understanding of the MFI and provide an opportunity to defuse any potential problems.

1.2.6 Strategic Risk

Strategic risks include internal risks such as those from adverse business decisions or improper implementation of those decisions; poor leadership, or ineffective governance and oversight; and external risks such as changes in the business or competitive environment. This section focuses on two critical strategic risks. These are:

- Governance Risk, and
- External Risks (comprising business risk, reputation risk, and event risk)

i. Governance Risk

One of the most understated and underestimated risks within MFIs are the risks associated with inadequate governance or poor governance structure resulting from poor direction and accountability from the Board of Directors.

The business, financial and social missions of MFIs attract many high profile persons to serve on their Boards. Unfortunately, these individuals do not apply themselves in the role to enhance the MFI operations. There are many MFIs with well known individuals on their boards but who have not met as a board and in a number of cases are not providing the needed direction to MFIs. Most of the members do not have the time and in other cases lack adequate understanding of microfinance business.

As MFIs face the challenges of management succession and the need to recruit managers that can balance social and commercial objectives, the role of directors becomes more important to ensure the institution's continuity and focus.

To protect against the risks associated with poor governance structure, MFIs should ensure that their boards comprise the right mix of individuals who collectively represent the technical and personal skills and backgrounds needed by the institution.

ii. External Risks

External risks relate to uncertainties that are considered external to the MFI's operations but whose occurrences have significant effects on the operations and sustainability on the MFI. These risks are:

- business risk,
- reputation risk, and
- event risk.

Business Risks	Business environment risk refers to the inherent risks of the MFI's business activity and the external business environment for example changes in the economic environment. To minimize business risks, MFIs must react to changes in the external business environment to take advantage of opportunities, to respond to competition, and to maintain good public reputation.
Reputation Risk	Reputation risk refers to the risk to earnings or capital arising from negative public opinion, which may affect an MFI's ability to sell products and services or its access to capital or cash funds. Reputations are much easier to lose than to rebuild, and should be valued as an intangible asset for any organization. Most successful MFIs cultivate their reputations carefully with specific audiences, such as with customers (their market), their funders and investors (sources of capital), and regulators or officials. A comprehensive risk management approach and good management information reporting helps an MFI speak the "language" of financial institutions and can strengthen an MFI's reputation with regulators.
Event Risk	Anticipating and preparing for possible events or risks is the MFI's responsibility. MFIs operating in trouble prone areas for example face external risks which can increase their credit and liquidity risk when loan clients' businesses slow down or are destroyed or their homes are damaged. While MFIs can rarely prevent external risks from occurring, they can often take preventative actions to minimize their impact on the institution. In general, the best way for an MFI to reduce external risks is to integrate an effective system of risk management into its culture and operations. This should encourage directors and management to ask whether they are prepared for certain possible internal and external situations and whether they have built in sufficient cushion for unexpected events.

1.2.7 Other MFI Challenges

MFIs are confronted with several additional risks. These include:

1. rapid growth and expansion,
2. management succession, and
3. new product development.

The above challenges confronting MFIs are discussed in the table below.

EXPOSURES	DETAILS	MITIGATING STRATEGIES
Rapid Growth and Expansion	Rapid growth refers to increase in outreach and loan portfolio among others. This places several strains on MFI's operations. Examples of challenges faced by rapidly growing MFIs include: • Inability to groom new managers and supervisors from within the ranks forcing rapid promotions to fill management positions (e.g. new branch managers) with less experience than required. • Weak human resource planning or insufficient investment in training leading to increased operational risk in the MFI. • Loss of focus on serving low-income clients through the selection of wealthier clients with larger loan requests. • Weak and inadequate management information systems.	Strategies to be adopted in the event of rapid growth related risks are: 1. Careful attention to staff recruitment and training - by carefully growing staff and ensuring that employees' interests are aligned with those of the goals of the MFI. 2. Control growth to allow time to develop internal systems and prepare staff for changes resulting from the expansion. 3. Carefully monitor loan growth and portfolio quality to better understand growth (e.g., number of loans per client, average loan size, growth in number of borrowers) and not to let growth mask increases in delinquency. 4. Good communication from senior managers to reinforce the MFI's culture and commitment to quality service and integrity.
Succession Planning	This results from difficulties by MFIs in replacing management staff due to inadequate succession planning. Inadequate succession planning by MFIs increases the risk of having the MFIs being managed by inexperienced managers. This increases operational risks resulting from poor decision making and ineffective leadership.	As management staff leave their positions in MFIs, they will need to create a strong management structure to help institutionalize elements of succession planning to ensure successive and sustainable operations.
New Product Development	New product risk is the potential loss that can result from a product that fails or causes unintended harm to the MFI. Since many MFIs are experimenting with new product innovations, identifying and managing this risk is increasingly important. Key risks for new products include: 1) New savings products that offer higher rates might attract high demand but also excessively increase the MFI's cost of	To reduce the risk of introducing products that do more harm to the MFI than good, management should subject new lines of business to a thorough risk/reward analysis before introducing the new product or service.

EXPOSURES	DETAILS	MITIGATING STRATEGIES
	funds. 2) Introduction of agricultural lending products may expose MFIs to new risks such as natural disasters (which affect crop production for several borrowers simultaneously, thus increasing credit and liquidity risks).	

OVERVIEW OF RISK MANAGEMENT IMPLEMENTATION

Fundamentals of Risk Implementation

Risk is a fundamental part of MFI operations. When MFIs disburse loans, there is the risk of borrower default; when they mobilize savings and on-lend, they put clients' savings at risk. Any institution that conducts cash transactions or makes investments, risks the loss of these funds. However, MFIs should neither avoid risk (thus limiting institutional scope and impact) nor ignore risk because, the extent of growth will cause their operations to be inherently risky and sophisticated requiring the implementation of a Risk Management Framework.

Implementing risk management should become a more conscious part of the MFIs management and staff responsibilities. Implementing risk management is, quantifying risks and their probability of occurring so that plans can be made by MFIs to manage them. Implementing risk management can take the form of creating awareness, development of appropriate framework to identify the risks and measure their potential impact on MFI, developing policies and procedures to minimise the effect of the risks identified, enforcing compliance with policies and procedures and continuous evaluation.

Key Fact

..Creating an organizational culture of identifying risks but allowing prudent risk taking.

Being prudent in taking risk means the MFI assumes and recognizes that risk taking comes with the potential of a loss and so their occurrence should not come as a complete surprise to management. In other words, management should be aware of the risks the MFI assumes and understand the extent of the exposures and their potential implications for MFI capital and earnings.

Guidelines to Implementing Risk Management in MFIs

There are a number of risk management guidelines prescribed by various authors for MFIs during their risk implementation process. Ten (10) of these simple risk management guidelines are presented for MFIs to pursuein implementing their risk management efforts.

1. Lead the risk management process from the top;
2. Incorporate risk management into process and systems design;
3. Align risk management goals with the goals of individuals;
4. Address the most important risks first;
5. Assign responsibilities and set monitoring schedule;
6. Keep it simple and easy to understand;
7. Involve all levels of staff;
8. Design informative management reporting to Board;
9. Develop effective mechanisms to evaluate internal controls;
10. Manage risk continuously using a risk management feedback loop.

Collectively, these guidelines help MFIs to systematize risk management and integrate it into all levels of operations. The guidelines are further discussed below.

1. Lead the risk management process from the top: The Directors, CEO and Senior Managers must integrate risk management into the MFI's culture by communicating its importance to all levels of the MFI. More importantly, directors and managers should comply with risk management strategies. Employees can only perform in a manner that mitigates risk when the leadership is involved and support that cause with resources and actions.

2. Incorporate risk management into process and systems design : In the design of systems, processes and methodologies for supporting MFI operations, the Directors should consider risk management in order to reduce the likelihood of risk from the onset. Designing procedures that reduce the chance of human error for example can improve quality control and significantly boost productivity and efficiency.

MFIs should undertake an internal assessment of their procedures and information flow to determine which components could be improved. MFIs should implement risk management effectively by integrating it into the MFI's daily operation's controls such as the segregation of duties, documentation, authorization and approval levels, etc. A lack of segregation of duties, for example between cash transactions and recording or between cash authorizations and disbursement, creates opportunities for fraud and collusion among staff.

After incorporating internal controls, MFIs should conduct independent checks and reviews to ensure that the system works correctly.

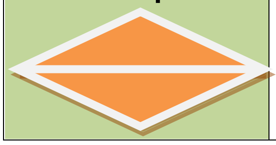
Insight

Generally successful MFIs both within and outside Ghana have built excellent credit risk management into their lending methodologies, using screening techniques, co-guarantors, and other mechanisms to reduce the likelihood of delinquency and default.

Lower delinquency rates elevate loan staff's efficiency and productivity by reducing the time spent on collection and increasing time to work with potential and existing customers.

3. Align risk management goals with the goals of individuals: MFIs should further reinforce a risk management culture by building risk management into the employees' goals and performance incentives. Individuals must be oriented to see the linkage between their progression in the MFI and the attainment of MFIs risk management objectives.

Example



Rather than reward loan officers simply for volume of disbursements and clients won, MFIs should reward staff based on a combination of loan disbursements, delinquency rates and repayment rates to establish linkage between credit risk management and individual compensation.

4. Address the most important risks first: In assessing risks, MFIs should prioritize high risks first. A simple risk management matrix, such as the one shown in **figure 3.1**, can be used to identify and assess the most critical risk areas based on relative probability and impact on the organization. The low risk areas which do not deserve attention earliest have an exception; '***risks that can jeopardize the financial viability of the MFI, however unlikely, require a conscious Strategy'***.

Once MFIs have identified the priority risks, they should focus on solutions. MFIs should focus on areas where interventions will have the greatest leverage, i.e. the most impact for the least cost.

Example	An investment in a better management information system will usually have a major impact on managing several key risks. The quality, comprehensiveness and timeliness of information provided to management and boards of MFIs are critical for risk management. Since managing risk is costly, MFIs should ensure that the long-term return on investment merits the costs.

Figure 1: Sample Risk Management Matrix

Likelihood of Occurrence		Low	Medium	High
	High	Medium: 10	High :50	Critical:100
	Medium	Low :5	Medium 25	High:50
	Low	Low :1	Low: 5	Medium: 10

Impact

5. Assign responsibilities and set monitoring schedule: Specific persons should be assigned operational accountability for monitoring and managing respective risks on a daily basis, as well as senior level accountability for oversight of specific risks. Senior management and the Board share the responsibility for the MFI's overall risk management strategy.

6. Keep it simple and easy to understand: The tools for implementing risk management should be simple and clear, comprising a short list of key ratios or figures in respect of operational and financial indicators. This should be supported with training.

7. Involve all levels of staff: Risk Management is an organisation wide activity. Every employee is a "risk manager". Employees at all levels of an MFI should play a role in risk identification and mitigation, from the field/loan officers and susu collectors through to cashiers and credit coordinators. Risk management should be a part of all line managers' jobs, not strictly a function of the internal audit department or risk management department or officer as the case may be.

By involving staff in the risk management design process, MFIs will logically build employee support and increase their motivation to participate. Many process design improvements can come from staff suggestions and observations, so MFIs should encourage and reward ideas and input from all staff especially field staff who work with operating guidelines and procedures.

8. *Design informative management reporting to Board:* Good management reporting is essential to risk management. Without good information, directors and management cannot assess whether current risk management strategies and tools are working effectively, or whether new risks have appeared that require immediate attention. MFI's require some regular management reports to monitor operations.

The report should include ratio and trend analysis, to facilitate the Board and Management's ability to quickly identify issues and manage them by "exception." Important ratios for MFI boards to detect changes and potential problems include: monthly trends in growth, clients, portfolio status, funds management, and financial performance. Management and directors must focus on the key performance indicators they need on a regular basis and then direct staff to implement the systems to provide that information.

A number of MFI loan tracking software can generate the necessary information on clients, savings, loans and accounts for the preparation of periodic management reports.

9. *Develop effective mechanisms to evaluate internal controls:* In addition to the checks and balances in process design, internal controls provide a warning system for existing problems that require closer investigation. Results of the ex-post evaluation, also known as the internal audit, support future risk management planning.

MFI's should have some form of internal audit, with the level of formality and complexity appropriate to the size and complexity of the MFI. Internal audit functions take various forms, from management spot checks, in which an operational manager is assigned specific audit duties, to an entirely separate department or outsourced arrangements.

10. Manage risk continuously using a risk management feedback loop: Risk management is a continual process, not a single event. Financial, operational, and strategic risks change constantly in response to changes in competition and the environment such as the economy. New product introductions or geographic expansions also expose the MFI to new risks that need to be incorporated into the system quickly, ensuring that useful information is generated during the pilot or test period.

Once an organization has prioritized its risks, it can begin taking small steps to implement changes that improve risk management. Risk management is a continual and iterative process requiring constant improvements, adjustments, and refinements based on the information produced by internal audit and management reports.