AccountAble

Micro-credit Revolving Funds **Issue 24 for Aug-01;** Revised & released: May-02

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Revolving Fund is a very wide term – it includes funds for purchasing raw material, stocks, running an Income Generation Project as also a credit program. Revolving Funds for running Income Generation Projects are also known as Working Capital.

In this issue, we are concerned mainly with Revolving Funds for credit programs.

What is a Revolving Fund

Running a credit-based Revolving Fund is very similar to managing a Bank. In fact Revolving Funds are created by NGOs mainly to overcome the shortcomings of commercial banks.

A commercial bank raises money by selling shares or accepting deposits. An NGO raises money for Revolving Funds through grants from Funding Agencies.

The bank generally avoids giving out small loans because they find management costs of such loans too high.

An NGO gives loans to people who cannot get loans from banks. These people may be women or men working in small business / trades (micro-enterprise) or they may be small farmers or they may wish to take up goat-herding, piggery, poultry etc. on a small scale. The loans given may range from Rs.750 to Rs.20,000 or more.

Quite often the loans are given through a small group of 5–30 persons. This helps group formation and improves recovery rate. Some NGOs have extensive paperwork (application forms, photographs, attendance records, pass-books, collection sheets, receipt books, loan agreements), whereas others may simply be satisfied with a thumb-impression on a voucher or a register.

In almost all cases, no security is taken. Sometimes these loans are interest-free – in other cases, flat interest (10% of the loan) or annual interest (10-25% per annum) may be charged. The interest helps pay operating costs and protects the Revolving Fund from inflation.

This kind of micro-credit programs have proved highly successful, much to the surprise of traditional bankers. Some of the better known examples are Grameen Bank, Bangladesh; SEWA Bank, Ahmedabad and MYRADA, Banaglore.

FCRA Treatment

If your Revolving Fund has been created out of Foreign Contribution, then you should keep the following in mind:

1) When the loans are given out:

a) When the loans are given out to the people, these should be shown on the Payment side of the FCRA Receipts & Payments Account.

b) The loans given out should not be shown as an expenditure in the Income & Expenditure Account.

c) Whatever amount is given out as loans during the year should be shown as utilization in FC-3 [Table 2, column 10].

d) The loans given to beneficiaries are recoverable and, therefore, an asset for your organization. These should be shown as assets in the FCRA Balance Sheet.

e) In order to tally the Balance Sheet, a Revolving Fund Account should be created on the Liabilities side of the Balance Sheet. This account would show the original amount of grant received for the Revolving Fund.

2) When the loans are recovered:

a) Loan recoveries should be deposited in organisation's FCRA Bank Account as per FCRA requirements. However, some people prefer depositing the recoveries in a separate bank account for better control over revolving fund.

b) Show these as receipt in the Receipts & Payments Account.

c) Also show these as receipt in FC-3 [table 2, row 10[1], column 7]. The amount should also be included under table 4, sub-head (iii) 'Individual donors below 1 lakh'. The amount should also be reported in the country analysis (table 5) as receipts from 'India'.

d) Show the total recovery in the Balance Sheet on the Assets side.

3) Interest received on micro-credit loans:

In some cases, NGOs receive interest and other service charges from the self-help groups. Both these are treated as FC funds[2].

a) Show these on the receipt side of the FCRA Receipts & Payments Account.

b) Also report these[3] in FC-3 under table 2, row 56, column 7. You can specify this as 'interest / service charges on revolving fund'.

c) Interest income should be shown in table 1A also. This can be done under sub-heading (ii)(b) as 'interest on revolving fund loans'.

4) Interest paid to funding agency:

In some cases, the NGO has to pay a nominal interest to the funding agency for the revolving fund[4]. This interest should be reported as an expense in FC-3. You could show this as utilization (column 10) in row 56 of table 2.

FCRA Balance Sheet (partial) of Lok Jagran Manch as at 31-March 2002

Liabilities		Assets	
Revolving Fund:		Beneficiary Loans:	
Opening Balance	450,000	Opening Balance	428,300
Add: Grant Received this year	50,000	*Add*: Loans given this year	275,800
	500,000	*Less*: Loans recovered	186,700
Less: Loans written off	4,850	*Less*: Loans written off	4,850
Closing Balance	495,150		512,550
Interest on Rev. Fund:		Bank Balance	23,900
Opening Balance	10,000		
Add: Received this year	31,300		
	41,300		
Total	**536,450**	**Total**	**536,450**

5) When the loans are given out again:

a) Show these on the Payment side of the FCRA Receipts & Payments Account.

b) Do not show these as an expenditure in the Income & Expenditure Account.

c) Whatever amount is given out again as loans during the year should be shown as utilization in FC-3 [table 2].

d) Show these loans on the Assets side of the FCRA Balance Sheet.

FCRA Receipts & Payments Account (partial) of Lok Jagran Manch for year ended 31st March 2002

Receipts		Payments	
Opening Bank Balance	31,700	Loans given out	275,800
Grant received this year	50,000		
Loans recovered from benef.	186,700		
Interest received on RF loans	31,300	Closing Bank Balance	23,900
Total	**299,700**	**Total**	**299,700**

You should not transfer these funds to Indian section of the Balance Sheet at any time. Any loans that become irrecoverable during the year can be written off by reducing the Revolving Fund in the Balance Sheet as shown on page 2.

[1] Micro-finance projects, including setting up banking, co-operatives and self-help groups

[2] If generated on a revolving fund created with foreign contribution

[3] Interest and service charges etc.

[4] Provisions of Foreign Exchange Management Act, 1999 may also apply.

Village Level Organizations

Can you transfer an FCRA Revolving Fund or its recovery to Village Level Organizations, such as *Mahila Mandals*[5] or self-help groups?

6) What is the law?

Let us first look at FCRA provisions regarding this.

1. FCRA covers all 'associations of individuals', whether incorporated or not [Section 2(1)(a)].
2. Foreign contribution includes delivery or transfer of funds from a foreign source. This is much wider than the commonly understood sense of 'donation' or 'grant' only [section 2(1)(c)].
3. The FCRA registration letter[6] prohibits transfer of FCRA funds to any other organization not registered (or having prior-permission) under FCRA.
4. However, receipt of foreign contribution is regulated only if the 'association' has a 'definite cultural, economic, educational, religious or social programme'.

7) Applying the law

How does this apply to our situation? To understand this, *Mahila Mandals* or self-help groups can be categorised into five stages of evolution:

Stage	Association[7]	Program[8]
1	People just meet every week. No formal leadership.	No program. Just a common interest.
2	Meetings continue. A name is given to the Mandal. Leaders start emerging.	No program. Just a common interest in savings and credit.
3.	Group becomes more organised. A membership register is started. Office bearers are appointed.	Objectives of the group are widened and put down in writing.
4.	Memorandum of Association is signed. Society is not yet registered.	Memorandum of Association serves as a definite program.
5.	Society is formally registered.	Definite program continues to exist.

What happens if these groups want to receive FC funds?

- Groups at stages 1 & 2 do not need FCRA registration or prior permission.
- Groups at stage 3 may or may not need FCRA.
- Groups at stages 4 & 5 definitely need FCRA.

Accounting & Control

Classic accounting wisdom holds that recoverable loans should be treated as an asset. All banks follow this practice (though sometimes one wishes they wouldn't!). It is on this basis that FCRA department insists on revision of FC-3 wherever NGOs write off recoverable loans as Program Expenditure (*see FCRA Treatment*). Keep in mind that FCRA Revolving Funds should always be accounted in FCRA Cash Book and Ledgers.

When you treat the loans as an asset, the following issues come up:

8) Individual loans:

You need to keep track of each loan separately. However, you can not open hundreds of loan accounts in the main ledgers. A sub-ledger is normally kept for individual accounts of the beneficiaries. In the main ledger, only total entries for each day may be recorded – the details are recorded in each individual's account. The main ledger and the sub-ledger are periodically tallied (reconciled). This system is similar to how your bank maintains your organization's account in a sub-ledger.

9) Pass Books:

Individual beneficiaries are issued loan pass-books. The loans given and the installments collected are entered in these pass-books. It is a good idea to have a photograph of the beneficiary pasted on the pass-book. Also if the pass book is printed bilingually (English and local language), it will help both your auditors as also the beneficiaries. If possible, try to cross-

[5] Women's Groups

[6] Also see explanation to section 2(1)(c)

[7] Section 2(1)(a)

[8] Section 6(1)

check the pass-books periodically with your sub-ledger accounts.

10) Loan Documentation:

You need to have enough details in your office to locate and identify the beneficiaries. This may mean that apart from the address and parent's / spouse's name, you also keep a photograph of the beneficiary on the files. Getting a photograph may be easier than it sounds – you can use your own camera and photograph two persons at a time, standing side-by-side. Village people are often known by common names or pet names - keep a note of these also.

A loan agreement on stamp paper is often useless in development work. However use it if you find it relevant as a psychological tool. In such a case, have the standard agreement reviewed by a lawyer or your auditors.

If you don't want to get into the stamp paper routine, try plain paper instead. The agreement remains effective whether it is on stamp-paper or not.

You will need to keep proof of payment. This can be on a voucher or on a plain paper. Use a revenue stamp if the loan amount exceeds Rs.500. If the beneficiary is going to use their thumb, make sure it is the left thumb. Thumb impressions should normally be witnessed by one or two villagers whose names and addresses should be noted on the receipt / voucher.

11) Recoveries:

If you want to keep your auditors happy, deposit the recoveries in the bank account first. In the long run, this will strengthen your internal controls and you are less likely to lose money through fraud.

Remember that you need to issue individual receipts. These should be pre-numbered and should have a carbon copy. Avoid using receipts which have a tear-off counterfoil. Bi-lingual receipts are better than English or local language receipts.

12) Internal Reporting:

You need to generate regular reports to monitor how the credit program is progressing. These reports can show you how the recovery is progressing around different areas and how the funds recovered are being given out again. This will help you identify weaknesses in group-formation as also potential problems.

The key to managing a Revolving Fund is keeping the maximum amount of money out on loans at any given point of time. At the same time, you need to ensure that the money rotates from hand-to-hand reasonably fast. This will help you spread the benefit of your revolving fund.

13) DonorReporting:

Quite often the donors are satisfied to see a one time expense on their reports – 'All loans disbursed'. However, this misses out on the basic idea behind a Revolving Fund. Donorreports should show how much money has been recovered and how much has been disbursed again. The reports should also show how much loan amount remains healthy and recoverable at the end of the period.

Revolving Fund Status on 31st March '02	
Total Revolving fund Grant received so far	**500,000**
Utilization of This Grant:	
Opening Balance of Beneficiary Loans	428,300
Add: Fresh loans given out in this period	275,800
Total	**704,100**
Less: Recovery of Loans in this period	-186,700
Balance of Beneficiary Loans	517,400
Less: Loans written off as irrecoverable	-4,850
Final Balance of Beneficiary Loans	**512,550**

Your questions, comments and suggestions can be sent to AccountAid India, 55-B, Pocket C, Siddharth Extension, New Delhi-110 014; Phone: 011-2634 3128; Ph./Fax: 011-26346041, e-mail:accountaid@vsnl.com ; accountaid@gmail.com