
# INFRASTRUCTURE DEVELOPMENT BANK OF ZIMBABWE

## Prudential Standards, Guidelines and Rating System Assessment at 31 December 2021

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9 September 2022

**Attention: Mr. T Mabuto**
Head - Risk Management
Infrastructure Development Bank of Zimbabwe
99 Abdel Gamal Nasser Road
P. O. Box 1720
**HARARE**

Dear Sir,

**RE: <u>PRUDENTIAL STANDARDS, GUIDELINES AND RATING SYSTEM FOR AFRICAN DEVELOPMENT BANKS AND FINANCE INSTITUTIONS ("PSGRS")</u>**

We have pleasure in providing our final report on the Prudential Standards, Guidelines and Rating System ("PSGRS") for the year ended 31 December 2021 for the Infrastructure Development Bank of Zimbabwe ("the IDBZ"). The IDBZ is also referred herein as the development finance institution ("DFI"). Our review was conducted in accordance with the self-assessment framework as required by the Association of African Development Finance Institutions as presented to you in our Planning Audit Committee Report.

We confirm that our report and findings therein are for the exclusive use of IDBZ.

We would like to express our appreciation to you and all members of staff of IDBZ for your assistance throughout this review.

Yours sincerely,

BDO

**<u>BDO Zimbabwe</u>**
**Chartered Accountants**

## Contents

# EXECUTIVE SUMMARY

The Infrastructure Development Bank of Zimbabwe ("the IDBZ"), as a member-institution of the Association of African Development Finance Institutions ("AADFI"), is required to submit annual self-assessments of their institutions using the Prudential Standards, Guidelines and Rating System ("PSGRS"). African leaders in their articulation of the New Partnership for Africa's Development ("NEPAD") committed themselves to adhering to international standards in the conduct of policy and management of their institutions in order for the economic and business affairs of their countries and institutions to be conducted in a transparent and predictable way.

The rating system has been designed to meet five principal objectives:

i) Provide DFIs with useful guidance as to what their own rules and regulatory policies should be as well as provide a benchmark to compare these policies and results with other DFIs in the region.

ii) Introduce a self-regulated early warning system for DFIs to assist them in initiating credible remedial measures before they are forced to do so by owners, regulators or lenders.

iii) Provide central banks and owners in some countries with useful proposals for possible custom tailoring of existing regulatory requirements imposed on DFIs as well as provide them with some leverage to require weaker DFIs to take corrective measures when they are showing signs of trouble.

iv) Provide partners with a useful set of standards and yardsticks by which to assess DFIs and their suitability as financial intermediaries worthy of funding and/or technical assistance support.

v) Improve the reputation of DFIs that adopt the standards to provide them with a tool for dialogue with government, owners, and regulators by showing them what is considered good practice within the region, provide them with insight as to how they compare with other DFIs in the region, and assist in presenting their case to donors for support.

The Rating System has 3 categories subject to assessment, as follows: governance guidelines (40% weighting of overall score), financial prudential standards (40% weighting of overall score), and operational guidelines (20% weighting of overall score). The questionnaire is comprised of 100 questions constructed in a compliance rating format where full compliance is rated 2 points, partial compliance or non-applicability is rated 1 point and non-compliance is given no points.

We understand that management is responsible for the preparation and presentation of the rating questionnaire worksheet in accordance with guidelines set out by the AADFI. Our responsibility is to validate the self-assessment ratings based on our procedures performed during the validation process. The approach followed in the validation process is detailed under "our approach" section.

# STATEMENT OF RESPONSIBILITY

This Report has been prepared for the Infrastructure Development Bank of Zimbabwe ("the IDBZ") as a member institution of the Association of African Development Finance Institutions ("AADFI"), as required to submit this annual self-assessment using the Prudential Standards, Guidelines and Rating System ("PSGRS"). We accept no duty, responsibility, or liability to any other parties, since this report has been prepared and not intended, for any other purpose. It is not to be used for any other purpose or to be distributed to any other parties without our prior written consent.

The communication has consequential limitations and is intended solely for the information of the Infrastructure Development Bank of Zimbabwe and is not intended and is not to be used by anyone other than the Infrastructure Development Bank of Zimbabwe.

Yours sincerely,

Jonas Jonga CA(Z)

For and on behalf of

<u>BDO Zimbabwe</u>
Chartered Accountants

# OUR APPROACH

Based on our understanding of your requirements the following approach was followed in providing the PSGRS validation services:

- We obtained the recommended excel ratings spreadsheet from the Head - Risk Management, Mr. Mabuto. We were also provided with the Ratings Questions and Instructions manual which we used as guidance in determining the ratings;

- For components of the questionnaire which were covered as part of our audit of financial statements for the year ended 31 December 2021, we rated compliance using the information gathered during the course of the audit;

- For the components of the questionnaire which were not covered during the audit, we inquired from the respective process owners to get an appreciation of compliance around identified areas. This was also corroborated through inspection of documentary evidence; and

- We held deliberations with the Risk Management team where IDBZ's internal ratings were compared to BDO's ratings. Any differences in opinions are adequately disclosed in this report.

Our report summarizes our assessment of the performance of IDBZ based on the PSGRS questionnaire. Where non-compliance was identified, details of the matters have been provided.

## RESULTS SUMMARY

The PSGRS questionnaire is made up of 100 questions and was constructed in a compliance rating basis where full compliance is rated 2 points, partial compliance or not applicable is rated 1 point and non-compliance is rated nil. As mentioned in our Executive Summary, there are three broad standards subject to assessment namely Governance Standards (40% weighting), Financial Prudential Standards (40% weighting) and Operational Standards (20% weighting). The broad standards above have subclasses which are presented below.

| Governance Standards (40%) | Maximum Possible Rating | IDBZ Rating | BDO Rating | Variance |
|---|---|---|---|---|
| Sufficient Independence from Government | 12 | 10 | 10 | - |
| Management Independence and Incentives | 12 | 12 | 12 | - |
| Operating in accordance with reasonable commercial principles | 8 | 8 | 8 | - |
| Accounting and auditing | 18 | 14 | 14 | - |
| Management Information systems and procedures | 12 | 11 | 11 | - |
| Corporate Citizen Governance Standards | 16 | 16 | 16 | - |
| Subtotal: Governance Standards) | 78 | 71 | 71 | - |
| | | | | |
| Financial Prudential Standards (40%) | | | | |
| Capital adequacy | 6 | 3 | 3 | - |
| Profitability and efficiency | 10 | 0 | 0 | - |
| Asset quality | 12 | 10 | 10 | - |
| Asset diversity and safety | 14 | 12 | 12 | - |
| Liquidity | 12 | 10 | 10 | - |
| Funding | 6 | 5 | 5 | - |
| Subtotal: Financial Prudential Standards | 60 | 40 | 40 | - |
| | | | | |
| Operational standards (20%) | | | | |
| Risk Management policies | 10 | 10 | 10 | - |
| Lending Policies | 16 | 12 | 12 | |
| Loan Appraisal and Disbursement Policies and Procedures | 18 | 17 | 17 | - |
| Supervision and Collection Policies | 14 | 14 | 14 | - |
| Local currency resource mobilization | 2 | 0 | 0 | - |
| Measurement of development impact | 2 | 2 | 2 | - |
| Subtotal: Operational standards | 62 | 55 | 55 | - |
| Grand Totals | 200 | 166 | 166 | - |

The table below summarizes the comparison of the weighted ratings given by IDBZ and BDO.

| Standard | Maximum Possible Rating | IDBZ Rating | BDO Rating | Variance |
|---|---|---|---|---|
| Governance standards | 46.2% | 42.0% | 42.0% | - |
| Financial prudential standards | 35.5% | 23.7% | 23.7% | - |
| Operational standards | 18.4% | 16.3% | 16.3% | - |
| **Total** | **100.0%** | **82.0%** | **82.0%** | - |

**Governance standards**
The Governance Standards were negatively affected by the qualified opinion on the financial statements.

**Financial Prudential Standards**
The financial prudential standards ratings were negatively affected by the qualified audit opinion.

**Operational Standards**
The operational ratings were negatively affected because the DFI does not utilize co-financing mechanisms or co-loaning mechanisms and limited scope for guarantee programs to catalyze lending by financial institutions.

# DETAILED RESULTS

Compliance ratings for each section were converted into quantitative ratings using the following scores:

- Full compliance 2
- Partial compliance 1
- Non-compliance 0

In cases where a question was not applicable it scored as "partial" i.e. a "1." The above listed scoring criterion is in accordance with the guidelines issued by the Association of African Development Finance Institutions (AADFI).

The rating questions listed below were taken 'as is' from the Ratings Questions and Instructions Manual issued by the AADFI. We have indicated and commented on instances where we had differences in opinion with the ratings given by IDBZ's management.

## GOVERNANCE STANDARDS

### Sufficient independence from government

1. All Board members except Government ex-officio members should meet professional and technical eligibility requirements

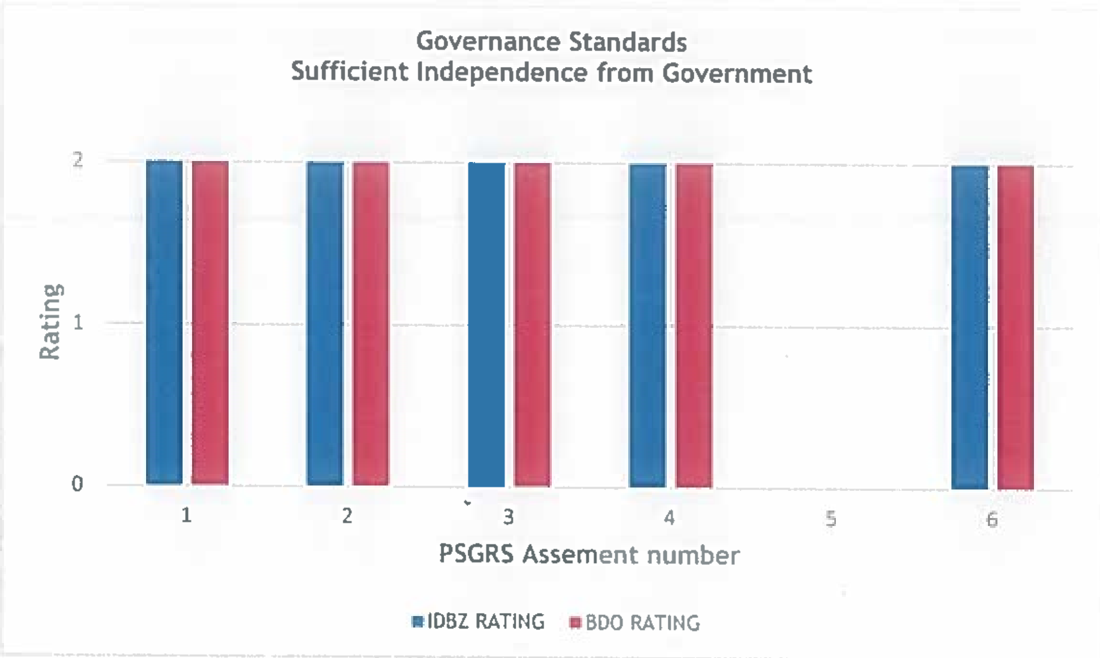
2. Government officials should play a minor role on Boards of Directors and should not be Chairman

3. No direct Government approvals should be required except for those normally made at a Shareholders Meeting

4. A DFI should operate under the Companies Act and/or the Banking Act, not under its own Act

5. A DFI should have some private ownership which is represented on its Board of Directors

6. A DFI should be supervised by a central bank or financial institutions advisory board if it is not a regional institution




**Comments**

Below is a motivation for the non-compliance (0) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 5 | IDBZ is 84.31277% directly owned by the Government and 15.68712% is held by the Reserve Bank of Zimbabwe, another government institutions. This gives a total of 99.6% Government ownership. The remaining 0.00011% is private Zimbabwean institutions and other international development finance institutions who do not have representation on the Bord of Directors |

**Management independence and incentives**

7. The CEO should be chosen by the Board or the Shareholders based on strong professional and technical background

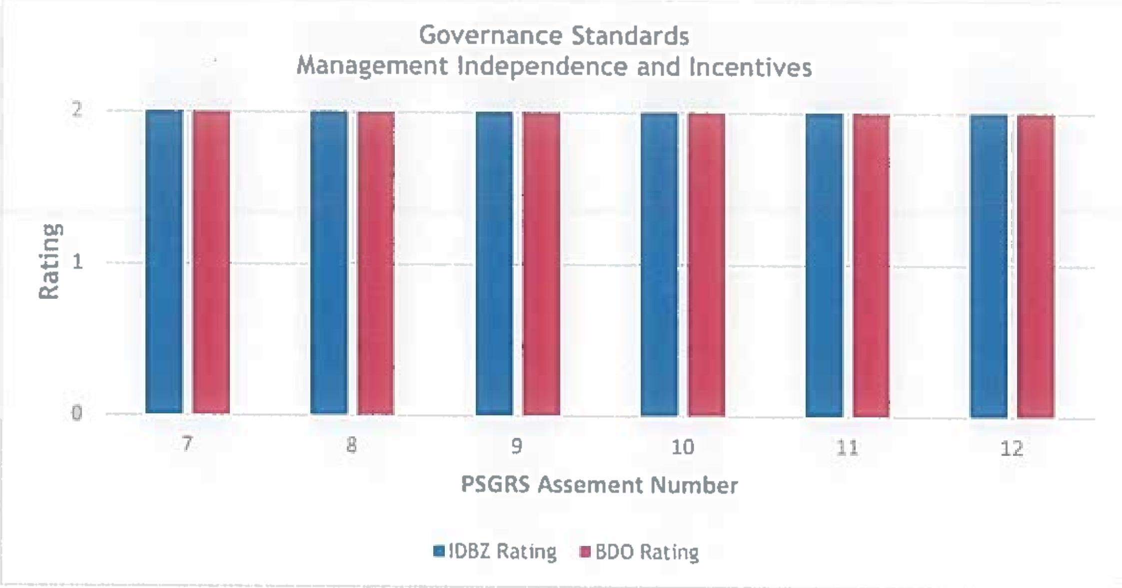
8. The Board of Directors or the shareholders meeting should be the only entities that have the right to fire the CEO

9. Boards of Directors and key committees of the Board should meet quarterly or monthly

10. The Chairman and a majority of the members of the Board should not have executive responsibilities

11. The CEO and key managers should have performance-based contracts

12. The Board and CEO should have the power to make important changes in strategy, product mix and closing branches




**Comments**
There was no variation between IDBZ's rating process and the Auditors' validation process.

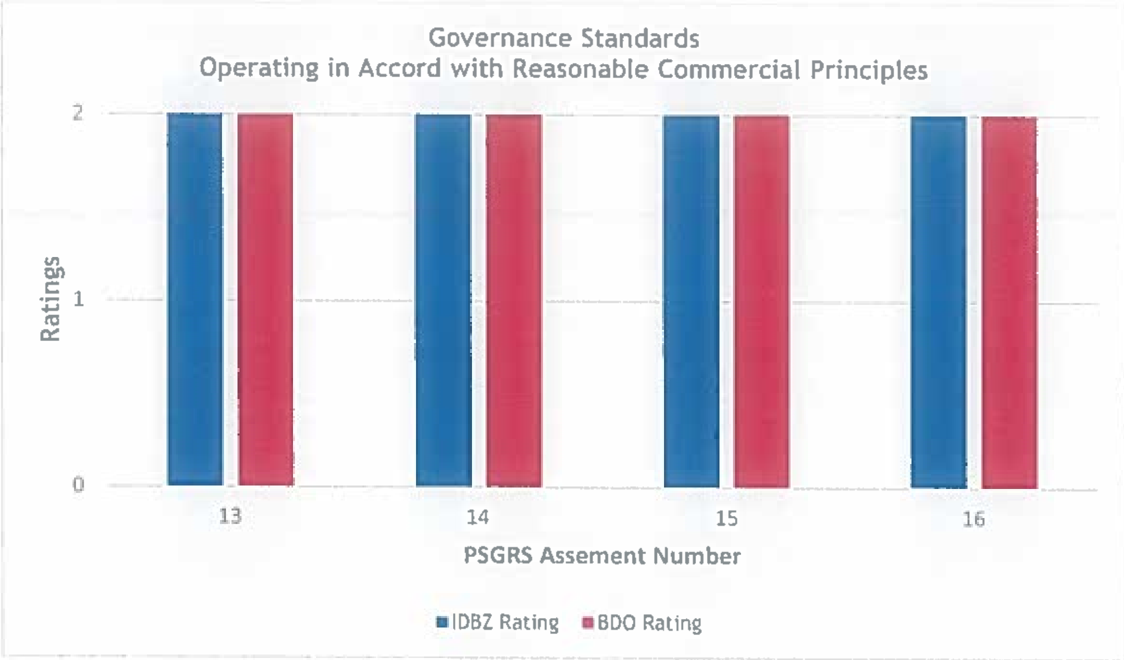
**Operating in accord with reasonable commercial principles**

**13.** Salaries of all higher-level staff should be at roughly the same levels paid by private financial institutions

**14.** Salary increases, promotions and conditions of service should be based primarily on merit and performance

**15.** Individual senior line managers should have specific performance targets and salary and performance review should be tied to performance against these targets

**16.** The DFI should have satisfactory procurement policies which enable it to conduct procurement largely in accord with normal commercial practice




**Comments**
There was no variation between IDBZ's rating process and the Auditors' validation process.

**Accounting and Auditing**

17. Accounts should be kept in accord with international accounting standards and principles and audited accounts should not be qualified

18. Internal balance sheets, income statements and loan status reports should be prepared at least monthly

19. Loans should be classified and provisioned in accord with international standards or local central bank requirements

20. Interest should be accrued and not taken into income in accord with international standards or local central bank requirements

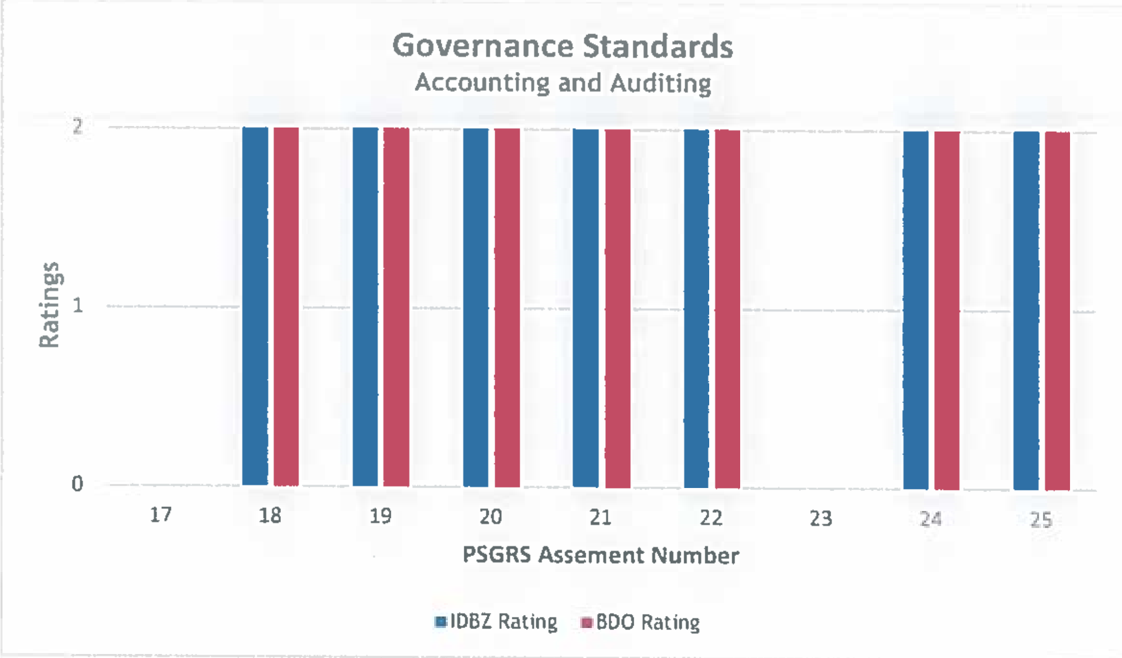
21. Audited accounts should disclose amount of gross loans and basis for their classification and uncollected interest income. Interest should not be capitalized except in cases of formal rescheduling

22. Accounts should be audited by international auditing firms or by one of the best private domestic auditing firms

23. Audited accounts should be available within 4 months of the end of each fiscal year and should be unqualified and published

24. There should be an internal audit department and it should report directly to the Board of Directors

25. Detailed accounting records should be kept of all off-balance sheet commitments and these commitments should be disclosed in the financial statements




**Comments**

Below is a motivation for our non-compliance (0) ratings for the ratings criteria above.

| No. | Comment |
|---|---|
| 17. | IDBZ was issued with qualified opinion due to the following;<br>• Valuation of investment property and property and equipment<br>• Fair valuation of deferred revenue |
| 23. | Audited accounts were not made available within 4 months of the end of 2021 fiscal year and were issued with a qualified opinion. |

**Management Information Systems and Procedures**

26. Detailed annual budgets should be approved by the Board of Directors before the beginning of each fiscal year and should be reviewed and, if necessary, revised at least semi-annually

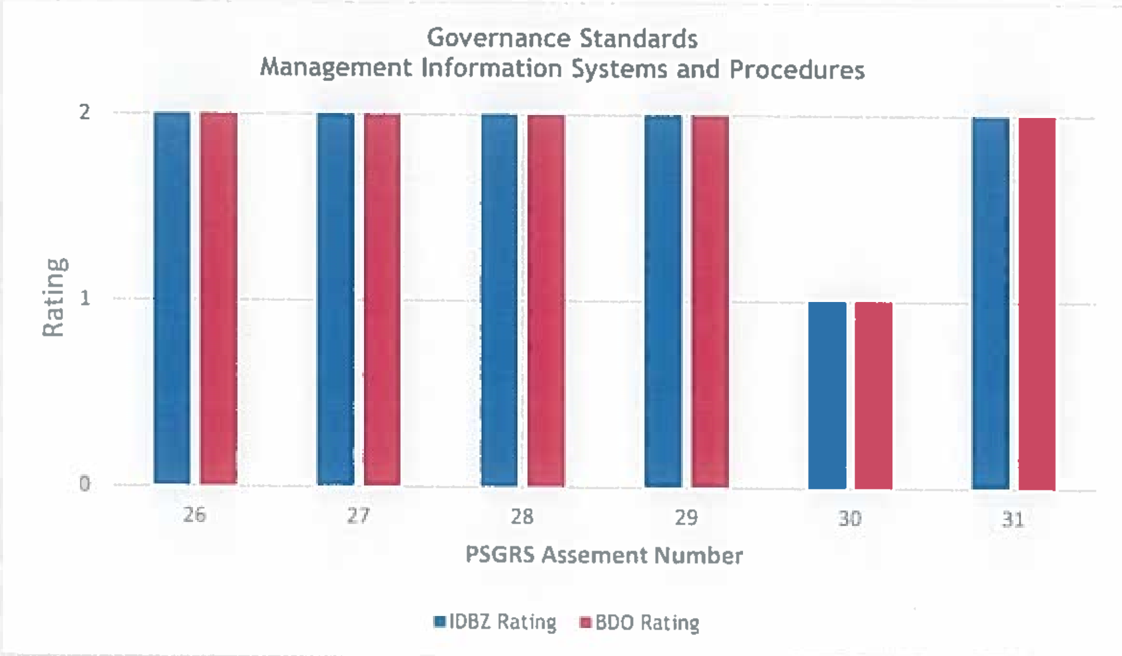
27. Financial performance should be reported against budget at the management level on a monthly basis

28. There should be a cost accounting system that regularly reports profit and loss of all significant programs and products

29. Cost accounting should be used to measure losses on commercially nonviable socio-economic oriented programs undertaken at Government request

30. Government should set up a managed fund or budget for, and reimburse DFIs for losses on commercially nonviable socio-economic oriented programs undertaken at Government request

31. Loan status reports should be available monthly which provide detailed analysis of performing and nonperforming loans and aging data




**Comments**
Below is a motivation for our partial-compliance (1) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 30. | Government of Zimbabwe has agreed in principle to reimburse the DFI for the financial losses and there is no specific fund or budget set to reimburse the DFI for losses on commercially non-viable projects |

**Corporate Citizen Governance Standards**

32. A DFI should have written performance agreement with owner

33. A DFI should have a clear written strategy as to how it intends to implement its mandate and performance agreement

34. There should be written job descriptions and lists of responsibilities for Board members and the corporate secretary

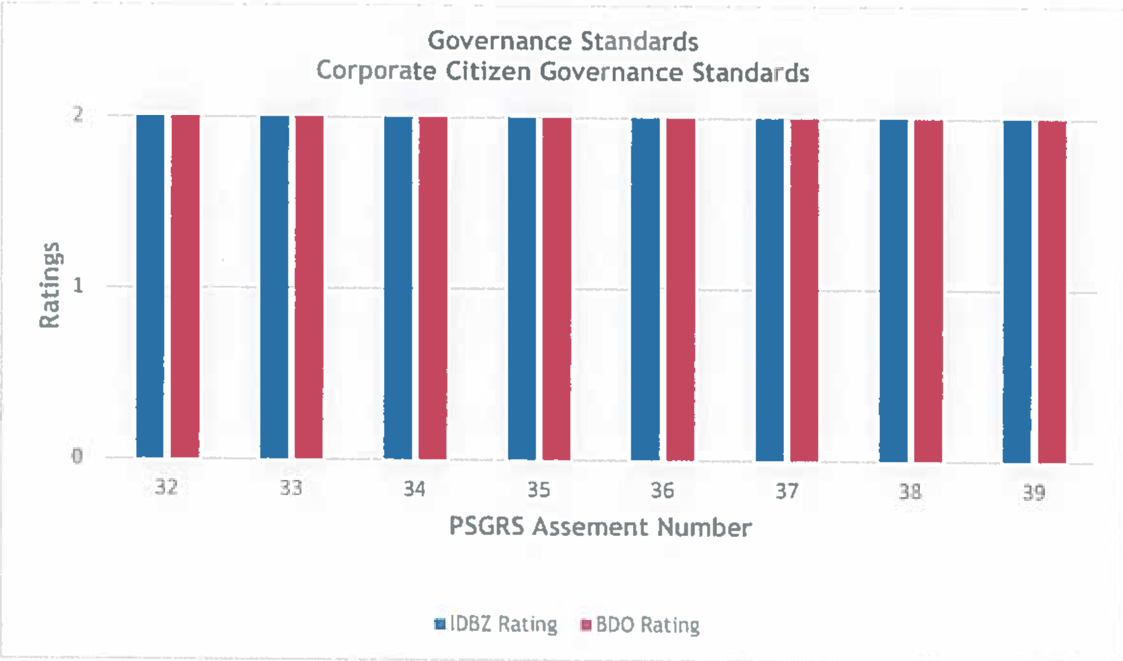
35. There should be clear policies with respect to ethics, corruption, and "knowing your customer"

36. There should be satisfactory policies for dealing with conflicts of interest and insider lending which are complied with

37. DFIs should adhere to internationally recognized guidelines (e.g., nationally required guidelines) relating to environmental impact

38. DFIs should have satisfactory written policies on anti-money laundering and comply with those policies

39. DFIs should have corporate social responsibility policies and comply with those policies




**Comments**
There was no variation between IDBZ's rating process and the Auditors' validation process.

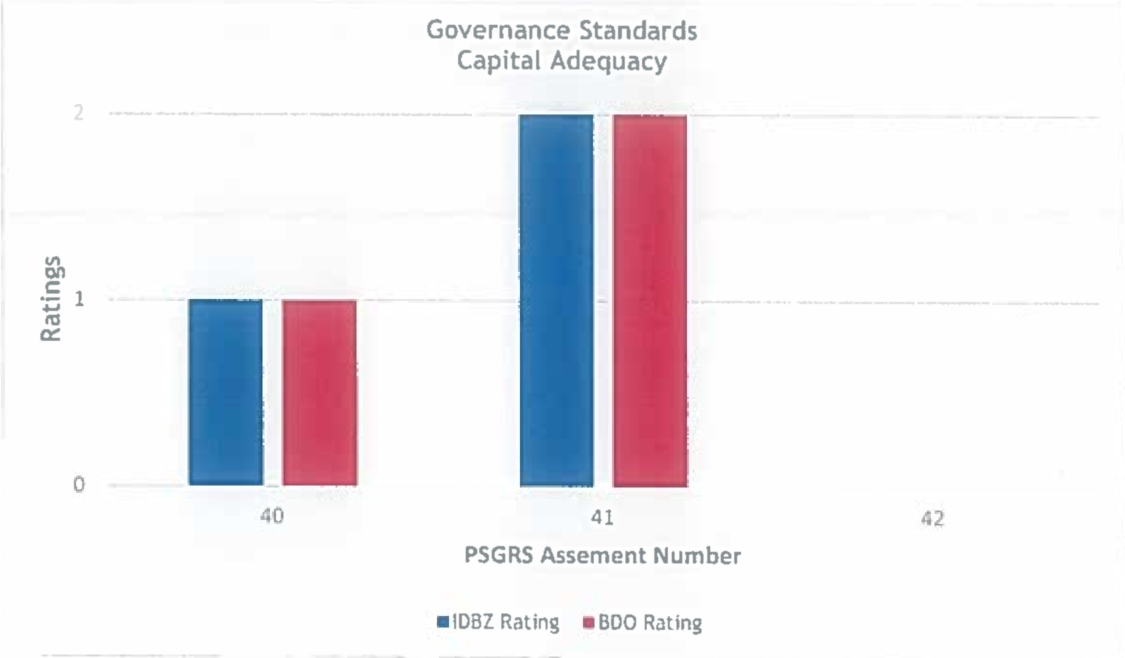
## FINANCIAL PRUDENTIAL STANDARDS

### Capital Adequacy

40. DFIs should have or exceed capital adequacy levels of at least 15% of risk weighted assets as defined by Basel.

41. DFIs should have long term debt to equity ratios of less than 4 to 1.

42. DFIs should ensure their capital (net worth) is adequately measured by having unqualified audited statements available less than 6 months after the fiscal yearend.




**Comments**

Below is a motivation for our partial (1) rating and non-compliance (0) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 40. | IDBZ has capital adequacy level of 10% which is below the threshold of the required 15% but withing the range of 6% to 15% for partial compliance |
| 42. | IDBZ Financial statements had a qualified opinion. |

**Profitability and Efficiency**

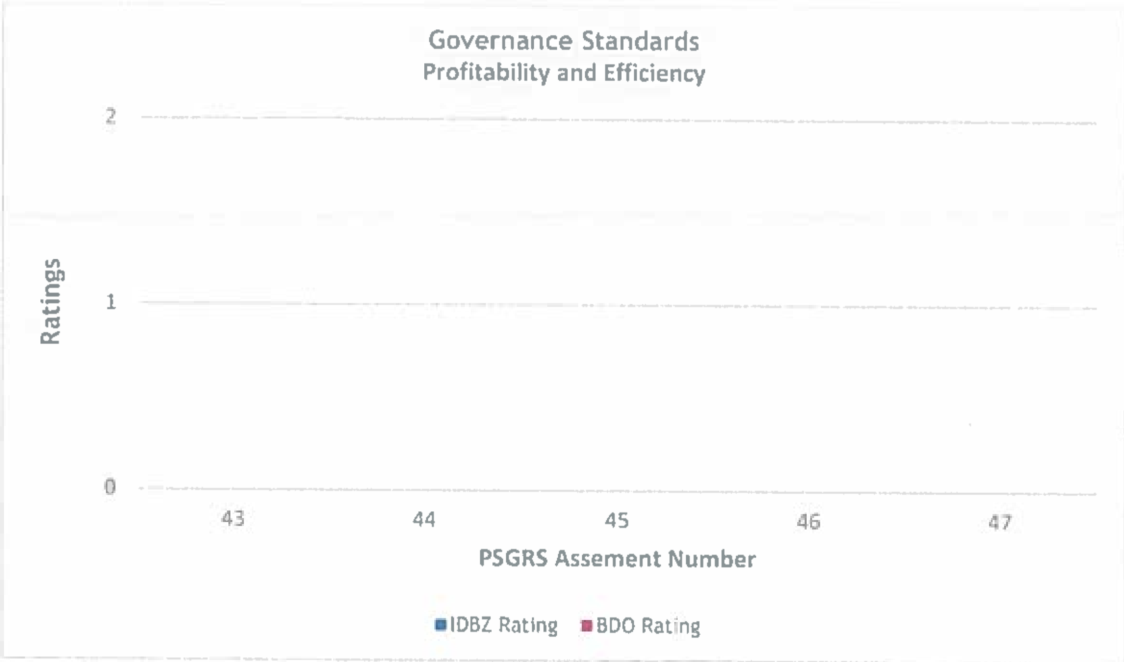
43. Administrative expense should not exceed 4% of average assets.

44. Minimum profit after tax should exceed 1% of average assets.

45. Retained net profit should be at least equal to 15% of the increase in risk weighted assets during each year to maintain capital adequacy.

46. DFIs should attempt to diversify into new products or businesses beyond long-term financing such that they represent at least 15% of gross revenue

47. Interest margin (defined to include dividend income) should exceed 4% of average assets.




**Comments**
Below is a motivation for our non-compliance (0) ratings for the ratings criteria above.

| No. | Comment |
|---|---|
| 43. | Administrative expenses were 13% of average assets which is above the 4% threshold required for a full compliance rating. |
| 44. | The DFI made a loss during the period under review. |
| 45. | The DFI made a loss and did not retain any profits during the period under review. |
| 46. | Non-funded income was less than 1% of gross revenue |
| 47. | Interest margin was less than 4% of average assets |

**Asset Quality**

48. Loans should be classified and uncollectible loans written off in accord with international standards or central bank requirements

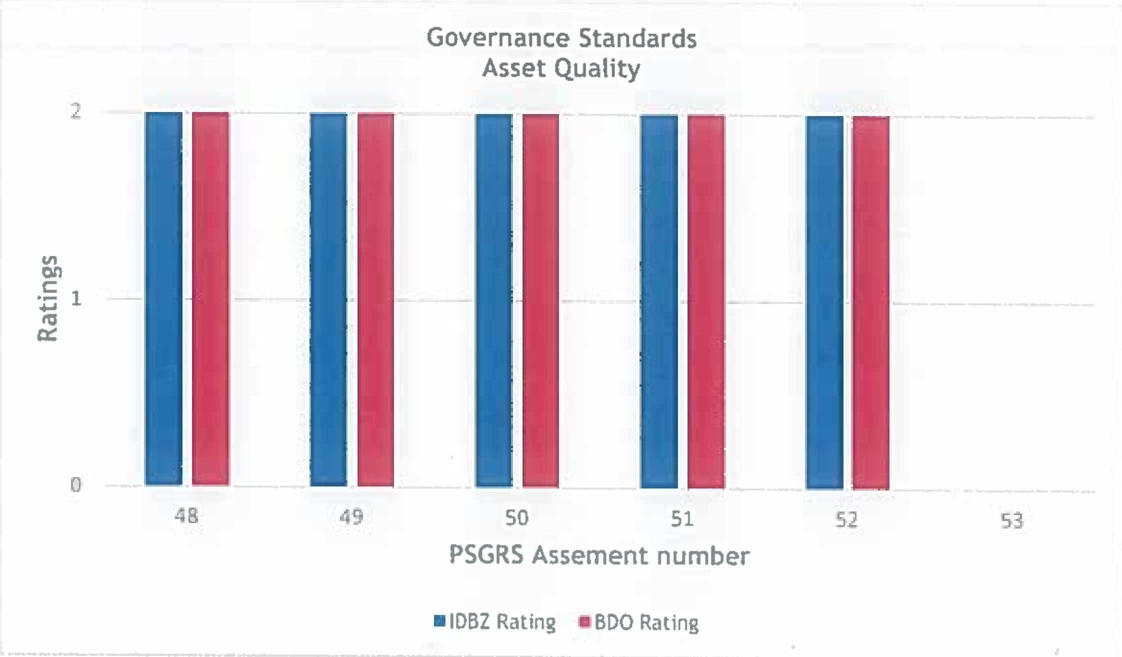
49. Non-performing loans should not exceed 25% of the gross loan portfolio

50. Bad debt provisions should be calculated in accord with international standards or central bank requirements

51. Bad debt provisions should normally be not less than 40% of non-performing loans

52. Equity investments should be valued in accord with international norms, i.e., at the lower of cost or fair market value or IFRS

53. Minimum average dividend return on net equity investments should exceed 2% per annum




**Comments**

Below is a motivation for our non-compliance (0) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 53. | The average dividends received in 2021 were less than 2% of equity investments. |

**Asset Diversity and Safety**

54. DFIs should have an Asset Liability (ALM) committee that meets at least monthly and have a policy of minimizing risk on management of liquid assets

55. DFIs should not have maximum single financial exposures that exceed 25% of net worth

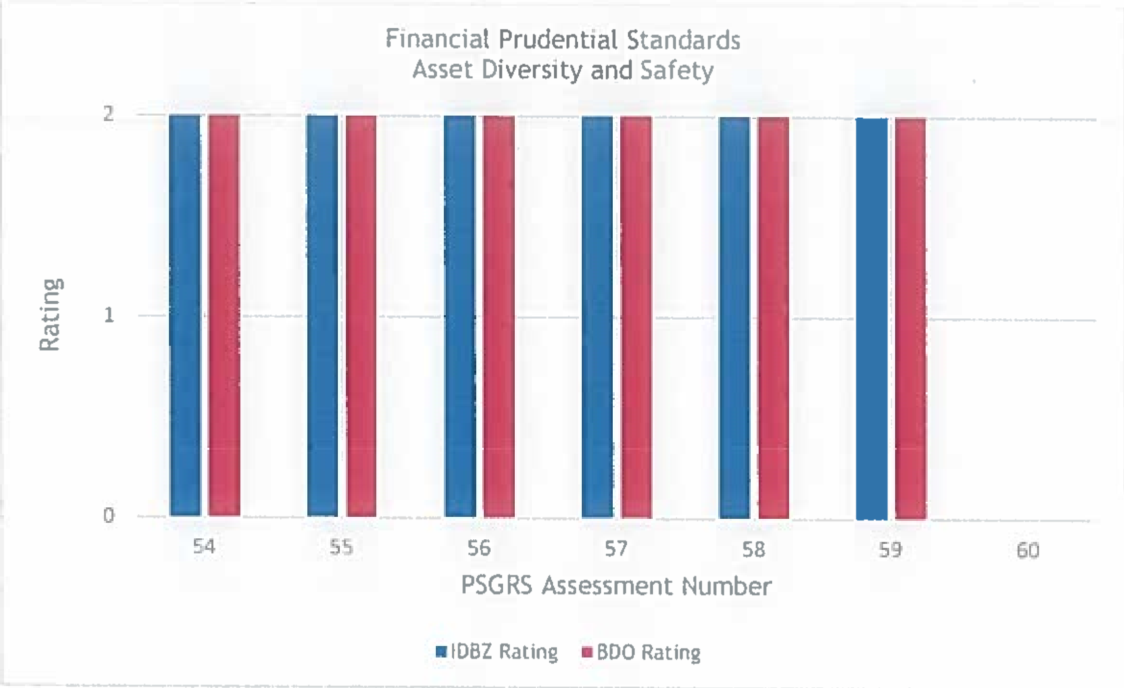
56. Not more than 40% of total assets should be denominated in foreign exchange

57. Net foreign exchange asset positions should not exceed 20% of net worth and should comply with central bank requirements

58. Sectoral gross loan and equity investment positions (sub-sectoral in the case of specialized DFIs) should not exceed 30% of total investment in loans and equity

59. Value of all equity investments should not exceed 50% of net worth

60. No equity ownership positions in any entity that is not a financial institution subsidiary should exceed a 35% ownership share




**Comments**
Below is a motivation for our non-compliance (0) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 60. | The DFI has holdings in the following which is above 35%<br>Mannelli Investment (Private) Limited (100%)<br>Waneka Properties (Private) Limited (70%)<br>Norton Medical Center (Private) Limited (60%)<br>Hwange Empumalanga West Housing Project (90%) |

**Liquidity**

61. Projected liquid resources over the next 3 to 12 months should exceed cash outflow projections by at least 10%

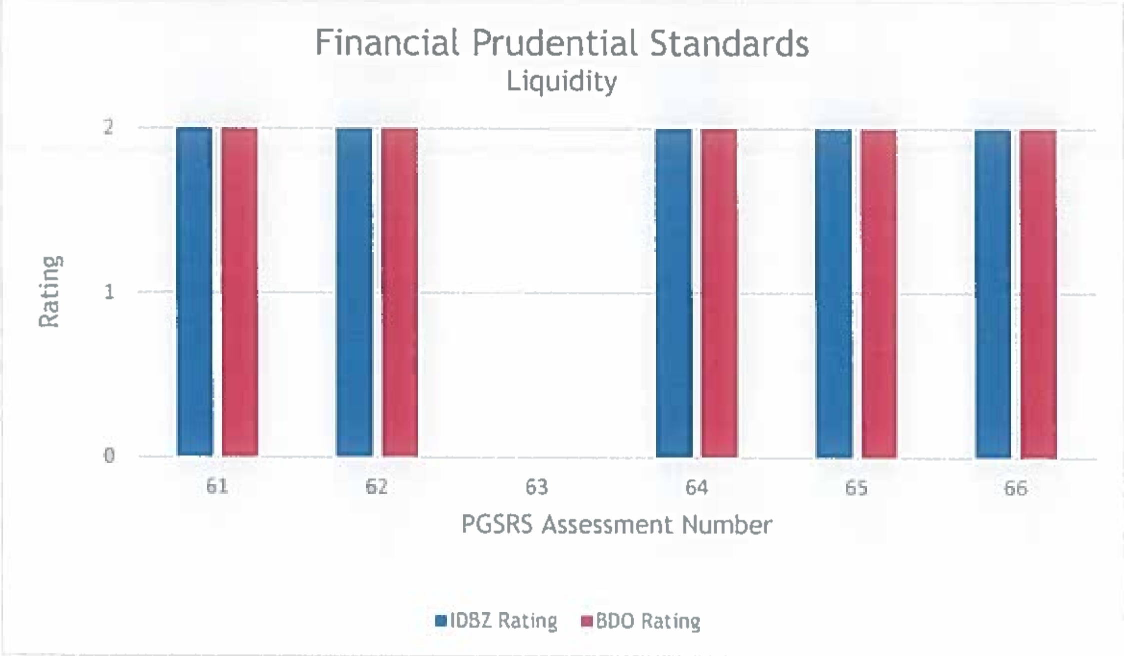
62. DFIs should be in compliance with all central bank liquidity requirements to which they are subject

63. DFIs should have a projected debt service ratio over the next 12 months of at least 1.3 times

64. DFI should have adequate liquid resources to meet all projected cash requirements over the next 90 days

65. There should be a definite plan for dealing with any significant excesses of liabilities over assets in at least 6 liquidity time buckets

66. DFIs should have a cumulative projected net liquid asset position over the next 12 months and the next 2 years




**Comments**
Below is a motivation for our non-compliance (0) rating for the ratings criteria above.

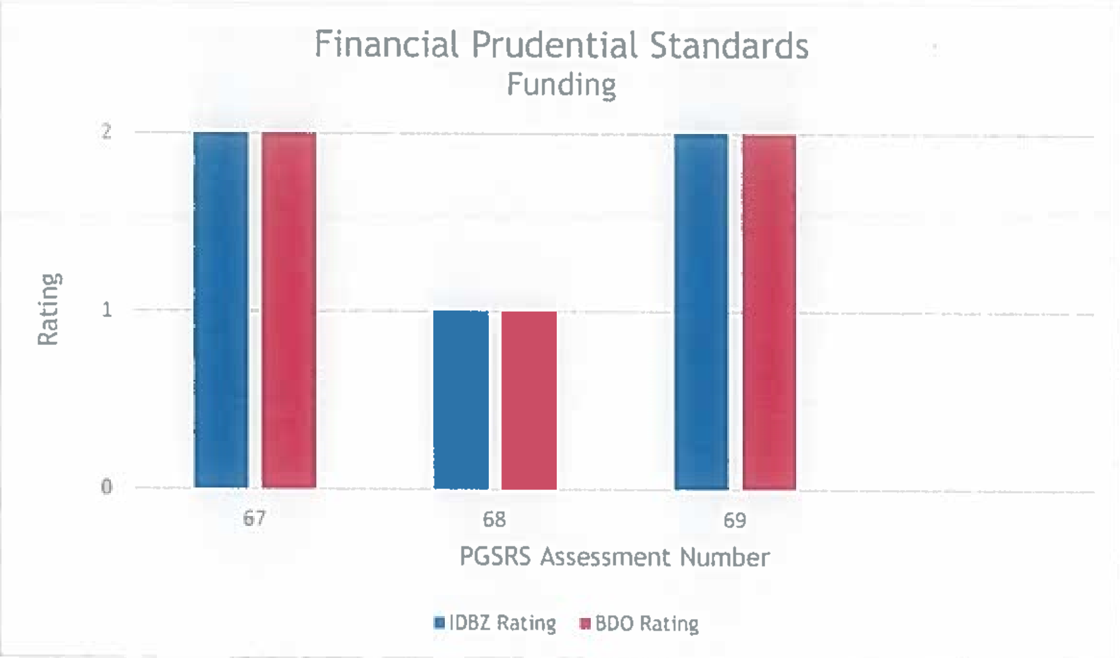
| No. | Comment |
|---|---|
| 63. | The Bank projected debt service ratio over the next 12 months is less than 1.3 times. |

Funding

67. DFIs should have uncommitted long-term resources that exceed budgeted commitments over the next 12 months by at least 50%

68. DFIs should have a dependable source of both long term foreign and long-term domestic funding resources

69. Local borrowed resources (including deposits) should exceed 25% of total liabilities and at least 40% should have maturities of more than 6 months




**Comments**

Below is a motivation for our partial (1) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 68. | The DFI does not have a dependable source of both long term foreign and long term domestic funding resources |

OPERATIONAL STANDARDS

**Risk Management Policies**

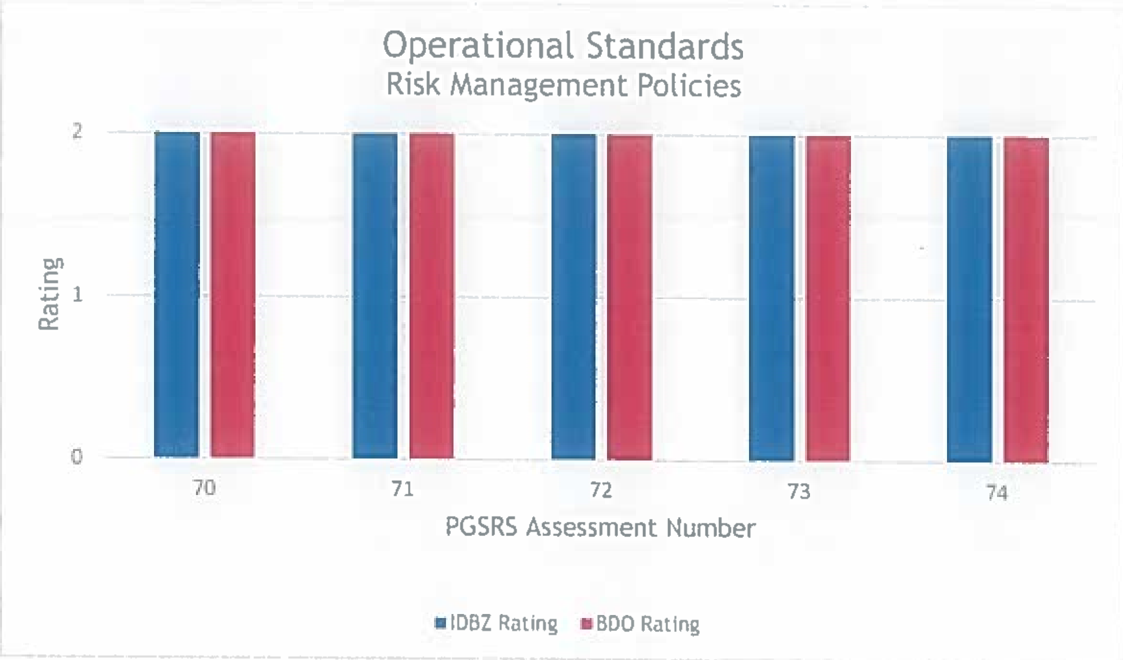
70. DFIs should charge a market rate of interest on essentially all lending and should charge higher interest rates on higher risk loans

71. DFIs should always avoid interest rate risk by matching variable rate lending with variable interest rate borrowing and fixed rate lending with fixed rate borrowing

72. The majority of new lending and at least 25% of the total loan portfolio should be lent on a variable interest rate basis

73. Foreign exchange risk should be minimized by limiting net foreign exchange assets to less than 5% of total assets and avoiding net foreign exchange liabilities

74. Foreign exchange-denominated lending should either be exchange risk insured or in foreign exchange with exchange risk passed on only to borrowers who are exporters or de facto exporters who can hedge that risk




**Comments**
There was no variation between IDBZ's rating process and the Auditors' validation process.

**Lending Policies**

75. Most new loans should be custom tailored to seasonal cash flow of borrowers or repayable on a quarterly or monthly basis

76. At least 50% of lending during the last year should be for expansion projects or green field projects sponsored by repeat borrowers

77. DFIs should be reducing overall average maturity of lending by making at least 20% of new lending during the last year for terms of not more than two years

78. DFIs should utilize co financing with commercial bank on a regular basis and do some co-loan administration

79. DFIs should utilize credit risk guarantee alternatives where available to reduce their own risk or catalyze term lending by others

80. DFIs should reschedule Greenfield project loans routinely at end of grace period if there are small cost or time overruns

81. Records and projections of at least two years should be maintained for uncommitted approvals, undisbursed commitments, uncommitted long term funding sources and project pipeline

82. DFIs should have specific policies and procedures for reducing potential undermining of portfolio quality caused by trying to meet lending volume targets


**Comments**
Below is a motivation for our partial (1) ratings and non-compliance (0) ratings for the ratings criteria above.

| No. | Comment |
|---|---|
| 77. | The percentage of new lending for IDBZ with a tenor of less than 2years is between 5% and 10% giving it a partial compliance (1) |
| 78. | IDBZ has not been utilizing co-financing mechanisms or co-loaning mechanisms. |
| 79. | In the period under review the Bank, offered credit risk guarantee programs to catalyze lending by other institutions to its clients resulting a partial compliance |

83. Appraisal officers should be organized on a sectorial basis, be responsible for supervising projects they appraise, and receive feedback on the performance of their loans

84. Appraisal reports and credit committee approval should be required for all term loans. Credit committees should represent at least 3 non-appraisal departments

85. DFIs should have a policy that ensures most loans are appraised in less than 4 months

86. Minimum equity requirements for projects should include a minimum of 30% of project cost of which at least 10% of project cost should be in the form of liquid resources

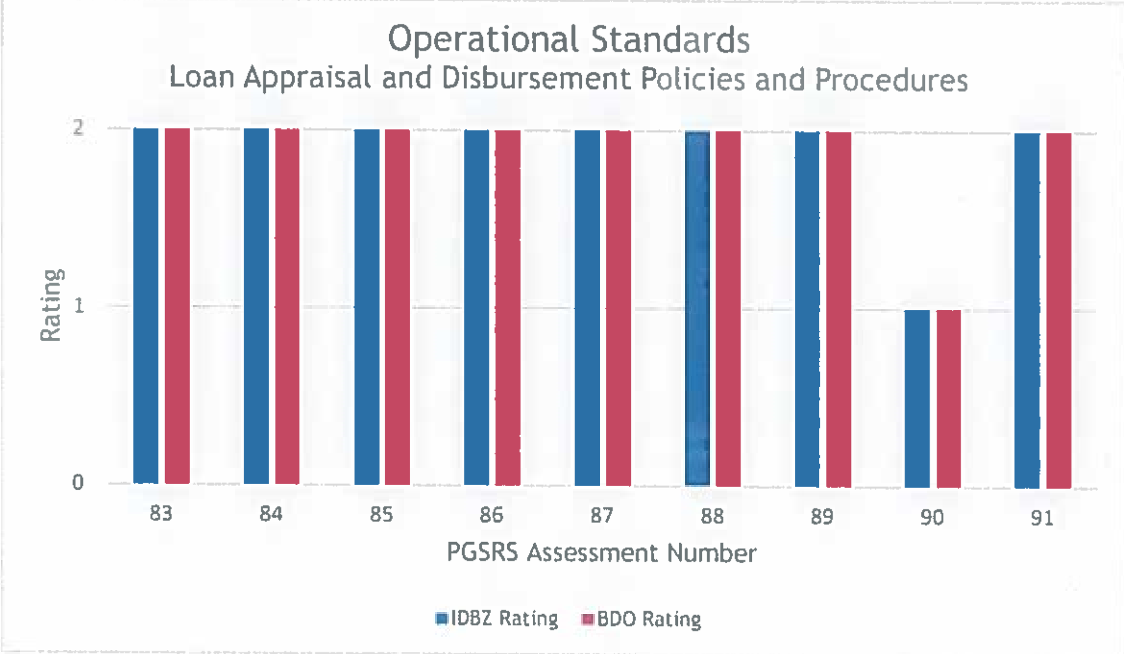
87. DFIs should normally require that projects have projected debt service coverage ratios of at least 1.3 times and loan security (collateral) of at least 110% of the loan amount

88. A satisfactory formal credit reference report, inter alia, including all banking relationships, should be required for all loans

89. All significant project risks should be explicitly identified and an FIRR inclusive of sensitivity tests for all such risks should be calculated

90. An ERR, jobs created, and resource leveraging (amount of debt supplied by other lenders) should be calculated for all projects

91. DFIs should ensure that all disbursements are handled by work units and staff who do not appraise or supervise loans




**Comments**
Below is a motivation for our partial (1) rating for the ratings criteria above.

| No. | Comment |
|---|---|
| 90. | IDBZ has not met all the indicators to ensure full compliance. |

**Supervision and Collection Policies**

92. Detailed supervision reports should be prepared at least quarterly for all projects under implementation or in their first year of operation

93. New amounts coming due and collections should be recorded at least monthly and individual responsibility for collection should be assigned for all loans

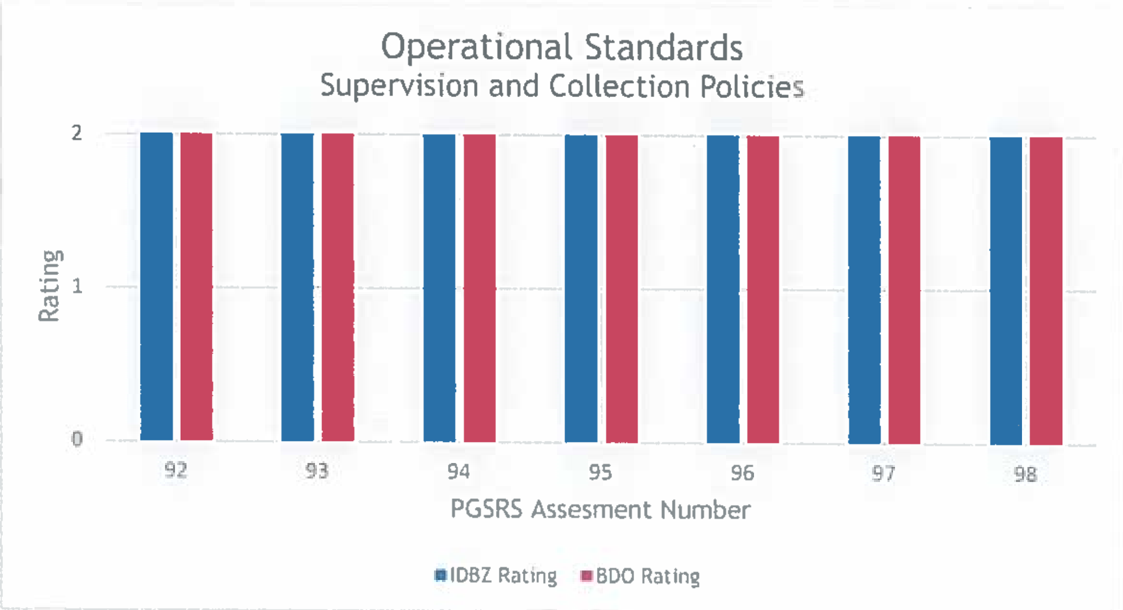
94. Written procedures should be adhered to for action to be taken when a loan first falls 30 days and 90 days overdue

95. Supervision reports should be prepared semi-annually and projects visited at least annually for all borrowers who are in default for over 60 days

96. DFI should adhere to written loan rescheduling procedures in accord with international practice or central bank requirements

97. There should be an adequately staffed workout unit for problem loans and written policies and procedures for resolving and reporting on these loans

98. Specific written criteria should be established for determining when legal action should be taken against defaulters which are followed in at least 75% of the cases

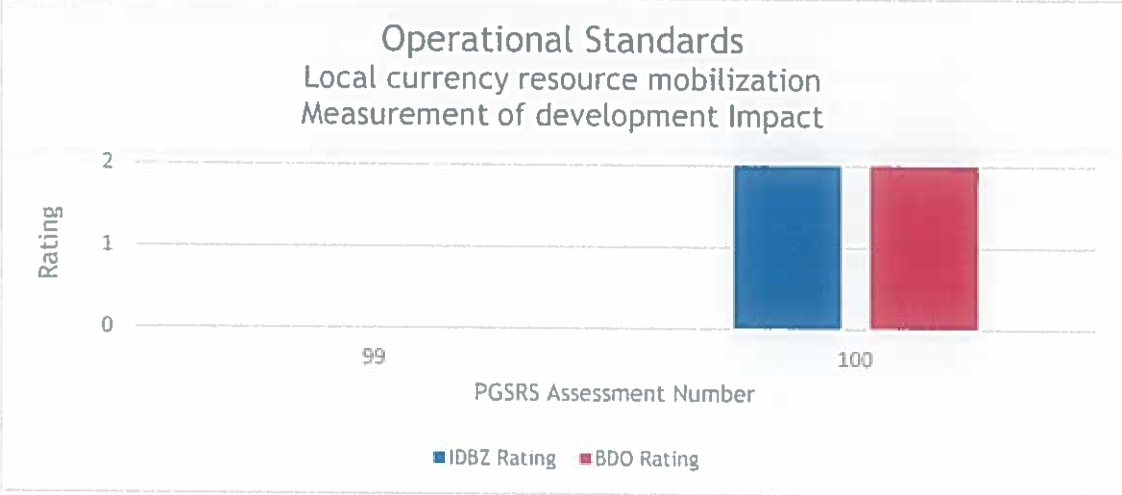



**Comment**
There was no variation between IDBZ's ratings and those on the PSGRS Assessment, therefore the DFI was in Full Compliance.

**Operations Strategy Policies**

99. DFIs should collect long term local currency resources with a tenor of more than one year equal to at least 10% of the net value of its loan portfolio

100. DFIs should attempt to diversify into new products or businesses beyond long term financing such that they represent at least 15% of gross revenue




**Comments**

Below is a motivation for our non-compliance (0) ratings for the ratings criteria above.

| No. | Comment |
|---|---|
| 99. | IDBZ has not met all the indicators to ensure full compliance. |