

A hand in a brown sleeve points towards the left side of the frame. The background is a blurred office setting with papers and a desk.

Financial Analysis

What is Financial Standard?

- **PEARLS is the international prudential standards for credit unions**
- **Developed by the World Council of Credit Unions**

Important Features of PEARLS?

- **Executive Management Tool**
- **Standardized Evaluation Ratios and Formulas**
- **Objective, Comparative Rankings**
- **Facilitate Supervisory Control**

What is the trend in Financial Standard?

Adoption of PEARLS and CAMEL in Asian Countries

- ***COOP-PESOS in Philippines***
- ***PEARLS-GOLD in Bangladesh***
- ***COOP-Rupees in Sri Lanka***
- ***GLARES in Hong Kong***

Best Practices Benchmarking:

A Road Map for moving towards

WORLD-CLASS

*performance by employing best
practices*

The Power of PEARLS



Key Ratios

PEARLS

P *Protection*

E Effective Financial
Structure

A Asset Quality

R Rate of Return & Cost

L Liquidity

S Signs of Growth

P1. Allowance for loan losses / Delinquency
> 12 months

Purpose: Measure adequacy of loan loss allowance when compared to all delinquent loans over 12 months.

Formula:

$$\frac{\text{Allowance for Loan Loss}}{\text{Loan Balances of All Delinquent Loans > 12 Months}}$$

Goal: Protection against 100% of loans delinquent greater than 12 months.

P2. Net Allowance for Loan Losses / Delinquency From 1 to 12 Months

Purpose: Measure adequacy of net loan loss allowance when compared to all loans delinquent from 1 to 12 months.

Formula:

Allo. for Loan Loss for Loans Delinquent 1- 12 mos.

Balance of All Delinquent Loans Outstanding From 1-12 Mos.

Goal: Protection against 35% of loans delinquent from 1 to 12 months.

PEARLS

*P*erception

Effective Financial
Structure

*L*ease

*S*tructure

*L*iquid

*S*ignificant Gain

CUDCC

Module 5

Effective Financial Structure

ASSETS

LIABILITES & CAPITAL

E 2

Liquidity -maxi. 20%

E1

*Loans
70-80%*

A 2

Non-Earning Assets -maxi. 5%

E5

*Deposits
70-80%*

Share Capital 10-20%

E7

*Institutional Capital
minimum of 10%*

E8 & 9

E1. Net Loans / Total Assets

Purpose: Measure percentage of total assets invested in the loan portfolio.

Formula:

$$\frac{\text{Total gross loan portfolio} - \text{Loan Loss Allow.}}{\text{Total assets}}$$

Goal: Between 70 and 80% of total assets.
Less than 50% of total assets changes the CU's role as a financial intermediary.

E2. Liquid Investments / Total Assets

Purpose: Measure percentage of total assets invested in earning liquid assets.

Formula:

$$\frac{\textit{Total liquid investments}}{\textit{Total assets}}$$

Goal: Maximum 20%

E3. Financial Investments / Total Assets

Purpose: Measure percentage of total assets invested in financial investments.

Formula:

$$\frac{\textit{Total financial investments}}{\textit{Total assets}}$$

Goal: Maximum 10%

E5. Member Savings Deposits / Total Assets

Purpose: Measure percentage of total assets financed by member savings deposits.

Formula:

$$\frac{\textit{Total member deposits}}{\textit{Total assets}}$$

Goal: Between 70 and 80%

E7. Member Shares / Total Assets

Purpose: Measure percentage of total assets financed by member shares.

Formula:

Total member shares

Total assets

Goal: 10-20%

E8. Total Institutional Capital / Total Assets

Purpose: Measure percentage of total assets financed by institutional capital.

Formula:

Total institutional capital

Total assets

Goal: Minimum 10%

E9. Net Institutional Capital / Total Assets

Purpose: Measure the real level of institutional capital after adjusting the allowances for delinquent loans to meet the standards of P1 & P2, and covering any other potential losses

Formula:
$$\frac{(\text{Institutional Cap.} + \text{Allo. For Bad Loans}) - (\text{Bal. Of loan outstanding delinquent} > 12 \text{ mos} + \text{Bal. Of loan del. 1 to 12 mos.} \times .35) + \text{Problem Assets}}{\text{Total assets}}$$

Goal: Minimum 10%

PEARLS

*P*erformance

Efficient Financial Structure

*A*sset Quality

Rate

Profit

Solvency

CUDCC

Module 5

A = Asset Quality

**A1. Total Loan Delinquency /
Total Gross Loan Portfolio**

**A2. Non-Earning Assets / Total
Assets**

**A3. Zero Cost Funds / Non-
Earning Assets**

A = Asset Quality

- Asset Quality is the main variable that affects institutional profitability.
- Delinquency must be correctly measured and zealously pursued.
- Non-earning assets should be minimized.
- Savings, External Credit, or Shares should never be used to purchase Non-earning Assets.

A1. Total Delinquency / Gross Loan Portfolio

Purpose: Measure percentage of delinquency in loan portfolio using *Outstanding Delinquent Balances* NOT *Accumulated Delinquent Payments*.

Formula:

$$\frac{\text{Sum of delinquent loan balances}}{\text{Gross loan portfolio outstanding}}$$

Goal: Less than or equal to 5%

A2. Total Non-earning Assets / Total Assets

Purpose: Measure percentage of total assets that is not producing income.

Formula:

Total non-earning assets (*total of building, furniture, land, prepaid expenses, office supplies inventory, cash on hand, cash in current account*)

Total assets

Goal: *Less than 5% of total assets*

Examples Of Non-earning Assets

- **Cash on hand**
- **Non-interest bearing monetary checking accounts**
- **Accounts receivable**
- **Assets in liquidation acquired in execution of a guarantee**
- **Fixed assets (land, buildings, furniture, etc.)**
- **Prepaid or deferred assets**

A3. Net Zero Cost Capital + Liabilities w/o Interest / Non-earning Assets

Purpose: Measure percentage of non-earning assets financed with net institutional capital, transitory capital and liabilities without interest.

Formula:

*(Liabilities w/o interest + transitory & net
institutional capital)*

Total non-earning assets

Goal: Greater than or equal to 100%

PEARLS

P *Protection*

E *Effective Financial Structure*

A *Asset*

R ***Rate of Return & Cost***

S *Sign*

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Module 5

R9. Operating Expenses /Average Total Assets

Purpose: Measure cost to manage all assets.

Formula:

Total operating expenses, w/o loan loss provisions

[(Total assets year-end + last year-end) / 2]

Goal: 5 %

R12. Net Income/Average Total Assets

Purpose: To measure the adequacy of earnings and also, the capacity to build Institutional Capital.

Net Income

[(Total assets year-end + last year-end) / 2]

Goal: Enough to attain the goal of E9

PEARLS

*P*erformance

Efficient & Effective Financial Structure

Asset-Cost

Capital

*L*iquidity

Signaling

L = Liquidity

- L1. Liquid Assets – Short-term Payables / Total Savings Deposits
- L2. Liquidity Reserve / Total Savings Deposits
- L3. Non-Earning Liquid Assets (Cash on Hand)/Total Assets

L1. Liquid Assets --- Short-term Payables / Member Deposits

Purpose: Measure adequacy of liquid cash reserves to satisfy withdrawal requests, after paying all obligations of ≤ 30 days.

Formula:

$$\frac{\text{(Bank deposit Earning.+Non-earning. liquid assets} \\ \text{--- Total payables } \leq 30 \text{ days)}}{\text{Total member savings deposits}}$$

Goal: Minimum 15%

L2. LIQUIDITY RESERVES / SAVINGS DEPOSITS

Purpose: To measure compliance with obligatory Central Bank, CFF, or Other Liquidity Reserve

Formula:

$$\frac{\text{(Bank deposit Earning.+Non-earning. liquid assets)}}{\text{Total member savings deposits}}$$

Goal: 10%

PEARLS

P *erformance*

P *ercentage of Financial Structure*

P *ercentage of*

P *ercentage of*

P *ercentage of*

S *igns of Growth*

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Module 5

S10. Growth in Membership

Purpose: Measure growth in membership from one year to the next

Formula:

$$\left[\frac{\text{\# of members for current year}}{\text{\# of members at last year-end}} - 1 \right] * 100$$

Goal: >12%

S11. Growth in Total Assets

Purpose: Measure growth of total assets from one year to the next.

Formula:

$$\left[\left(\frac{\text{Total assets for current year}}{\text{Total assets for last year-end}} \right) - 1 \right] * 100$$

Goal: Greater than the inflation rate

The Power of PEARLS



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Module 5