



Credit Rating Company Limited

---

# NON-PROFIT ORGANIZATIONS METHODOLOGY

### Table of Contents

SCOPE OF CRITERIA.....	3
THE PAKISTANI CONTEXT .....	3
RATING METHODOLOGY.....	4
RATING SCALE & DEFINITIONS .....	6



## SCOPE OF CRITERIA

VIS has recently reviewed its Non-Profit Organization Rating methodology to include Assessment of Environmental, Social and Governance (ESG) aspects in the ratings. Core aspects of the VIS-NPOs methodology however are maintained.

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 entities. 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 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 difficult 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, education, 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. Funding is one of the biggest obstacles NPOs face in the implementation of their mission. Since most NPOs are involved in endeavors that do not generate a stream of self-sustaining revenues, they are forced to rely on donations. Donors fall in four main categories: governments, multilateral agencies, corporates and individuals. Donation from the first two sources is available if the mission of the NPOs meet the agenda of the donor or is part of government to government support programs. Although funding from these two sources tends to be substantial, it also brings with it a great deal of bureaucratic hassles and is also relatively less predictable being a byproduct 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. Such efforts 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 makeup 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 hundreds of billion rupees annually, an 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 and there is little or no official support to these organizations in their work. Further, the level of regulation for NPOs also remains inadequate in absence of comprehensive laws governing their functioning and absence of a body to regulate their activities. At the same time, no form of benchmarking is available for the potential donors to an apex for distinguish in a one NPO from another. In order to fulfill this need, VIS has developed this methodology, which elaborates criteria for the Governance Ratings of NPOs (GR). Although this methodology is an adaption of our methodology on Corporate Governance Ratings, it is an entirely separate rating employing 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. 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**

As mentioned earlier, there is currently no consolidated law governing the functioning of NPOs in Pakistan. Even though some regulatory measures are in place 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. 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 for their comprehension 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>)

**Faheem Ahmad**

President & CEO, VIS Credit Rating Company Limited  
Founder, VIS Group Chairman,  
Association of Credit Rating Agencies in Asia

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.

**Javed A. Callea - Member**

Advisor

Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate. Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.

**Syed Asif Ali**

Executive Director - Ratings

Mr. Ali is a professional banker having more than thirty years of experience mainly in risk management, project finance, project management and credit management. He has worked in leadership positions in local as well as international financial institutions and commercial banks. He obtained his B.S degree in Mechanical Engineering from NED University of Engineering and Technology, Karachi. He also holds Masters Degrees in Business Administration from the Institute of Business Administration, Karachi and Management from USA.



## NATIONAL EXCELLENCE

## INTERNATIONAL REACH

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.

**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

## Affiliates

Islamic International Rating Agency – **Bahrain** – iira.com  
Credit Rating Information & Services Ltd. – **Bangladesh** – crislb.com

## Collaborations

Japan Credit Rating Agency, Ltd. – **Japan**  
China Chengxin International Credit Rating Company Limited – **China**

## CONTACT

## Karachi VIS House

128/C, 25th Lane off Khayaban-e-Ittehad,  
Phase VII, DHA, Karachi  
Tel: (92-21) 35311861-64

## Lahore VIS House

431, Block-Q, Commercial Area, Phase-II,  
D.H.A. Lahore - Cantt.  
Tel: (92-42) 35723411-13

## DISCLAIMER

Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. Copyright VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.