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Microfinance Accounting

Abstract

Every business cycle requires money at every steps, this is true also for any type of businesses. Micro Finance too begins with money for money. Micro Finance is about the finance to satisfy the need for small entrepreneurs to fulfill or to set up a business at a small scale and give a source of livelihood to people from poor villages, and increase the standard to live life in an optimistic manner. Good accounting practices are an important cornerstone in building a successful microfinance project. Accounting records are the starting point for measuring performance, revising your budget, and reporting progress.

Keywords: Microfinance, Money, Accounting, Financial Reporting, Accounting Standards.

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Introduction

On a daily basis, MFIs engage in transactions, which result in money changing hands. All these transactions need to be recorded accurately otherwise an MFI will lose track of its operations. The process of recording these financial transactions and summarizing the results is referred to as Book Keeping. The bookkeeper will typically be responsible for recording all financial transactions in a transactions journal (Book of prime entry) on a day-to-day basis. Once the transactions have been summarized, they need to be interpreted and communicated to the end users. Accounting is therefore concerned with the interpretation and communication of the financial information to its users through the use of financial reports. These financial reports include amongst others the Balance Sheet, Income Statement. For MFIs, they also need to include a Portfolio Performance report.

Generally accounting is concerned with:

1. Identifying and selecting the information which intended users will need
2. Evaluating the information in the manner which is most useful to the intended users
3. Communicating the selected information and processing it in the form most appropriate to the requirements of its users.

It should be noted that the focus of accounting information is on its users. Accounting is therefore simply a way of recording, analyzing and summarizing transactions of a business and communicating the financial information to the end users.

Below are end users of accounting information and their respective uses of such information;

Board Members

The board members would like to analyse financial statements and operational statistics to better perform their key duty of monitoring management performance and steering the MFI towards attaining its institutional objectives, which includes financial sustainability.

Management

They measure their performance with a view to improve it. They would also like to study, identify and address areas of good, average and poor performance.

Shareholders

These evaluate the probability of capital growth and receiving dividends and total safety of assets in the institution. For non-shareholding MFIs, the members are more concerned about management caution in running the affairs of institution's, safety of assets and ensure them that the institution continues to run according to their mission and vision.

Creditors

The creditor assures that the institution will be able to pay both interest and principal. They are concerned with short term liquidity (ability to meet current financial obligations as they become due) as well as long term solvency (ability to generate enough cash to repay long term debts as they mature) as well as the levels of debt in relation to equity.

Donors

The donors would like know whether the institution will be able to provide the service on a sustainable basis and create impact while meeting grant or loan requirements and conditions.

Regulatory Bodies

These would like to be convinced that the institution is run professionally. They would also like to know whether the institution is financially and operationally sound and that is run in such away as to maintain the soundness. As earlier stated, various MFI stakeholders require information to assess the extent to which the MFI objectives have been attained. Accounting through financial statements provides most of this information. Best practice in microfinance suggests that good financial analysis is the basis for successful and sustainable microfinance operations. The quality of financial analysis depends on the quality of the information that has been recorded for analysis and this information is derived largely from the accounting system.

Therefore, the purpose of accounting for every MFI should be:

1. To provide records that are the starting point for measuring performance, revising budgets, and reporting progress.
2. To provide information to facilitate high quality financial analysis by various stake holders.
3. To provide factual information to aid clear-sighted management rather than guesswork.
4. To reassure and inspire confidence from donors and other sources of loan capital of the institutions soundness and performance.
5. To help microfinance institutions to achieve their basic existence objectives: expanding outreach to the poor and achieving sustainability and self-sufficiency.

This is done through-

1. Data collection on projects that allows prospective donors and commercial lenders to evaluate performance.
2. Reporting information that includes data on the loan portfolio and outreach; interest rate policy; income and expenses; balance sheet information, and analytical performance indicators.
3. Further processing the financial and portfolio information so assembled into conventional ratios and other performance indicators.

Accounting Practices Followed

There are different organizational structures adopted by the MFI's. The laws and legal formalities applicable to such different organisations differ. Some trusts registered under the Indian trust act and others prepare and present the accounts according to their whims and fancies since such laws do not contain provisions relating to accounts.

Financial Reporting

There exist various interest groups who require different kinds of information from the accounts of the organization. For eg the Income Tax Department may be most interested in the calculation of net profit and the classification of expenditure as revenue or capital, since only revenue expenditure are allowed as deduction. They are also interested in the information relating to donations and whether it is corpus donation or not since corpus donations do not form part of income taxable. Likewise donors may be interested in the figures relating to utilization of their donation and how effectively it was spent. Bankers and other debt providers may be interested in the information relating to interest coverage visa vis the net profit and the efficiency of repayment etc. Thus the financial accounts preparation and reporting has to be fine tuned in such a way as to satisfy to the maximum extent possible the requirements of the users of the financial reports.

Methods of Accounting

They are two methods of Accounting, Cash system of accounting and Accrual system of accounting. A hybrid of the above two systems are also followed. In the case of cash system of accounting transactions are recorded when the relative cash receipts are actually received or when the expenses are actually paid out. Accrual system of accounting on the other hand would record transactions as when the right to receive the revenue arises or the liability to pay the expenditure is incurred. It is pertinent to note that under the Companies Act 1956 vide Section 209(3)(b) it is mandatory to follow the accrual system of accounting. It is to be noted that Section 145 of the Income Tax Act allows a person to follow either of the two methods. But accrual basis of accounting would be preferable since the same is more scientific and conceptually superior to cash system. Thus the MFI's are free to choose the method as may be found suitable to them except in the case of MFI's which are companies where it is compulsory to follow accrual system.

Applicability of Acounting Standards

Accounting standards are designed to apply to the general purpose financial statements and other financial reporting which are subject to the attest function of the members of the Institute of Chartered Accountants of India (ICAI). The ICAI is of the opinion that micro finance activities are of a commercial nature even though the objectives may be charitable or non- profit. Thus the various accounting standards issued by the ICAI are applicable to such MFI's and the same would help maintaining the uniformity in the presentation of accounts. Even where the same is not applicable still it is recommended that the standards may be followed. As such Accounting Standards (AS) 1 to AS 7 and AS 9 to AS 29 shall be applicable to MFI's.

Aim of The Study

To Tell about Microfinance and accounting importance in Microfinance, Variour Mathods

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