

# **VIS**

Credit Rating Company Limited

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## **NON-PROFIT ORGANIZATIONS METHODOLOGY**

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## SUMMARY OF CRITERIA CHANGES

Non-Profit Organization Rating methodology dated October 2023 has been reviewed, while the fundamental criteria as outlined in the aforesaid methodology 'remains the same, this document provides a revised rating framework in light of the updated regulations and developments in the local markets as well as considerations related to Environment, Social and Corporate Governance (ESG).

## SCOPE OF CRITERIA

Non-profit organizations play a crucial role in addressing various social, environmental, humanitarian, and cultural challenges across both developed and developing countries. While their focus varies - from human rights in advanced economies to basic needs like healthcare in developing nations - they share a common mission of creating meaningful social change.

By raising awareness, they help educate the public about issues that might otherwise go unnoticed or be misunderstood. Beyond merely highlighting problems, NPOs are actively engaged in researching, designing, and proposing practical solutions to complex social challenges. This involves in-depth analysis, collaboration with experts, and innovative thinking. NPOs don't just stop at identifying solutions. They actively lobby policymakers, engage with government agencies, and work to ensure that effective strategies are implemented. In many cases, they also directly participate in executing these solutions. In regions where governments struggle with limited resources, bureaucratic inefficiencies, or infrastructural challenges, NPOs can fill critical gaps in service delivery, provide targeted interventions, reach marginalized or hard-to-access communities or offer specialized expertise and resources. With rapid population growth in many developing countries, NPOs become essential in addressing primary needs such as healthcare, education, food security, and basic infrastructure that governments might find overwhelming.

Unlike for-profit businesses, NPOs are driven by a specific mission or cause rather than financial gain. NPOs are fundamentally defined by their commitment to a specific social goal or purpose. This might involve environmental protection, human rights advocacy, education, healthcare, poverty alleviation, or cultural preservation. The mission serves as the primary motivator and guiding principle for all organizational activities. NPOs often rely heavily on volunteers and deeply committed workers. This workforce is typically motivated by passion for the organization's mission rather than financial compensation. While some NPOs do have paid staff, volunteers play a critical role in extending the organization's reach and capabilities. Unlike for-profit enterprises, NPOs typically generate revenue through grants, fundraising events and donations from governments, multilateral agencies, corporations, and individuals. Each funding source presents unique challenges: governmental support often comes with bureaucratic constraints and political dependencies, while corporate and individual donations, though more flexible, remain unpredictable. They reinvest any surplus funds back into their mission rather than distributing profits to shareholders. NPOs are usually governed by a board of directors or trustees who are responsible for ensuring the organization remains true to its mission and maintains financial accountability. NPOs enjoy special tax exemptions, recognizing their contributions to social welfare and their non-commercial nature.

The global recognition of organizations like Greenpeace and Amnesty International demonstrates the potential of NPOs to create significant awareness and drive meaningful change on international scales. These organizations have successfully leveraged media, grassroots mobilization, and strategic advocacy to influence public opinion and policy.

The landscape of non-profit organizations continues to evolve, with increasing emphasis on transparency, measurable impact, and innovative approaches to addressing complex global challenges. The effectiveness of NPOs lies in their flexibility, specialization, and ability to work closely with local communities, often bringing a more nuanced and targeted approach to solving social challenges compared to broader governmental strategies.

## THE PAKISTANI CONTEXT

Philanthropy in Pakistan is fundamentally shaped by Islamic principles of 'Zakat' and 'Sadqa', which encourage charitable giving. This cultural and religious imperative is so strong that even households with modest incomes participate in philanthropic activities. The scale is remarkable - estimated at hundreds of billions of rupees annually - an impressive figure for a developing country like Pakistan.

Despite this vibrant culture of giving, the NPO sector in Pakistan faces significant challenges. Considering these challenges, VIS has developed a specialized methodology for Governance Ratings of NPOs (GR). While adapted from our corporate governance rating approach, this methodology provides a distinct rating system with its own unique scale, aimed at providing donors with a more reliable method of evaluating NPO effectiveness and credibility.

## 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. 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. The mission should be realistic, achievable and should cater to 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, VIS evaluate the following aspects:

### A. REGULATORY COMPLIANCE

The NPOs in Pakistan working as public limited company are regulated by the Companies Regulations 2024. The Regulations requires an NPO to obtain a license from the Securities & Exchange Commission of Pakistan (SECP) and obtain registration of the NPO as a public limited company. The regulations also define modus operandi for working of such organizations. While other philanthropic missions are setup as associations, trusts or societies, each having their own set of rules and regulations, which implies that currently there are no consolidated law governing functioning of the NPOs in Pakistan. VIS uses operating benchmarks defined for the NPOs incorporated as public limited company for assessing regulatory compliance of all NPOs irrespective of their legal status. 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.

## B. 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 supervision of execution of these strategies by the executive management. The first area examined here by VIS 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 endeavors. The composition of the governing body is one of the most important elements in 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.

Once the composition has been considered, VIS proceeds with the assessment of working 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 beforehand and meetings with selected members of the governing body. VIS main aim is to gauge the understanding of the governing body of the mission of the NPO, challenges facing the NPO and its ability to devise strategic responses to deal with the same. Further, the adequacy of review of governing body 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 its 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.

## C. 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, 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.

Likewise governing body, members of executive management, are gauged on the basis of their education and experience profiles and also assessed for their commitment to the mission of the NPO. Working 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.

## D. 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 fund received from donors be used for their stated purpose. In this regard, one of VIS's key rating considerations is that the financial disclosures of an NPO should be of such extent 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.

VIS also assess fund utilization broken down utilization into direct costs, infrastructure development and administrative costs. The proportion of administrative costs to total costs should be controlled to remain within reasonable limits, as this is one of the key indicators in determining actual 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 VIS will look to determine the cause of the problem, which generally arises from one of two reasons. First, an overambitious program without the arrangement of adequate funding can place a strain on an NPO's resources. Secondly, a setup not geared towards efficient delivery of the desired end results. In both cases the governance ratings of the rated NPO will be impacted adversely.

## E. 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. VIS looks at self-regulation from two perspectives. First is the internal reporting system 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 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 an NPO in order to ensure a system of check and balances. This function should carry out periodic system reviews as well as transaction monitoring.

## F. STAKEHOLDER RELATIONS

The most important stakeholder in any NPO is the segment of society it is trying to benefit. 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. VIS also assesses the relationship of the NPO being rated with all its other stakeholders including donors, employees, beneficiaries, etc.

## G. ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ASPECTS

Non-Profit Organizations are generally aligned with the ESG values. A well-structured ESG framework however can help NGOs in setting sustainability goals, attract and retain likeminded donors and volunteers, and help build social capital, as well as evaluate risk factors for potential partnerships and donors. VIS ESG Rating Methodology for NGOs primarily focus on their performance in areas such use and promotion of renewable energy, waste management within and in the communities, they work with, gender diversity in the organization, particularly at management and governing body level and employees' development and satisfaction. Overall, VIS ESG assessment is designed to prompt NGOs to demonstrate tangible impact of their ESG efforts. Detailed "ESG NON-PROFIT ORGANIZATION RATING METHODOLOGY", is available at our website on the following link, <https://docs.vis.com.pk/docs/ESGRatingMethodology.pdf>

## H. 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 loose regulatory environment, the need for a third-party opinion on the governance practices of NPOs becomes even more important. 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 assisting in reallocation of funds that, in the end, will serve the best interests of society as a whole.

## RATING SCALE & DEFINITIONS

Rating scale and Definitions may be accessed at (<https://docs.vis.com.pk/docs/VISRatingScales.pdf>)

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Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. 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.



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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 genrosity 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.

**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, VIS is positioned to aim for an international mark. In this regard, the global experience of our international affiliates and partners have 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, VIS continues its endeavour to remain an emblem of trust.

## INTERNATIONAL

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