CENTRE FOR PROMOTING ACCOUNTABILITY

INTER*face*

Vol. X Issue 1 October 2010 - March 2011

Inside:

- Management Letter as a Management Tool
- Core cost and NGO sustainability
- FCRA 2010 and FCR rules 2010- Implications for Donors Agencies
- Budget 2011

for private circulation only

Winds of forgiveness and waves of gratitude

Once upon a time, there were two friends, Sam and Anil. One day the two friends were walking through a desert. During the journey, they had an argument and Sam slapped Anil on his face. Anil felt hurt, but did not say anything. Instead, he wrote on the sand, "To-day my best friend slapped me on my face".

The two friends continued to walk until they found an oasis. They stopped and decided to take a bath. Anil, who had been slapped earlier, got stuck in the swamp and started sinking downwards. However, just the right time, Sam caught hold of him and saved him. After Anil recovered, he wrote on a stone, "Today my best friend saved my life".

Sam was quite puzzled and asked Anil, "After I had hurt you, you wrote on the sand and now you are writing on a stone, why?"

Anil replied," When someone hurts us, we should write it down in sand so that the winds of forgiveness can erase it away". However, when someone does something kind or good to us, we must engrave it in stone so that no wind can ever erase it!"

Sanjay Patra

CONTENTS

The opinions expressed by the authors are not necessarily that of CPA.

Editorial Team: Sanjay Patra, S. P. Selvi & Anuradha Singh
Published by Sanjay Patra on behalf of
Centre for Promoting Accountability
"ACCOUNTABILITY HOUSE", A-5, Sector 26, NOIDA - 201 301
Tel: 00-91-120-2546732, 2546733, 2546744, 2546745
Fax: 00-91-120-2546731
E-mail: cpa@cpaindia.in, Web-site: www.cpaindia.in

Management Letter as a MANAGEMENT TOOL

Sanjay Patra, FMSF

"Several oral communications exchanged during the course of the audit are given finality by putting them in black and white."

1. Introduction

With the complex operations and working of various departments, carrying out an audit has become essential. It is done with the objective to ensure that the Organisations are using fair accounting policies as prescribed by law and the protection of stakeholders' interest. An audit keeps away the Organisations from trying to indulge in fraudulent practices as it is a means of accountability. Multiple stakeholders have different information needs and they rely on auditors report as an authentic document that provides relevant information. It is also sometimes said that financial information without an auditors report is of "no value" for investment purposes. An auditors report thus is considered as an essential tool when reporting financial information to users.

The auditors report on financial statements is neither an evaluation nor any other similar determination used to evaluate entities in order to make a decision. The report is only an opinion on whether the information presented is correct and free from material misrepresentations whereas all other determinations are left for the user to decide.

2. Objective and Audit Process

The objective of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, is to enable the auditor to express an opinion as to whether the financial statements exhibit a true and fair view of the financial position and operating results of the Organisation. The auditors' opinion does not, however, provide an assurance regarding the future viability of the organisation or regarding the efficiency or effectiveness with which the management has conducted its affairs. The responsibility for the preparation and presentation of financial statements is that of the management. This responsibility includes maintenance of adequate accounting records and internal controls, selection and application of accounting policies, and safeguarding of assets. The books of accounts must comply with the following conditions:-

2.1 The books must give a true and fair view of the state of affairs of the Organisation and explain its transaction.

2.2 The books must be kept on cash/accrual basis and according to double entry system of accounting.

The Organisation has to prepare its Balance Sheet and Income and Expenditure Account from the books of account maintained by it. Every Balance Sheet of an Organisation must give a true and fair view of the state of affairs of the Organisation as at the end of the financial year/reporting period.

2.3 The following persons are responsible for maintaining the books of accounts of an Organisation:-

- The Treasurer;
- The Chief Functionary;
- Finance Manager/Accountants or any other employee authorized to maintain such books.

It is the duty of the auditor to conduct the audit of the books of account and to make his report to the members of the Organisation on the accounts examined by him. The audit report is laid before the board of members in the Annual General meeting of the Organisation. The auditors report, besides other things necessary in any particular case, must expressly state:

2.4 Whether, in his opinion and to the best of his information and according to explanation given to him, the accounts give the information required by the Act and in the manner as required;

2.5 Whether the Balance-Sheet gives a true and fair view of the Organisation's affairs as at the end of the financial year and the Income and Expenditure Account gives a true and fair view of the surplus/ deficit for the financial year.

2.6 Whether he has obtained all the information and explanations required by him for the purposes of audit.

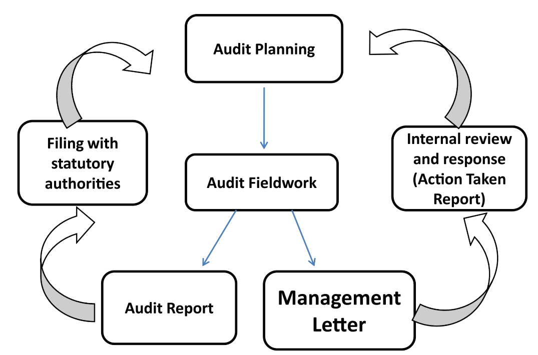
2.7 Whether in his opinion, the Income and Expenditure account and Balance Sheet referred to in his report comply with the generally accepted accounting standards recommended by the Institute of Chartered Accountants of the respective countries;

2.8 Whether, in his opinion, proper books of account as required by law have been kept by the Organisation;

2.9 Whether the Organisation's balance sheet and Income and Expenditure Account dealt with by the report are in agreement with the books of account and returns.

3. Need for issuing Management Letter

The figure below depicts the audit process as to how it starts and what are the final steps in this process.



Audit Process

An audit is an examination of the Balance Sheet and Income/Expenditure account of an Organisation, conducted by an auditor. The auditor after doing the review of the books of account submits two reports in this process-:

3.1 Opinion letter and

3.2 Management letter.

These letters are required as per the generally accepted auditing standards and help provide stakeholders with an overall picture of the operations of an organization.

When an auditor completes an audit of an Organisation, he expresses his opinion of the financial statements/books of account in a formal letter to be annexed with the financial statements. This letter is called an audit report or opinion letter, which expresses the auditor's opinion of the financial statements and whether the Organisation has prepared them in accordance with generally accepted accounting principles.

A management letter is issued to communicate the status of internal control systems of an organisation. In this report, the auditor details the areas where there are significant deficiencies and material weaknesses in an organisation's internal control system. The purpose of management letter is not only to identify the problems but also to provide recommendations, from the auditor. The management in response to this letter needs to provide a written Action Taken Report (ATR) to the auditors' comments.

4. Salient Features of a Management Letter

The main purpose of a management letter is to state the deficiencies in the internal control system and also cover certain essential points with respect to audit. Some of the topics/issues a management letter should cover are listed below:

4.1 A general review of project progress and timeliness in relation to progress milestones and the planned completion date, both of which are stated in the project document. The letter is not intended to address whether there has been compliance with specific agreements relating to specific performance criteria or outputs. However, general compliance with broad agreements such as implementing the project with economy and efficiency should be commented upon but not with the legal force of an audit opinion.

4.2 An assessment of the project's internal control system with equal emphasis on

4.2.1 The effectiveness of the system in providing the project management with useful and timely information for the proper management of the project and

4.2.2 The general effectiveness of the internal control system in protecting the assets and resources of the project.

4.3 A description of any specific internal control weaknesses noted in the financial management of the project and the audit procedures followed to address or compensate for the weaknesses. Recommendations to resolve/eliminate the internal control weaknesses noted should be included.

4.4 The management letter should also include the following:

4.4.1 The categorization of audit findings by risk severity: High, Medium, or Low.

4.4.2 The classification of possible causes of the audit findings.

4.4.3 Management comments/response to audit findings and recommendations.

4.4.4 Comments as to whether recommendations made in the management letter for the previous audit were implemented and the implementation status.

5. Recipients of Management Letter

Management letter is submitted to the board of directors/management of an Organisation and is used as a tool in evaluation of management's performance. The Board or the management receiving the management letter does a verification of the stated discrepancies and prepares an action taken report (ATR) as stated above. Before issuing the management letter the auditor must obtain a representation from the management broadly stating that:

5.1 It acknowledges its responsibility for the design and implementation of internal control to prevent and detect errors; and

5.2 It believes the effects of those uncorrected financial statements/ discrepancies aggregated by the auditor during the audit are immaterial both individually and aggregate, to the financial statements taken as a whole.

6. Conclusion

It is very critical for the voluntary organisation to understand the value of audit. Audit must be used as a tool to promote accountability and transparency in organisation. A strong and independent audit process generates confidence of stakeholders and enhances credibility of the organisation. It is also important to realize that audit should be seen as a continuous quality improvement process. In that context management letter by the auditor is a very critical component. It is necessary for the voluntary organisation to insist on obtaining a management letter from the auditor and to internally process it so that it serves as a good tool to improve the control systems and other financial management process in the organisation.

Core Cost and NGO SUSTAINABILITY

(From: The Selected Works of Alfredo Ortiz Aragón, Manager of Financial Services, PACT Inc.)

1. Introduction

Core costs are those costs, activities or services that benefit more than one project.Core costs are vital organizational costs which benefit projects in an indirect way. They are those costs that are difficult to associate with any specific outputs, as they will exist irrespective of any project. However, there is an element of variability in core costs with varying degree/level of operation.

2. Why are they important?

The reality is that the core costs are not elective. Rather, these costs are vital costs which are the result of taking on various Projects and activities. These costs will always need to be covered, whether the organisation is running 30 projects or just three. They are fundamental to the organization's survival, but can't be directly associated with any specific outcome.

3. Core costs

These costs are common or joint costs which are not readily identifiable with a final cost objective of a particular project. Core costs still benefit although indirectly the organization and the Donor Agencies that fund the organization. Core costs are institution level costs.

Core costs can be placed under three headings:

3.1 Management

3.1.1 Costs associated with governance, board meetings etc.

3.1.2 Monitoring and evaluation of overall organisation.

3.1.3 CEO and associated administrative staff.

3.2 Research and development

3.2.1 Innovation - costs associated with developing new activities and ways of operating.

3.2.2 Quality assurance.

3.2.3 Developing various concept notes for project proposals for funding.

3.2.4 General Staff training and development.

3.3 Support services

3.3.1 Telephone, postage and fax.

3.3.2 Information Technology.

3.3.3 Finance and audit.

3.3.4 Income generation (including fundraising).

3.3.5 Brand Building for the organisation.

Direct Costs
+
Core Costs
+
Unrelated Costs
=
Total Costs

3.3.6 Premises.

3.3.7 Travel and subsistence.

Note: Treatment of any of the above costs differs from organisation to organisation. Some organisations treat portion of some of the above costs as indirect cost charging rest directly to the project. However, for the sake of simplicity it is presumed that 100 percent of all of the above cost are indirect in nature.

4. Direct Costs

These are costs which can be directly attributed to a specific project, e.g., salaries for project staff and materials required for a particular project. Since these activities are easily traced to projects, their costs are usually charged to projects on an item by item basis. These are specifically identifiable with a final cost objective of the project. It is a cost that can be directly related to producing specific goods or performing a specific service. Direct costs are classifieds as department / project/ activity level, as opposed to Core costs which is at institutional level.

5. Unrelated/Unallowable costs

These costs are sometimes treated as direct, indirect, or sometimes excluded. Generally speaking they are either:

5.1 Unrelated to a final cost objective of the project or,

5.2 Related somehow but specifically

not permitted as per the agreed framework with a donor agency.

Unrelated/Unallowable costs are classified as such not necessarily because they are improper or abnormal expenses. Rather, they are unrelated to any specific project. Unrelated activities however must not be charged to the donors as core costs. Examples of such costs are given below.

5.3 Advertising, lobbying and other fundraising expenses

5.4 Shortfalls on other projects booked as such

5.5 Entertainment expenses or expenses for personal use

5.6 Expenditure on activities not forming part of planned activities of the project/ program.

Although these planned activities are paid for by an organisation's unrestricted reserves, their aggregate amount must be thought of as coming from a "restricted fund" like any other project (for purposes of calculating overhead).

6. Cost Pools

An organization must be able to properly separate and allocate costs. To have a clear distinction between direct and core cost, Cost Pools are created. The main interest of Donor is to know what types of expenses are paid out of a NGOs core cost pool. To handle donor expectations, accounting procedures and system must be able to:

6.1 Separate and allocate funds by cost pool

6.2 Properly estimate and track core costs

6.3 Properly track direct costs by project/ activity

6.4 Pay for costs out of appropriate cost centers

Before a cost can be incurred out of the core cost pool, there must be funds available in the pool to pay for it. Assuming each donor agrees to pay its fair share, a donor should be able to examine the records of a recipient and quickly determine what and how much has been charged to the project it funds. With advanced accounting systems and processes and properly separating costs by cost pool, NGOs will be able to convince donors of their ability to properly manage their funds.

7. Overhead Management

Overhead Management means

7.1 To develop a core cost ratio to achieve better cost control.

7.2 Recovering full core costs instead of hiding them in direct costs.

7.3 Educating donors about the reality of legitimate core costs.

7.4 And spreading core costs across all donors and funding sources.

Overhead Management involves defining an overhead strategy, economies of scale and reporting.

8. Economies of Scale

Core costs do no increase in proportion to direct costs in times of sustained growth. The reason this occurs is because a big component of core costs are fixed costs, which do not increase when new projects are undertaken. For instance, if a medium-sized organization suddenly gets a new project, it does not have to rent a new building or hire a new CEO for that grant. Generally speaking, an NGO has to pay these costs whether it has one project or ten. For this reason, these costs don't typically go up rupee for rupee with new direct costs.

9. Reporting

The basic accounting for receipt from a donor that provides fund to carry out its project is Receipt of Funds and Expenditure of Funds**.** The reporting of overheads is a very critical issue for the organisation and the donor. The rationale for distribution of overheads must be clear and consistent over a period of time. Common core costs / Overheads apportioned for project must be clearly reported in the financial statements.

10. Methodology

Once we are clear with Core Cost, Direct Cost, Unrelated Cost, Cost Pools and Overhead Management, the next important step is to understand how to calculate the Core Cost ratio.

The following four steps will illustrate practical and simple way to calculate core cost ratios-:

10.1 Step 1 – Salaries

10.1.1 First of all we have to total the salaries paid during the period. (Salaries are solely amounts paid to employees who are working under regular contracts) Therefore, consultant payments, temporary work and/or any other type of payment for wage labor to workers not under contract (and thereby not receiving benefits as salaried employees) will not be included.

10.1.2 Of total salaries calculated above, estimate total salaries paid to employees to carry out functions or tasks that were directly associated with specific project or contract during the time period being evaluated. This amount will form part of the direct expenses of the organization

10.1.3 In the same manner, estimate total salaries paid to employees to carry out functions or tasks those were indirectly associated with specific project or contract objectives. In other words, total salaries paid to employees carrying out functions that benefited the organization in general projects, contracts and programs specifically. This amount will form part of the core/indirect expenses of the organization.

10.2 Step 2 - Benefits

The purpose of this step is to determine the following:

10.2.1 Sum total of all benefits paid during the calendar years.

10.2.2 Calculate the Fringe Benefits (Fringe benefits are compensations provided to an employee beyond the regular benefit of being paid for their work.).

10.2.3 Each organization will need to list all of the different types of benefits granted to their workers according to law and organisational personnel policies.

10.2.4 Once all the different benefits are identified, it is time to calculate, or to obtain from accounting data, the sum total paid under benefits. Further the benefits need to be segregated between direct and core/indirect expenses.

10.3 Step 3- Estimation and Classification of Other Direct and Indirect Costs and Unallowable Expenses

The following examples are presented in order to reinforce the criteria for identifying and separating direct costs from indirect, and to identify unallowable costs:

10.3.1 Direct Costs:

· Planned activities funded through a specific project grant.

· Consultant's fees paid to individuals whose work has a direct relation to the delivery of a specific product or service, according to a specific grant award or project.

· Lawyer fees incurred for direct program activities.

· Data processing costs in relation to specific project activities.

· Travel costs that contribute directly to a specific program.

· Photocopying costs that contribute directly to a specific program

· Office space that contributes directly to a specific program

· Materials and supplies that contribute directly to a specific program objective

· Publication costs that contribute directly to a specific program objective

· Costs of the maintenance of vehicles that contribute to a program directly

· Costs of telephone, postage and shipping, training, seminars and conferences that contribute directly to a specific program objective

· Expenses of hiring employees to fill vacancies directly required by a project or program

10.3.2. Core/Indirect Costs:

Core/Indirect costs are costs that have been incurred to achieve common objectives or activities for the organization in general, that benefit donors indirectly, and that cannot be correlated with a specific, final cost objective.

The following costs are examples of some of the more common indirect costs:

· Costs incurred for the operation of the organization in general, or with predominantly administrative aims (finances, personnel, etc).
· Insurance costs for the organization in general.
· Legal costs for services to the organization for its normal operations
· Data processing services such as payroll, general fundraising, inventory of fixed assets, personnel data, etc.
· Audit costs for the organization's internal audit.
· Travel expenses for management or with administrative aims that favor the organization in general.
· Costs related to the preparation of proposals.
· Rent, supplies, printing, public services, mailings, publicity, telephone, publications, training, conferences, and maintenance costs for the entire organization.
· Cost of vehicles and equipment not approved by a donor for the specific use in a project, rather, purchased for the general use of the organization.

10.3.3. Unrelated/Unallowable Costs

Donor Agencies often consider that certain costs should not qualify for reimbursement through grant awards and contracts. An organization must take responsibility to directly identify the unallowable costs they incur and to classify them as such. This will help avoid claiming reimbursement of unallowable costs as overhead from donors.

Some of the expenses for unallowable costs are -:

· Bad Debts
· Provisions for contingencies
· Contributions (Contributions and donations from the organization to

	Direct Costs (1)	Core Costs (2)	Unallowable Costs (3)	Total Cost (4)
Salaries	XX	XX		XX
Benefits	XX	XX		XX
Direct Project Costs	XX			XX
Other Indirect Costs		XX		XX
Other Unallowable Costs			XX	XX
Total	XX	XX	XX	XX

others are not allowable.)

· Entertainment Costs

· Costs of interest, obtaining of funds and management of investments

10.4 Step 4 - **Calculation of Core Cost Ratio**

In order to calculate core cost ratio one needs to follow the following steps:

· Extract from Step 1 the sum total of salaries, indirect salaries and direct salaries.

· By means of the fringe benefits calculated from Step 2, calculate total be indirect benefits, and direct benefits.

· List the remaining costs calculated in Step 3. Indicate the sum total of expenses, direct expenses, indirect expenses and unallowable expenses.

· The ratio will be the result of dividing the total of indirect expenses by the total of Direct expenses.

$$\text{Core Cost Ratio} = \frac{\text{Core Cost}}{\text{Direct Costs}}$$

11. Conclusion

The issue of allocation of costs is complex one. At the same time as we move to this new era of complex funding mechanisms, this concept becomes very important and critical as well. The key issue for success in allocation of costs is to have a clear accounting system within the organisation. Eventually clarity in allocation/recovery of core cost enhances credibility and trust level among various stakeholders.

(The above article is an attempt to bring clarity on the issues of core cost and cost allocation.)

FCRA 2010 and FCR Rules 2010 - IMPLICATIONS FOR DONOR AGENCIES

- FMSF Research Team

Introduction: The age old Foreign Contribution Regulation Act which was enacted in 1976 is all set to change. The new FCR Act was passed by both Houses of Parliament in August, 2010. Subsequently the Government has formulated the rules relevant to the FCR Act, 2010 and placed it in the public domain for response and feedback up till 31st March, 2011. Both the Act and the Rules read together raises certain issues which need to be kept in mind at the Donor Agencies level. However, it must be clarified that the proposed Act and the Rules have not come into effect through Government notification. Therefore the issues mentioned below are still at the draft stage though it is very close to being enacted.

1. DECLARATION OF AN ORGANISATION TO BE OF A 'POLITICAL NATURE'

1.1 The proposed Rule 3 provides the guidelines for declaring an organisation to be of political nature.

1.1.1. Rule 3(iii) provides that an organisation can be declared of political nature if it has objectives of political nature OR comments upon or participates in political activity. Even commenting on a political activity may render an organisation to be of political nature.

1.1.2. Rule 3(v) provides that any NGO may be deemed to be of political nature if its objects or activity are towards larger socio-economic or political interests. It may be noted that the word ‘or’ is used between ‘socio-economic or political interests’. In other words, even having socio-economic goal may render an organisation to be a political nature.

1.1.3. Rule 3(vi) provides that actions like ‘bandh’ or ‘hartal’ etc. shall be considered as political action.

1.2 What Donors Agencies should watch out for:

1.2.1 Donor Agencies must ask for a complete profile of the Organisation that may include specific declaration from the Organisation that it doesn’t have any activity of Political Nature.

1.2.2 Memorandum of Association/Trust Deed of the Organisation should be verified so as to ensure that the object clause doesn’t include any activity which can be interpreted as an activity of political nature.

1.2.3 While approving the project, it should be ensured that no activity in the project proposal as well as approved budget comes in the ambit of definition of ‘Political Nature’ under Rule 3 of FCR Rules 2010.

2. ADMINISTRATIVE EXPENDITURE

2.1 Rule 5 defines “Administrative Expenditure”.

2.1.1 Section 8 of the FCRA 2010 provides that the administrative expenditure shall not exceed 50% of the total utilisation of funds out of FCRA receipts.It states that the administrative expenses shall not exceed 50% and any expenditure of administrative nature in excess of 50% shall be defrayed with prior approval of the Central Government.

2.1.2 The definition of Administrative Expenditure briefly is as under:

i. Remuneration and other expenditure to Board Members and Trustees
ii. Remuneration and other expenditure to persons managing activity.
iii. Expenses at the office of the NGO
iv. Cost of accounting and administration
v. Expenses towards running and maintenance of vehicle
vi. Cost of writing and filing reports
vii. Legal and professional charges
viii. Rent and repairs to premises

2.2 What Donors Agencies should watch out for:

2.2.1 The program/project budget should be structured properly in order to absorb the salary and other administrative components which can be directly attributed to the program.

2.2.2 Donor Agencies may ask for the overall budget of the organization and analyse the administrative cost component in the budget in line with the Rule 5 of FCR Rules 2010.

3. VALIDITY OF THE REGISTRATION CERTIFICATE

3.1 Rule 10 & 11 lay down the provisions regarding the validity and renewal of the registration certificate.

3.1.1 Section 11 of FCRA 2010 has restricted the validity of FCRA registration to a period of 5 years from the date of its issue.

3.1.2 All organisations registered on the date of the enactment of FCRA 2010 will remain valid for the next 5 years. As per Section 16 of the proposed Act, all NGOs should apply for renewal of the certificate within 6 months prior to the expiry of the five year period.

3.1.3 The organization failing to apply in time would have to face cancellation of registration and the funds and assets would go in custody of the competent authority.

3.2 What Donors Agencies should watch out for:

3.2.1 The Donor Agencies should be aware of the status of registration of the Organistaion that they are funding or planning to fund and period for which it is valid.

3.2.2 In case, the project is going beyond the expiry of registration, Donor Agencies should keep track of application for renewal.

3.2.3 It is advisable to synchronise the project period to end within Original date of expiry of registration and start another project only if the registration has been renewed for the next block of five years.

4 CHANGE IN MEMBERS OF EXECUTIVE COMMITTEE/GOVERNING COUNCIL

4.1 FCR Rules through its Forms require prior permission for change of more than 50% of members of Executive Committee of an NGO.

4.1.1 Form FC – 3 pursuant to FCR rule 9 (1) (a) of 1976 and Form FC – 4 pursuant to FCR rule 9 (2) (a) of 2010 includes 'Declaration and undertaking' by the Chief Functionary of the applicant organization which in point (ii) specifies obtaining of prior permission for the changes causing replacement of 50% or more members of the Executive Committee/Governing Council.

4.1.2 There is no corresponding provision in FCR Act 1976 or 2010 which provides for the above and so forms in rules takes the effect of superseding the Act. The rules are made under the power conferred by the Act itself and cannot have provision which stretches beyond the Act.

4.2 What Donors Agencies should watch out for:

4.2.1 Donor Agencies should regularly monitor the constitution of the Executive Committee to ensure that there is no substantial change in the overall composition.

4.2.2 In case of change of more than 50% members, Donor Agencies should ensure that necessary prior approval has been obtained from Ministry of Home Affairs.

5 CONSULTANCY INCOME OF AN NGO

5.1 FCRA Bill 2010 excludes 'the professional/consultancy fees paid to NGOs from Foreign Source' from the definition of Foreign Contribution.

5.1.1 Explanation 3 to Section 2(1)(h) of FCRA bill 2010 states that any amount received, by any person from any foreign source in India by way of fee (including fees charged by an educational institution in India from foreign student) or towards cost in lieu of goods or services rendered by such person in the ordinary course of his business, trade or commerce whether within India or outside India or any contribution received from an agent of a foreign source towards such fee or cost shall be excluded from the definition of foreign contribution within the meaning of this clause.

5.1.2 Thus any fee or cost against business, trade or commerce shall not be considered as foreign contribution. In other words, such receipts shall be kept outside the FCRA account.

5.1.3 However, the provision is in contradiction with the amended section 2(15) of the Income Tax Act which prohibits trade or business related receipts beyond Rs.25 lakh. Therefore, NGOs should be careful in treating consultancy income and other receipts as local income even though it is now permissible under the proposed Act.

5.2 What Donors Agencies should watch out for:

5.2.1 Payment of Consultancy Fees to NGOs by foreign Donor Agencies would not fall into the ambit of FCRA.

5.2.2 Foreign Donors can make payment towards consultancy fees to NGOs who are not registered under FCRA.

6 REQUIREMENT TO PUT INFORMATION IN PUBLIC DOMAIN

6.1 Rule 12 provides for requirement of keeping the information regarding receipt and utilization in public Domain.

6.1.1 The Rule provides that if the contribution received during the year exceed 'Rs.10 million, then the organisation has to keep in the public domain all data of receipts and utilisation during the year and also in the subsequent year. The rule also states that the Central Government will also upload such summary data through its website.

6.1.2 The manner of disclosure or meaning of 'public domain' has not been explained. It seems that all such organisations are required to have their own website where such data should be uploaded.

6.2 What Donors Agencies should watch out for:

6.2.1 Donor Agencies may ask for website in the organizational profile and verify that the information, as required by the rule, is kept in the website and is accessible to all.

6.2.2 Donor Agencies may ask the NGOs they are funding or planning to fund but not having website, to create website and put its accounts on it if the amount of funds would be more than Rs 10 million in a year.

7. INTER ORGANISATIONAL TRANSFER OF FC FUND.

7.1 Prior Approval to be obtained from Central Government for transfer of FC fund from one NGO to another *even if the transferee NGO is registered under FCRA.*

7.1.1 Rule 23 provides that an organisation should apply on Form FC-10 for transfer of FC funds to registered organisations.

7.2 Prior Approval to be obtained from Central Government for transfer of FC fund from one NGO to another who *has not been granted a certificate of registration or prior approval.*

7.2.1 The organisation may apply for permission to the Central Government for Transfer of FC funds, not exceeding 10% of the total value of the foreign contribution received.

7.3 What Donors Agencies should watch out for:

7.3.1 This Rule would be of much relevance in case of funding Network Partners. The Foreign Donor Agencies should ensure that Nodal/Principal Partner has to obtain the prior approval for the transfer of funds to the proposed network partners.

7.3.2 The budget for each Network Partner should be properly defined in advance so that prior approval for the transfer of specified amount can be obtained by the Nodal Partner.

7.3.3 To be on the safer side, the funds meant for the network partners should be transferred to the Nodal Partner only after obtaining the copy of approval from FCRA for transfer of such fund to the specified partner.

7.3.4 In case network partners include those not registered under FCRA, care should be taken while framing the budget so that the amount to be transferred doesn't exceed 10% of total expected foreign fund to be received by the Nodal Partner.

Conclusion: *The compliance of FCRA and FCR Rules however is the responsibility of NGOs receiving Foreign Contribution , Donor Agencies would have to follow up for the compliance and keep vigil as non compliance may make their funds land up in Government Custody . Donor Agencies should keep a note of area of concern and do proper follow up to keep their funds intact and used for the purpose it is meant to be.*

Note: The FCRA 2010 and the Rules thereof are yet to be notified. Therefore they are still drafts.

Budget 2011 - CHANGES AFFECTING VOLUNTARY SECTOR

-Manoj Fogla, FCA

Introduction

1.01 The Budget 2011 has turned out to be more or less a status quo affair for the voluntary organizations. Even though there are very few changes, these will have a considerable impact. The main proposals are discussed below.

Increase of Business Activity Limit to 25 Lakhs

2.01 The Finance Bill 2011 has amended the proviso to section 2(15) and has increased the limit of incidental business activity to Rs. 25 lakh. It may be noted that the current limit is Rs. 10 lakh. The proposed amendment to the proviso is as under :

In section 2 of the Income-tax Act, in clause (15), in the second proviso, for the words "ten lakh rupees", the words "twenty-five lakh rupees" shall be substituted with effect from the 1st day of April, 2012.

This amendment is proposed to take effect from 1st April, 2012 and will, accordingly, apply in relation to the assessment year 2012-13 and subsequent years.

2.02 It is worthwhile to recall that the amendments in the definition of 'charitable purpose' under section 2(15) in the year 2008 had far reaching implications on the business income of charitable organisations. It may be noted that the NGOs engaged in advancement of any other object of general public utility, were not allowed to have any incidental business activity. The Finance Act, 2010 retrospectively provided relief to small

NGOs by providing a limit of Rs. 10 lakh. And now Finance Bill 2011 has further increased this limit to Rs.25 lakh. However, this enhancement shall be prospective in nature and will be applicable from the assessment year 2012-13.

2.03 The definition of 'charitable purpose' can be divided into 6 parts, viz.
(i) relief of poor,
(ii) education,
(iii) medical relief,
(iv) preservation of environment,
(v) preservation of monuments or places or objects of artistic or historic interest,
(vi) advancement of any other object of general public utility. However, the Finance Act, 2008 w.e.f. 1-4-2009 had excluded any trade, commerce or business related activity by any trust or NGO engaged in the sixth category i.e. advancement of any other object of general public utility, from the purview of 'charitable purpose'. In other words an NGO exclusively engaged in the field of education, medical relief and relief of poor preservation of environment & preservation of monuments can have incidental business activity without any monetary ceiling.

2.04 Therefore, w.e.f. 01.04.2009 the income from trade, commerce or business pertaining to those NGOs which come under the sixth category of 'charitable purpose' were not to be treated as charitable activity and the entire exemption of such NGOs were at stake. Consequently, such organisations were not eligible for any exemption under section 11 or other provisions which provide exemptions towards charitable purpose. It may be noted that the issue of incidentality of business will not be relevant to such group of NGOs. Whether the business activity is incidental or not, is of no consequence, as this sixth category of NGOs would lose the charitable status. However, the Finance Bill, 2011 has provided a great relief to the sixth category NGOs as NGOs having business activities to the extent of rupees 25 lakh (receipt) will not be affected.

2.05 It is pertinent to note that all other NGOs (other than the NGO coming under the sixth category) can have business related activity beyond Rs. 25 lakh, as permitted under section 11(4A), and other provisions pertaining to business activities shall be applied without any changes.

2.06 Hitherto the law was very liberal with regard to the business activities of NGOs and even income from unrelated businesses (for example, publishing newspapers) held by them was eligible for exemption if the entire income was used for charitable purposes. The law will continue to remain liberal for the first five categories of NGOs.

2.07 To sum up, the proposed amendment will be immensely helpful to smaller charitable organisations who have incidental business activities. For example, trading of goods produced by beneficiaries or sale of

Khadi and handicrafts etc. will be benefitted by this amendment.

Special Exemption for Government Bodies Engaged in Charitable Activity

3.01 The Finance Bill, 2011 has inserted a new clause (47) to section 10 of the Income Tax Act. By virtue of this clause, the income of various body, authority, trust etc. setup by Government for charitable purposes shall be exempted. The proposed amendment is as under :

"It is proposed to insert a new clause in section 10 of the Income-tax Act to provide exemption from income-tax to any specified income of a body, authority, board, trust or commission which is set up or constituted by a Central, State or Provincial Act or constituted by the Central Government or a State Government with the object of regulating or administering an activity for the benefit of the general public, provided

(i) It is not engaged in any commercial activity, and
(ii) It notified by the Central Government in this behalf. The nature and extent of Income to be exempted will also be specified by the Central Government while notifying such entity.

A consequential amendment is proposed in section 139 of the Act to provide for filing of the return of income by such notified entity. These amendments are proposed to take effect from 1st June 2011."

3.02 It may be noted that in the past there were many court cases pertaining to 12AA registration of such government promoted bodies. The Income Tax department had rejected application of such bodies such as Marketing Committees, Producer's Society etc. The charitable status of such government promoted bodies was a matter of judicial debate. Various High Courts held that even government constituted bodies were eligible for registration under Section 12AA as charitable organisation.

3.03 This above amendment resolves the existing controversy regarding government promoted charitable organisations. It may further be noted that this amendments will be retrospective by one year. It is applicable for the assessment year 2011-12.

Reporting Requirement for Liaison Offices

4.01 The Finance Bill, 2011 has made a very significant amendment, by virtue of which all liaison offices of foreign NGOs working in India will have to report to the Assessing Officer within 60 days from the end of the financial year. The rules and forms in this regard will be notified later. It may be noted that liaison offices, currently, are not required to file any return/document, unless they have income in India. The proposed Section 285 is as under :

"Every person being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the Reserve

Bank of India under the Foreign Exchange Management Act, 1999, shall in respect of its activities in a financial year, prepare and deliver or cause to be delivered to the Assessing Officer having jurisdiction, within sixty days from the end of such financial year, a statement in such form and containing such particulars as may be prescribed."

Mr. Manoj Fogla is a development consultant who specializes in financial evaluations & reviews of development programs. He has also has authored several books on Governance, Financial Management, Legal & Taxation aspects of NGOs. He can be reached at mfogla@yahoo.com

Budget 2011 - AN OVERVIEW

- FMSF Research Team

INTRODUCTION:

The Union Finance Minister, Government of India presented the budget 2011-12 on Feb 28, 2011.

Generally serious concern was raised over recent corruption issues and need to improve regulatory standards and administrative practice.

Another area of concern underlined was the Food Inflation. It was stated that the increase in the prices of food items that normally reduce in winter season has revealed the shortcomings in the distribution and marketing system. Total food inflation, however has reduced from 20.2% in Feb 2010 to 9.3% in Jan 2011 but is still high.

Some Specific Scheme, Allocation and Decisions

Taxation:

The Direct Tax Code Bill introduced in August 2010 in the Parliament is proposed to be made effective from Apr 1, 2012. This would, as shared by the Honorable Minister, bring moderation of rates and better compliance.

For the roll out of GST (Goods and Service Tax), the Honorable Minister has proposed to introduce the Constitution Amendment Bill in this session. Work is also underway on drafting the model legislation for the Central and State GST.

Subsidy:

A task force headed by Shri Nandan Nilekani has been constituted to work out modalities for proposed system of direct transfer of Subsidy for Kerosene, LPG and Fertilizers. The modalities have to be further worked out.

Micro Finance Institutions:
It has been proposed to create "India Microfinance Equity Fund" of 100 Crore with SIDBI. Another Fund called "Women's SHG's Development Fund" has been proposed with a corpus of Rs.500 Crore.

The Committee set up by RBI to look into the issues related to micro finance sector in India has submitted its report and Government is considering putting appropriate framework to protect the interest of small borrowers.

Others:
It has been proposed to create Mortgage Risk Guarantee Fund under Rajiv Avas Yojna to guarantee the house loan taken by Econimically Weaker Sections and LIG Households.

Allocation to Rasthriya Krishi Vikash Yojna (RKVY) has been increased from 6755 crore in 2010-11 to 7,860 in 2011-12

Further allocation of 400 crore for green revolution in North East has been done in line with the last year's initiative.

An amount of 300 crores have been proposed to promote 60000 pulses villages in the rainfed areas to increase crop productivity and market linkages

The target of credit flow to farmers have been increased from 3,75,000 crore in 2010-11 to 4,75,000 crore in 2011-12.

The existing interest subvention scheme of providing short term crop loans to farmers at 7 per cent interest will be continued during 2011-12. Further, an additional subvention (Financial Support) of interest of 3% have been declared for the farmers who repay their crop loan on time making the effective rate of interest for those farmers as 4%.

Approval is being given to set up 15 more Mega Food Parks in 2011-12 to prevent the wastage of fruit and vegetables.

The National Food Security Bill is close to finalization and would be introduced in the parliament during the course of this year.

Social Sector Outlay:
T**he proposed allocation to social sector for year 2011-12 is 1,60,887 Crore** which is an increase of 17 percent over last year. It amounts to 36.4% of total plan allocation.

Bharat Nirman which includes Pradhan Mantri Gram Sadak Yojna (PMGSY), Accelerated Irrigation Benefit Programme, Rajiv Gandhi Grameen Vidyutikaran Yojna, Indira Awas Yojna, National Rural Drinking Water Programme and Rural telephony have together been allocated '**58,000** crore. This is higher by 10,000 Crore over the last year's allocation.

The Government has decided to index the wage rate notified under MGNREGA to the consumer price index for Agricultural Labour. The remuneration of Anganwadi Workers and Anganwadi Helpers have been increased from Rs.750 and Rs.1500 to Rs.1500 and Rs.3000 respectively.

Specific allocations have been provided in budget 2011-12 towards Scheduled Caste sub-plan and Tribe sub-plan. An increase in the budget allocation for the primitive Tribal groups from 185 crore in 2010-11 to 244 crore in 2011-12 has been proposed.

Total allocation for **Education** for 2011-12 is 52,057 crore which is an increase of 24% over last year's allocation. Allocation towards Sarva Shiksha Abhiyan for 2011-12 is 21,000 Crore which is 40% increase over the last year's allocation of 15,000 crores

Total allocation for **Health** for year 2011-12 is 26,760 crore which is 20% increase over the last year's allocation. The Rastriya Swastya Bima yojna has been further extended to the MAGREGA benificiaries, Beedi workers and others.

Environment and Climate Change:

The Government has launched ten-year Green India Mission and a proposed allocation of 200 Crore from National Clean Energy Fund has been done to begin its implementation in 2011-12.

An allocation of 200 Crore has been done for National Clean Energy Fund for Launching Environmental remediation programmes.

An allocation or 200 Crore has been done for the clean-up of some important Lakes and Rivers other than Ganga.

Direct Taxes:

The Exemption limit for the general category of individual Tax payers have been increased from Rs.1,60,000 to Rs.1,80.000 which will bring tax relief of Rs.2000 to each individual.

The qualifying age for senior citizenship has been reduced from 65 to 60 and at the same time the exemption limit has been increased from Rs.2,40,000 to Rs.2,50,000. Further, a new category of Very Senior Citizens has been created for individual of age of 80 or above for whom the exemption limit would be Rs.5,00,000.

There is a reason for the NGO sector to cheer up as the exemption limit of Rs10 Lakhs for the 6th limb of the charitable institutions for undertaking incidental business activities has been increased to Rs.25 Lakhs.

The provision of section 2(15) as before Finance Bill 2010 was

"*Charitable purpose includes relief of the poor, education, medical relief, Preservation of environment (including watersheds, forests and wildlife), preservation of monuments or places or objects of artistic* *or historic interest and the advancement of any other object of general public utility:*

Provided that advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce of business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of any use or application, or retention, of the income from such activity;"

In the Finance Bill 2010, the following para was added to the above definition

Provided further that the first proviso shall not apply if the aggregate value of the receipt from the activities referred to therein is ten lakh rupees or less in the previous year The above threshold of ten lakh rupees has been now increased to twenty five lakh rupees.

Indirect Taxes:

The standard rate of Central Excise Duty has been maintained at 10%, however it is proposed to increase the lower rate of Central Excise Duty from 4% to 5%.

Central Excise Duty of 1 per cent is being imposed on the 130 items that are entering the tax net.

Some tax concession has been extended to the agricultural sector.

The standard rate of Service Tax remains at 10 percent.

CONCLUSION:

The budget has not brought much of change for individual except a nominal increase of the exemption limit. However, a good allocation of fund has been done for social sector with much of objectivity making specific scheme and funds, the actual implementation of the same would still be an issue to observe. In pursuance to the recommendations of Second Administrative Reforms Commission, the Government has set up a Performance Monitoring and Evaluation System (PMES) to assess the effectiveness of Government departments in their mandated functions which involves preparation of a Results Framework Document (RFD) by each department, highlighting its objectives and priorities for the financial year and achievements against pre-specified targets at the end of the year. This is to address the implementation gaps in public programe to ensure that the funds allocated benefit the actual beneficiaries.

In Loving Memory of
MR. K. P. PHILIP

Feb 19, 1934 to Jan 11, 2011

Honorary Chairman of FMSF since 1994 to 2005

Mr. K. P. Philip, also known as KP by his friends, was born into a missionary family on Feb 19, 1934. After completing his graduation in Science, his dream and desire was to serve God in any capacity.

He is survived by his wife, a daughter and a son.

He had long years of association with YMCA spanning more than three decades. He was also associated with St. Stephen's Hospital as its General Superintendent for more than 6 years from 1994 to 2000.

KP was also the founding Trustee and the first honorary Chairman of Financial Management Service Foundation (FMSF, an Organization set up by EZE, a reputed funding agency in Germany), for more than 10 years. At the inception of this organization, he provided significant leadership and guidance in the formation and growth of this organization. He also guided the organization in its transition period to become a Foundation during 1999 – 2000. The Trustees as well as staff respected him and held him in high esteem for his personal integrity, honesty, insights and vision.

Not only during the tenure of his chairmanship but also after his withdrawal on health grounds, he was a firm believer in basic principles of transparency and accountability FMSF stands for. He continued to encourage us to move forward.

FMSF which guides NGOs in India/ South Asia in the areas of Capacity Building, Social Accountability, legal assistance and advocacy has received much from him.

On Tuesday Jan 11, 2011, KP was promoted to heaven, to experience firsthand the glory of the Lord he faithfully served.

The memory of our association with him and that of his leadership and contribution to FMSF will continue to inspire us to carry on our work in the area of strengthening accountability and transparency to achieve social and economic development, in order to strive for a more just society in which peace a good will prevails.

With fond rememberance of KP's tenure with FMSF...

In grief, mourning and deep sense of gratitude

Chairman, Board of Trustees and Staff of FMSF

News & Events

Governance Workshop in BANGLADESH

Good governance is defined as "a transparent decision-making process in which the leadership of a nonprofit organization, in an effective and accountable way, directs resources and exercises power on the basis of shared values."

FMSF as an organisation focuses on good practices in the areas of Financial Management and Governance of NGOs. As a means to achieve them, FMSF conducts a number of workshops, training and consultations on these issues. One such workshop was organised in Dhaka, Bangladesh on 1st and 2nd December, 2010 on the subject,

"Workshop on Achieving Effectiveness through Good Governance"

The workshop was conducted for the partner organisations in Bangladesh and 11 Organisations participated in this workshop. The participants included the Office Bearers, Board Members and Heads of Organisations. The methodology for the workshop was through case studies, group discussions and presentations. The key topics discussed were understanding governance, board make up and structure, board recruitment, CEOs and Board, standards of good governance, How to set up a Good Governance Framework in NGOs and Conflict of Interest.

There were 18 participants from the above partner organisations and the workshop was very well received by the participants. The participants decided to implement the learing in their organisations and be benefited in long run. In the words of the participants-

- *During the discussions, I looked back on our ongoing practices and found some areas need to be developed, also there are challenges. However, we will try to close the gap between the practices and policy. Also need to review few of our policy.*

- *The entire subject discussed e.g. Governance process in NGOs, good governance framework in NGO and Key governance control, will help and as such I may implement them in my organisation.*

- *I actually never thought deeply about the board and all other issues of NGO governance. Now I have more clarity on NGO governance.*

DIPLOMA IN FINANCIAL MANAGEMENT & ACCOUNTABILITY

fmsf

A Joint initiative of FMSF &TISS

The Diploma in Financial Management & Accountability (DFMA) is a one year diploma program in the financial management of the non-profit organizations. The course is open to all applicants from all over the world. The course is offered online via the internet.

Ideal for persons already working in the Voluntary Sector seeking to equip themselves with Financial Management Skills and for persons who are seeking to join the Voluntary Sector.

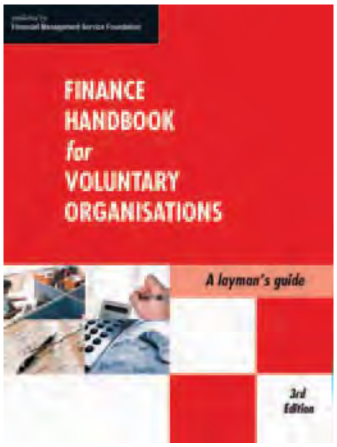
- The entire program is divided into 4 modules. Each module is further sub-divided into 8 papers.
- Now offered in a flexi-mode with exit option after 6 months!
- On completion of first 4 papers, Certificate will be provided and on completion of all 8 papers Diploma.

	Cousre Fee	For Indian Applicants	
		Certificate	Diploma
1.	For institutional sponsored candidates	INR 14,500/-	INR 22,500/-
2.	For individual candidates	INR 7250	INR 14,500
3.	For students	INR 3,625	INR 7,250
		For International applicants	
		Certificate	Diploma
4.	For applicants from developed countries	750 US$	1500 US $
5.	For applicants from SAARC & other developing countries	275 US$	550 US$

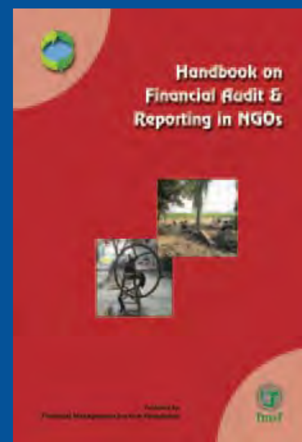
Registration for Batch –IV open till 27th May 2011
Limited Seats
Register Now!!!

Please visit: www.fmsflearningsystems.org or
Contact us at coordinator@fmsflearningsystems.org or
satyajit.das@fmsfindia.org

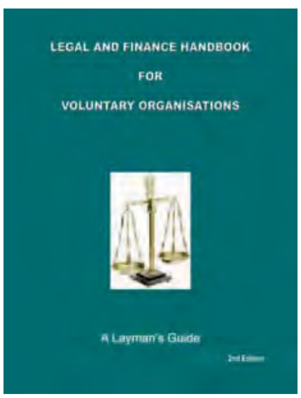
Publications of FMSF



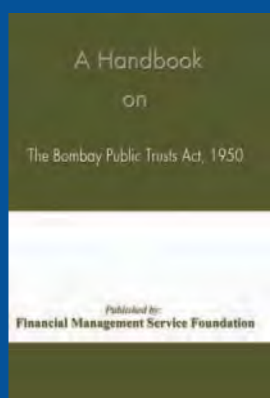
New Price: Rs. 250/-



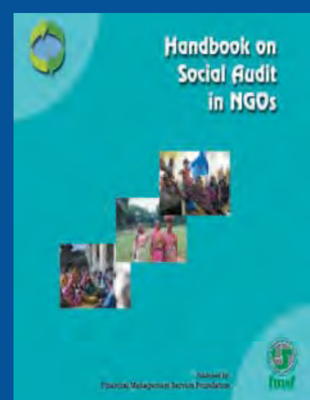
Contribution Price: Rs. 200/-



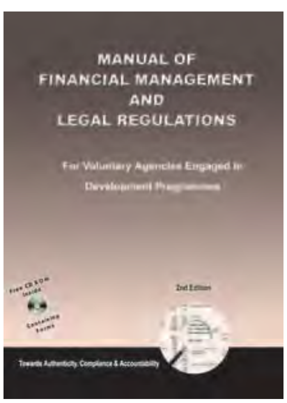
Contribution Price:- Rs. 100



Contribution Price: Rs.50 /-



Contribution Price: Rs. 100/-



Contribution Price:- Rs. 100

Contribution Price: Rs. 100/-

Centre for Promoting Accountability
"ACCOUNTABILITY HOUSE"
A-5, Sector 26, NOIDA - 201 301
Tel: 00-91-120-2546732, 2546733, 2546744, 2546745
Fax: 00-91-120-2546731
E-mail : cpa@cpaindia.in
Website : www.cpaindia.in

ISSN 0972-7248
9 770972 724006
Design & Print : Crystal Communications 98119 13799