



GOVERNANCE OF NON-PROFIT ORGANISATIONS

Rating Methodology

Non-profit organizations (NPOs) have created a strong presence for themselves on the global level, with names such as Greenpeace and Amnesty International enjoying the same recognition as major corporate giants. NPOs are characterized by dedication to a declared mission and rely on a core of committed workers, many of whom are volunteers, in order to fulfill their mission.

The role of NPOs is that of raising social awareness regarding issues as well as trying to come up with solutions to solve these issues and then lobbying for, and/or actively participating in, the implementation of these solutions. Further, they are able to supplement government efforts in various areas, particularly in developing countries, where lack of resources and other inefficiencies make it almost impossible for the government to cater to even the primary needs of their ever-expanding populations.

In developed countries, NPOs tend to focus on areas such as the environment and human rights, whereas in developing countries they also tackle more basic issues such as health, edu-

cation, sanitation, etc. NPOs generally command a great deal of respect in society, as they are perceived to be working for the socioeconomic uplift of the masses without any monetary reward. However, this is not to say that their activities do not attract controversy. Sometimes, where these activities have not conformed to local norms, NPOs have been accused of importing an alien culture and damaging the social values of the local population, although this opposition usually stems from resistance to new ideas. Violence against NPOs has also not been uncommon, as they often come into conflict with powerful vested interests by challenging the status quo.

One of the biggest obstacles facing NPOs in the implementation of their mission is funding. Since most NPOs are involved in endeavours that do not generate a stream of self-sustaining revenues, they are forced to rely on donations. Donors fall in four main categories: governments, multi-lateral agencies, corporates and individuals. Aid from the first two sources is only available if the mission of

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the NPO meets the agenda of the donor or is part of government-to-government support programs. Although, if it becomes available, funding from these two sources tends to be substantial, it also brings with it a great deal of bureaucratic hassles and is relatively less predictable being a by-product of the political environment, government-to-government relations and annual budgets of the donors. On the other hand corporate and individual donations provide a more stable, but nonetheless still unpredictable, stream of donations. Most NPOs target these two sources for their fund raising efforts, which can be as varied as direct fund collection through dedicated offices to the holding of large-scale charity benefit events.

The Pakistani Context

Philanthropy is an integral part of the religio-cultural make-up of Pakistani society, deriving its roots to a large extent from the injunctions regarding 'Zakat' and 'Sadqa' in Islam. Therefore, philanthropic activities are witnessed in even relatively lower income households. With the level of philanthropy estimated to run into several billion rupees annually, an

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incredible figure for a developing country like Pakistan, it is a natural progression to assume that there would be a large number of NPOs functioning in the country.

Unfortunately, this sector, despite its importance, remains grossly neglected with there being

little or no official support to these organizations in their work. Further, the level of regulation for NPOs also remains inadequate, as there is no one law governing their functioning or any body to regulate their activities. At the same time, no form of benchmarking is available for the potential donors to be able to distinguish one NPO from another. In order to fulfill this need, JCR-VIS has prepared this methodology, which elaborates our criteria for the Governance Ratings of NPOs (GR). Although this methodology is an adaption of our earlier methodology on Corporate Governance Ratings, it is an entirely separate rating for which we shall be using a unique rating scale.

RATING METHODOLOGY

NPOs differ from other entities in that they are mission oriented rather than profit oriented. As a consequence, the first step in a GR is the understanding of the mission of the NPO being rated.

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A mission statement should define the objectives of the organization in clear terms and constitute the terms of reference for the governing body and the executive management in all their actions. The mission should also be achievable in nature and be in keeping with the needs of the society in which the NPO is functioning. Sometimes there might be differences between the stated mission statement and the understanding of the organization's aims by the governing body and the

executive management. In such a situation the NPO may be required to either amend its written mission statement or redirect the efforts of its team towards the originally stated mission. Since the donors provide funds to NPOs based on their declared mission, any variation from it would amount to a serious breach of trust.

Once the mission has been examined, the adherence to it has to be judged, along with the capacity of the NPO to implement it in letter and spirit. In order to determine the performance of an NPO in this regard, the following aspects of its functioning are evaluated:

Regulatory Compliance

As mentioned earlier, there is currently no consolidated law governing the functioning of NPOs in Pakistan. Even though some regulatory measures have recently been introduced with respect to the taxation and registration of NPOs, the applicability of laws is generally a function of their respective organizational structures e.g. companies, associations, trusts, societies, etc. JCR-VIS requires a written representation from the management of the rated NPO stating whether or not the NPO has complied with all relevant laws and regulations (including taxation laws). In case of violations, full details of that event along with the remedial action undertaken by the NPOs management are required.

Governing Body

The governing body of an NPO (irrespective of its nomenclature) is its focal point for development of strategies required to achieve the goals laid out in its mission statement. In addition, the governing body is responsible for the supervision of the execution of these strategies by the executive management. The first area examined here by our analysts is the composition of the governing body. It should ideally comprise of persons with diverse experience and educational backgrounds in order to give the NPO a strong skill mix on which to draw on and include independent experts in the NPO's field of endeavour. The composition of the governing body is one of the most important element in JCR-VIS' ratings, as an inadequate composition will affect the operational capabilities of the governing body, which in turn would have severe ramifications on all facets of the NPOs operations.

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Once the composition has been considered, our analysts proceed with the assessment of the operations of the governing body. This basically involves a thorough review of the minutes of meetings of the governing body along with the agenda for these meetings, the agenda working papers provided to the members before hand and meetings with selected members of the governing body. Our main aim is to gauge the understanding of the governing body of the challenges facing the NPO

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Further, the adequacy of review of executive management's performance without actually participating in day-to-day activities of the NPO is also determined. In order to achieve the latter, there should be clear delegation of authority from the governing body to the executive management, which would ensure the smooth functioning of the organization without taking away ultimate control from the governing body. The governing body is also judged on the frequency of meetings, attendance and the quality of discussions at these meetings.

Executive Management

The executive management is the permanent senior staff of the NPO, charged with the actual implementation of its mission under the guidance of the governing body. Although this area is sometimes not given due importance in NPOs, with members of the governing body doubling as executive management, JCR-VIS believes that a separate, strong executive management cadre is the key to the long-term success of an NPO. It has been observed that personality-driven organizations are seldom able to make the necessary transition in the post-founder era. Hence, organizational depth becomes as important a rating driver in the governance of an NPO as it is for any corporate entity.

Executive management personnel, like the governing body,

are gauged on the basis of their education and experience profiles as well as being assessed for their commitment to the mission of the NPO. Operations of the executive management are also reviewed in a similar manner as those of the governing body to determine the methods adopted to implement governing body instructions and development of the necessary systems and infrastructure for successfully implementing the NPOs mission.

Utilization of Funds & Financial Transparency

As very little of the funding of the NPOs operations is self or sponsor generated, it is essential for good governance that the donor funds received be used for their stated purpose and one of JCR-VIS's key rating considerations is that

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and quality that ensure complete transparency regarding its financial dealings. The financial disclosures of an NPO should be extensive enough, even where not required by law, so as to satisfy all possible queries of the donors.

Fund utilization is also broken down into direct costs, infrastructure development and administrative costs. The proportion of administrative costs to total costs should remain controlled within reasonable limits, as this determines the actual level of performance of the NPO. The lesser the

funds available for the first two forms of expenditure, the lesser the ability of the NPO to implement its mission. If administration cost control is not being achieved our analysts will look to determine the cause of the problem, which generally arises from one of two reasons. First, an over-ambitious program without the arrangement of adequate funding can place a strain on an NPO's resources. Secondly, a set-up not geared towards efficient delivery of the desired end-result will exhibit this problem. In both cases the governance ratings of the rated NPO will be impacted adversely and immediate remedial measures will be required.

Self-Regulation

As a result of the nature of fund handling, including a large proportion of cash transactions in an NPO, self-regulation acquires critical importance. JCR-VIS looks at self-regulation from two perspectives. First is the internal reporting systems or MIS of the NPO. The efficiency of these systems determines the level of control the executive management is able to exercise over the day-to-day operations of the NPO. A well-designed MIS should generate

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information about all critical performance parameters on a regular basis and without any significant time lag. Secondly, a strong independent internal audit function should be present in every NPO in order to ensure a system of check and balances. This function should carry out periodic system reviews as

well as transaction monitoring.

Stakeholder Relations

The most important stakeholder in any NPO is the segment of society it is trying to provide benefit to. Regular impact studies should be carried out by the NPO to determine the actual level of success it has attained with respect to its mission. An NPO should also maintain proper feedback channels with its stakeholders so it can continuously assess their needs and adapt accordingly. JCR-VIS analysts will also assess the relationship of an NPO with all its other stakeholders including donors, employees, etc.

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Conclusion

Governance becomes as critical, if not more, for NPOs as it is for corporates. In the absence of a defined code of governance for NPOs and the inconsistent regulatory requirement, the need for a third party opinion on the governance practices of NPOs becomes even more pronounced. This will provide a great deal of help to potential donors in distinguishing the efficient NPOs from among the numerous such organizations in existence thus leading to a reallocation of funds that, in the end, will serve the best interests of society as a whole. **JCR-VIS**

NPO Governance Rating Scale & Definitions

GR-10 Highest level of governance.	GR-5 Adequate level of governance.
GR-9 Very high level of governance.	GR-4 Moderately low level of governance.
GR-8 High level of governance.	GR-3 Low level of governance.
GR-7 Moderately high level of governance.	GR-2 Very low level of governance.
GR-6 Satisfactory level of governance.	GR-1 Lowest level of governance.

Suspension

In the event that JCR-VIS deems that, as a result of lack of cooperation with regard to the provision of information or for any other reason, it is not possible to assess the current status of the assigned rating, the rating will be suspended.

Withdrawal

A rating is withdrawn in the following situations:

- a) Non-renewal/cancellation of the rating agreement; and
- b) Cessation of an entity for any reason.

**Faheem Ahmad**

President & CEO, JCR-VIS
Founder, VIS Group

Faheem Ahmad has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copyrighted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of shareholders in group companies include the largest publication house in Pakistan and major financial institutions.

He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters degrees in Engineering and Business Administration from USA. His research work has been published in various international journals.

**Saad Ahmed Madani**

Vice President

Saad Ahmed Madani currently leads ratings of Industry, Corporate Governance Ratings and Islamic Finance at JCR-VIS. He is also involved in ratings of various leasing companies and commercial banks. Prior to joining JCR-VIS he had completed his articles at a leading Chartered Accountancy firm in Karachi. Mr. Madani is an Associate member of the Institute of Chartered Accountants of Pakistan.

Jahangir Kothari Parade (Lady Lloyd Pier)

Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari
Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

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