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Between Us

PEACE

A farmer went to a Veterinary specialist because ten of his chickens had suddenly died. The specialist instructed the farmer to give aspirin to all the surviving chickens. Two days later, however, the farmer returned. Twenty more chickens had died. What should he do now? The specialist said quickly: "Give all the rest castor oil." Two days later, the farmer returned a third time and reported thirty more dead chickens. The specialist now strongly recommended penicillin. Two days later a sad farmer showed up. All the rest of his chickens had now died. "What a shame," said the expert, "I have lots more remedies!"

The world offers many so-called remedies to the problem of lack of peace within - Get away - Run away - Fly away - Take a pill to ease your nerves - Take a drink to drown your sorrows - Take a shot to kill the pain - Get drunk, take drugs, sleep a lot. However the truth is most of them don't work. What is the remedy? The most important solution is to find peace with oneself, to be reconciled. Running after the materialistic pleasures that the world offers, will not lead us to finding peace. May we find the peace and the peace giver.



Saijay Ram

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

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NGO Governance Program-an initiative of FMSF

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Analysis of **FOREIGN CONTRIBUTION (REGULATION) ACT 2010 & RULES 2011**

-Manoj Fogla & Sanjay Patra

INTRODUCTION

1.1 The Foreign Contribution (Regulation) Act 2010 and The Foreign Contribution (Regulation) Rules 2011 have been enacted w.e.f. 01.05.2011. The old FCR Act and Rule, 1976 have been repealed. In this issue, we are discussing the major changes and the impact thereof.

THE SCOPE OF FCRA EXPANDED

2.1 The new FCRA, 2010 has a much broader applicability; it is applicable to individuals, Hindu Undivided Family (HUF), Association and a section 25 company. In the old Act, the term person was not defined and generally the Act referred to the term 'Association'. However, now it is very clear that FCRA applies to the above category of persons.

DOES FCRA APPLY TO COMMERCIAL OR BUSINESS ORGANISATIONS

3.1 Movement of foreign funds in the normal course of commerce and business is outside the purview of FCRA. Therefore, business organisations are not covered by FCRA 2010 also. However, the provision of Foreign Exchange Management Act, 1999, which is a financial legislation, would be applicable.

WHAT IS FOREIGN CONTRIBUTION

4.1 Foreign Contribution includes all kind of transfers from foreign sources. The new act retains the older definition which includes any kind of *transfer, delivery or donation of currency, article or securities*. The notable change in the new act is that Foreign Contribution does not include

In other words an NGO can receive consultancy or other commercial receipt from foreign sources even without having FC registrations.

commercial receipts. In other words, an NGO can receive consultancy or other commercial receipt from foreign sources even without having FC registrations. FC registered NGOs should receive such receipt in their domestic account and the commercial receipt are not required to be reported to the FCRA department.

PANCHAYAT HAS BEEN DEFINED AS LEGISLATURE

5.1 'Panchayat' has been included under the definition of 'Legislature' under section 2(1)(k). The implication of this change is that a member of a Panchayat cannot receive any foreign contribution. Secondly, NGOs who are working closely with Panchayat will have to be careful and ensure that their activities are not interpreted as of political nature.

FC FROM RELATIVES OR SCHOLARSHIP, STIPEND ETC.

6.1 The term 'Relative' has been defined for the first time giving it the same meaning as under section 2(41) of the Companies Act, 1956.

6.2 No permission is required to obtain foreign contribution from a relative under section 4 which is a relaxation. However,

rule 6 provides that any gift from relatives above ' 1,00,000/- in one year shall be intimated to the FCRA department in Form FC-1. Therefore, the rules seems to be in contravention of the Act.

6.3 Similarly scholarship, stipend etc. received from foreign sources are excluded under section 4. This again is a relaxation over the old Act.

ORGANISATIONS OF POLITICAL NATURE

7.1 Organisations of political nature cannot accept foreign contributions which was possible under the old Act with prior permission. Elaborate Rules have been framed for notifying any organisation as an organisation of political nature.

7.2 Under Rule 3 the FCRA department may declare any organisation as an organisation political nature, if :

- It has political objectives in its memorandum.
- It is a trade union.
- It is a group of political nature.
- It is like Student Union, Worker Union, Youth Union and Women wing of Political party.
- Any organisation if any material evidence found to be engaged in political activity.
- Any organisation found to be engaged in political activity such as 'Bandh', 'Rasta Roko' 'Rail Roko' and 'Jail Bhao'.

TRANSFER OF FUNDS TO FC REGISTERED ORGANISATIONS

8.1 The Act prohibits transfer of funds to any other organisation unless the recipient organisation also possesses FC registration. However, there is some confusing requirement under Rule 24(2) which requires filing of Form 10 for prior permission even for transfer to registered FC organisations. This issue has been clarified by the FCRA department in writing. (the letter to FCRA department and response is enclosed in **Annexure 1 & 2**). It has been clarified that there is no need for obtaining prior approval for transfer of FC funds to organisations which are having FC registration.

TRANSFER OF FUNDS TO UNREGISTERED ORGANISATIONS

9.1 The old Act prohibited transfer of funds to any other organisation unless the recipient organisation also possesses FC registration. However, the new Act allows of FC funds to even unregistered organisation.

9.2 Section 7 of FCRA 2010 provides that foreign contribution can also be transferred non FC organisation with prior approval. Rule 23(4) provides that an organisation may apply in Form FC-10 for transfer of FC funds to unregistered organisations. Such transfer could be made to multiple recipients through one prior approval. However, the total amount of transfer to unregistered organisations shall not exceed 10% of the total foreign contribution received. Further, a recommendation from the District

It has been clarified that there is no need for obtaining prior approval for transfer of FC funds to organisations which are having FC registration

Magistrate have to be obtained. The aforesaid rule has practically defeated the purpose of this amendment as *prior permission* was in any case available to all organisations. Further, suppose a donor organisation wants to transfer funds to various districts, then certificate from District Magistrate would have to be obtained separately for each district. In other words, the purpose of this new provision will not be achieved and the small CBOs and registered SHGs will continue to be deprived of FC funds.

ADMINISTRATIVE EXPENSES

10.1 Under the new FCRA, 2010 there is a new provision which prohibits administrative expenses beyond 50%. The definition of administrative expenses includes various expenses such as rent, vehicles etc. which can also be incurred for programme purposes.

10.2 This amendment may cause hardship in interpreting the Rule 5 constituted in this regard. The definition of Administrative Expenditure briefly is as under :

- Remuneration and other expenditure to Board Members and Trustees

The definition of administrative expenses includes various expenses such as rent, vehicles etc. which can also be incurred for programme purposes.

- Remuneration and other expenditure to persons managing activity.
- Expenses at the office of the NGO
- Cost of accounting and administration
- Expenses towards running and maintenance of vehicle
- Cost of writing and filing reports
- Legal and professional charges
- Rent and repairs to premises

10.3 The Rule further provides that the following salaries shall not be considered as administrative in nature :

- Salaries of personnel engaged in training or for collection or analysis of field data of an association primarily engaged in research or training (1st proviso)
- Expenses related to activities for example salaries to doctors of hospital, salaries to teachers of school etc. (2nd proviso)

10.4 From the above definition of administrative expenses the followings issues need greater clarity :

- All kinds of vehicle expenditure has been considered as

administrative in nature. However, the last proviso provides that expenses for furtherance of activity shall be excluded. Therefore, it should be expected that all programme related vehicle expenses and other expenditures are excluded from calculation of administrative expenses.

- The Rule includes the salaries of persons engaged in management of activity and at the same time the proviso as discussed above also applies. Therefore, it is expected that all direct programme salaries shall be excluded.
- In case of network organisations, the programme is implemented through partner organisations. In such cases, it is not clear how the administration. expenditure of the mother NGO shall be determined. It is expected that the programme expenses incurred by the subsequent organisation will be considered as a part of programme expenses of the mother NGO as well.

APPLICATION FOR REGISTRATION & PRIOR PERMISSION

11.1 Under section 11 of new Act, application for registration and prior permission is required to be made. There are no major changes under this provision

and all the existing registered organisations will continue to remain valid for the next 5 years from the enactment of this Act. Other relevant issues in this regard are as under :

- All new registration and prior permission applications have to be made in Form FC-3 and FC-4 respectively. All applications should be made electronically followed by hard copies within 30 days of the electronic submission, otherwise the application will become void. A new application can only be made after 6 months of the cessation of the old application, both in the case of registration and prior permission.
- A new prior permission application can be made any time or simultaneously if it pertains to a different project.

11.2 In the old FCRA there was no time limit for processing an application for registration. Under section 12 of the FCRA 2010, applications have to be processed within 90 days. The FCRA department shall also provide reasons for rejections.

11.3 In case of prior permission, there is no provision which allows deemed approval as was the case in the old act.

POWERS FOR REJECTING AN APPLICATION

12.1 The FCRA 2010 has provided considerable powers to the authorities for rejecting an application for prior permission or registration. Under Section 12, various

Under section 12 of the FCRA department has to process all application for registration or prior permission within 90 days. The FCRA department shall also provide reasons for rejections.

strict conditions have been provided which include that the applicant should not have been prosecuted or convicted for indulging in activities aimed at conversion or creating communal tension. It may be noted that the word 'prosecuted' has been used which implies that even if there is a Court proceeding pending, then also FCRA registration could be denied.

SUSPENSION OF REGISTRATION CERTIFICATE

13.1 Section 13 of the new Act allows the power to suspend the registration pending cancellation of certificate, for a period upto 180 days. During suspension the organisation cannot receive any foreign funds without prior approval. However, such organisation can utilise the existing foreign funds to the extent of 25%, that to with prior approval from FCRA department. Before suspending any organisation, the FCRA department shall record the reasons in writing. ***One very important issue under this section is the absence of any provision for an opportunity of being heard, before suspension which seems to be very harsh and unfair.***

Registration may be cancelled for various reasons. However, no certificate shall be cancelled unless an reasonable opportunity of being heard is provided.

CANCELLATION OF REGISTRATION CERTIFICATE

14.1 Under section 14, the Central Government may cancel the registration certificate for various reasons. However, no certificate shall be cancelled unless reasonable opportunity of being heard is provided. The reasons for cancelling the certificate are :

- (i) Providing false information
- (ii) Violating the terms and conditions like filing of return, etc.
- (iii) Violating the Act or the Rules
- (iv) Acting against public interest
- (v) No reasonable activity for 2 years.

14.2 Once a registration certificate is cancelled, such person shall not be eligible for registration or prior permission for the next 3 years from the date of cancellation.

14.3 The term “reasonable activity” has not been defined. It may so happen that an NGO may have activity from local sources. Therefore, it is expected that reasonable activity whether from FC or local sources should be there for retaining FC registration.

FOREIGN COMPANY & FOREIGN SOURCE

15.1 The old FCRA 1976 considered Indian companies, where more than 50% of equity is held by foreigners, as foreign source. For example : companies like ICICI Bank, Infosys etc. were foreign source and donations can not be accepted from them without FCRA registration. Unfortunately this provision has been retained in the new FCRA 2010, though the stated intent of the Government was to exclude such companies. This provision could be a drafting error as the FCRA 2010 has defined a foreign company under clause (g) of Section 2, which does not include Indian Companies. This clause is apparently inserted to exclude Indian companies having more than 50% of Foreign equity holding. However section 2(j) which defines the term ‘foreign source’ includes an Indian company under the category of foreign source if more than 50% of its equity is held by foreigners.

15.2 This provision shall create problem in flow of funds from such organisations to various genuine NGOs as only FC registered NGOs can accept such contributions.

BUSINESS / CONSULTANCY INCOME OF AN NGO

16.1 As discussed earlier, the new Act excludes consultancy or commercial receipts from the purview of foreign contribution. This amendment was very necessary but it comes with a lot of potent controversies and trouble for the NGOs. As per the new provisions, any fee or cost against business, trade or commerce shall not be considered

as foreign contribution. In other words, such receipts can be treated as local income. However the problem is that this 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.

PERSONS SPECIFICALLY DEBARRED FROM RECEIVING FOREIGN CONTRIBUTION

17.1 Section 3 of FCRA 2010 specifies that the following persons cannot receive foreign contribution:

- (a) candidate for election.
- (b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper.
- (c) Judge, Government servant or employee of any corporation.
- (d) member of any legislature
- (e) political party or office-bearer thereof.
- (f) Organisation of a political nature.**
- (g) Association or company engaged in broadcast of audio or visual news.**
- (h) Correspondent, columnist etc. related with the company referred in clause (g)**

17.2 it may be noted that the category of persons debarred from receiving foreign funds have been increased. The clause (f), (g) and (h) have been added by the FCRA 2010.

NGOs should be careful in treating consultancy income and other receipts as local income even though it is now permissible under the proposed Act.

17.3 The above mentioned persons cannot receive foreign contribution subject to certain exceptions specified in section 4 which are as under:

- “(a) If they receive foreign funds by way of salary, wages or remuneration for services rendered. Or if they receive payment in ordinary course of business transaction in India by such foreign organisation or source.
- (b) If the funds are received in the course of international trade or commerce or in the ordinary course of business transacted outside India.
- (c) Payment is received as an agent of a foreign source of organisation in relation to any transaction made by such foreign organisation with the central or state government.
- (d) If the payment is received by way of gift or presentation as a part of any Indian delegation within the norms of acceptance described by Central Government.
- (e) From his / her relative.

FCRA 2010 provides that multiple bank accounts can be opened for the purposes of utilisation provided only one bank account is maintained for receiving foreign contribution

(f) By remittance under normal course under FEMA 1999.

(g) By way of Scholarship, stipend etc.”

17.4 This section is more or less the same except the fact that remittance from specified person has not been restricted to Rs.8000/- as was under FCRA 1976.

RENEWAL OF REGISTRATION EVERY 5 YEARS

18.1 The FCRA 2010 provides for renewal of registration of NGOs every 5 years. However, the Act has provided relief to all the existing NGOs for the first 5 years from the date of enactment. In other words, all existing NGOs have to renew their registration at the end of the period of 5 years from the date of enactment of FCRA 2010. This implies that the renewal of all the existing NGOs will become due on 1st May 2016.

18.2 Rule 12 provides the procedure for renewal application. All NGOs have to apply in Form FC-5 six months before the due date. Therefore, all the existing NGOs have to file their FC-5 for renewal before 1st November 2015. The Rule further

provides that NGOs implementing multi year projects shall be eligible to apply for renewal twelve months before the date of expiry of the certificate of registration.

18.3 In case an NGO fails to apply for renewal within the due date, its registration shall become invalid. However, the department may condone the delay if satisfactory reasons for not submitting the renewal application are provided. Such delay should not be for more than 4 months after the expiry of the original certificate of registration.

POWER TO PROHIBIT SOURCES FROM WHICH FC CAN BE ACCEPTED

19.1 The Act provides power to the Central Government under section 11(3)(iv) to notify such source(s) from which foreign contribution shall be accepted with prior permission only. It implies that the Central Govt. may notify specific donors or countries from which foreign funds could not be received or shall be received with prior permission only.

MULTIPLE BANK ACCOUNT

20.1 Section 17 of FCRA 2010 provides that multiple bank accounts can be opened for the purposes of utilisation provided only one bank account is maintained for receiving foreign contribution. This amendment provides a great relief to all the NGOs which were struggling under the arbitrary disallowance of multiple bank accounts under FCRA, 1976.

20.2 Under Rule 9 it is provided that the NGOs may open one or more bank accounts for the purpose of utilisation. However, in all such cases an intimation in plain paper should be sent to the FCRA department within 15 days of the opening of such account.

DISPOSAL OF FIXED ASSETS ON DISSOLUTION

21.1 Section 22 of the FCRA 2010 provides that, in case of dissolution, the Central Govt. shall have the power to determine the process of disposal of FC assets. The Central Govt. may specify the manner and procedure in which such asset shall be disposed off.

SPECULATIVE ACTIVITIES

22.1 Rule 4 specifies the circumstances under which an investment could be treated as speculative in nature.

22.2 Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund. This provision is in conflict with section 11(5) of the Income Tax Act which provides investment in certain stock linked mutual funds.

22.3 Rule 4(1)(b) prohibits investment in high return schemes or in land if it is not directly linked to the declared aims and objectives of organisation. This provision may create needless controversies as it will be very difficult to make distinction between investment in land in relation to the objectives and otherwise. Infact, NGOs cannot invest anything beyond the objectives. All investments have to be

Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund. This provision is in conflict with section 11(5) of the Income Tax Act

towards fulfillment of the long term objectives.

DISCLOSURE OF INFORMATION IF RECEIPTS EXCEED ' ONE CRORE

23.1 Rule 12 provides that if the contributions received during the year exceed ' one crore, 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.

23.2 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.

CUSTODY OF FUNDS AND ASSETS IN THE EVENT OF CANCELLATION

24.1 Rule 14 provides the procedure regarding the custody of foreign funds and assets in the event of cancellation of registration.

24.2 In case of available bank balances, the respective banking authority will

It seems due to the inclusion of Income and Expenditure account that the utilisation will be permissible on accrual basis also

become the custodian till the Central Government issues further directions.

24.3 If funds have been transferred to another NGO after cancellation, then the funds in the bank account of such NGO will also go to the custody of the banking authority.

24.4 All other assets of the organisation whose certificate has been cancelled or has become defunct shall go to the interim custody of the District Magistrate or any other authority which the Central Government may direct. This provision seems unfair, because the direction for repossession of asset should only be issued when all appellate remedies are exhausted.

REPORTING BY BANKS

25.1 Rule 15 provides that the bank should report to the FCRA department within 30 days under two circumstances :

- (i) if any foreign contribution is received without registration or prior permission,
- (ii) if foreign contribution is received in excess of 'one crore during a period of 30 days, this rule will apply to all FC funds received through valid registration or prior permission.

FILING OF RETURN & METHOD OF ACCOUNTING

26.1 Rule 16 provides that the annual return accompanied by Income and Expenditure statement, Receipt and Payment Account and Balance Sheet shall be submitted by 31st of December. The law regarding filing of returns remains, more or less unchanged. However, the notable changes are as under :

- The return shall be filed in Form FC-6 and not FC-3
- For the first time, FC rules are asking for submission of income and expenditure account
- A copy of bank statement certified by the bank has to be submitted
- A nil return is required to be filed if there is no activity

26.2 The FCRA 2010 and the Rules thereof do not specify any method of accounting. Section 19 of the FCRA 2010 just provides that accounts with regard to FC receipt and utilisation should be maintained. In the past, it was assumed that FCRA required cash basis of reporting (if not accounting). However, with the new requirement of filing *Income and Expenditure account* raises the question whether accrual basis of accounting is also permissible. On a plain reading of section 19 of FCRA 2010, Rule 16 and Form FC-6, it seems that the requirement is to report FC funds received and utilised during the year. In other words, the receipt of funds shall be on cash basis only but there is no direction regarding utilisation on payment basis only. FCRA 2010 does not seem to be prescribing any fixed

method of accounting. Any method of accounting may be followed by the organisation but the receipt of FC funds should be reported on cash basis only. **It seems due to the inclusion of *Income and Expenditure account*, the utilisation will be permissible on accrual basis also if the organisation consistently follows accrual basis of accounting. However, the proposed Direct Tax Code (DTC) prescribes cash basis of computation only.**

WHICH RETURN SHOULD BE FILED FOR THE CURRENT YEAR

27.1 The new Rules provide that the annual return shall be filed in Form FC-6. However, it has been clarified to file the return in FC-3 in the FAQs issued by MHA (Question No 24, Pg 10) which says “It may be noted that annual return for the financial Year 2010-2011 is to be filed by the 31st December, 2011 in Form FC-3, i.e., as per FCRA, 1976”

ADDITIONAL REQUIREMENT OF FILING FORM FC-7

28.1 All NGOs are required to file Form FC-7 alongwith a certificate for Chartered Accountant, if they receive contribution in kind. In the old act, there was no such requirement for filing a separate return for foreign contribution received in kind. It may be noted that old Form FC-3 and the new

The Rule 17(7) provides that accounting statements shall be preserved for 6 years.

Form FC-6 both have a column for contribution received in kind. Therefore, it was not necessary to have an additional requirement of filing Form FC-7. However, as it stands, FC-7 has to be filed in case of receipt of contribution in kind.

PRESERVATION OF ACCOUNTING RECORDS FOR 6 YEARS

29.1 The Rule 17(7) provides that accounting statements shall be preserved for 6 years. This is a very welcome change. Earlier it was seen that the NGOs were asked to provide books and records for past 10-15 years which was practically not possible. This rule will provide a lot of relief to the existing NGOs.

COMPOUNDING OF OFFENCE

30.1 Section 41 read with Rule 21 provides that the Ministry of Home Affairs may compound any offence punishable under the FCRA Act. When an offence is compounded, then such organisation is not prosecuted. This is also a positive change which will help in avoiding needless legal cases.

(Manoj Fogla - Senior Chartered Accountant and a Consultant with many Voluntary Organisations.)

(Sanjay Patra - Senior Chartered Accountant and Executive Director of FMSF.)

Annexure-1



Voluntary Action Network India

(An Apex Body of Voluntary Organisations)

Working Committee

Office-bearers

Chairperson
Joyant Kumar
CASA, New Delhi

Treasurer
Ashok Singh
SSN, Uttar Pradesh

Chief Executive Officer
Harsh Jaitli
VANI, New Delhi

Working Committee Members

Ajay S. Mehta
NFI, New Delhi

Anju Talukdar
Shikhu Sarathi, Assam

Arun Chandon
ERA, Himachal Pradesh

Binay Acharya
UNNATI, Gujarat

Farida Vahedi
NSAB, New Delhi

Gurinder Kaur
Social Worker
New Delhi

H. Bedi
DST, Maharashtra

Jacob Thundil
PREM, Orissa

K. Shivakumar
V K Foundation, Tamil Nadu

Neelima Khetan
Seva Mandir, Rajasthan

Rakesh Mittal
Chartered Accountant,
Madhya Pradesh

Sathyasree Goswami
Social Worker, Karnataka

Sehba Hussain
Beti Foundation, Uttar Pradesh

Sheelu Francis
Women's Collective, Tamil Nadu

Sukumar Singh
Mass Education, West Bengal

Y.V. Mallia Reddy
Action Fraterna, Andhra Pradesh

May 9, 2011

Mr. G.V.V.Sarma, IAS
JOINT Secretary (Foreigners)
Ministry of Home Affairs
Jaisalmer House, 26-Man Singh Road
New Delhi-110011

Dear *Sh. Sarma ji*

* Greetings from VANI!

VANI has started sharing the provisions of FCRA with the voluntary organizations. We have received quite positive response from numerous organizations.

Sir, I am thankful to you for clarifying that Rule 24(2) shall not apply in case of transfer of funds to organizations having valid registration under FCRA.

The text of the Rule 24(2) is as under for your reference.

"The Central Government may permit the transfer in respect of a person who has been granted the certificate of registration or prior permission under section 11 of the Act, in case the recipient person has not been proceeded against under any provision of the Act".

As, we understand that this rule applies only in case of those organizations that have been proceeded against under any provision of the FCRA Act. For other FC registered organizations, there is no need for applying in Form FC-10 for prior permission.

Sir, kindly confirm that our understanding and interpretation of the Rule 24 (2) as stated above is correct. Your early response will help me in sharing this information with VOs.

Best wishes

Harsh Jaitli
Chief Executive Officer

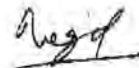
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Annexure-2

MHV-12-2011 17:23 From:

To: 414 95535

Page: 1



F.No.II/21022/58(37)/2011-FC-I
Government of India
Ministry of Home affairs
FCRA-I Section

New Delhi, dated the 11th May, 2011

To

The Chief Functionary,
Voluntary Action Network India
BB-5, 1st Floor, Greater Kailash Enclave-II
New Delhi-110048

Subject:- Transfer of funds to organizations having valid registration-clarification regarding.

Sir,

I am directed to refer to your letter dated 9th May, 2011 on the subject mentioned above and to say that in terms of Section 7 of Foreign Contribution (Regulation) Act, 2010, FCRA registered NGOs intending to transfer funds to other FCRA registered NGO do not need prior approval of the Central Government subject to the condition that the recipient association/NGO has not been proceeded against under any provision of the Act.

2. In all other cases, Rule 24 of the Foreign Contribution (Regulation) Rules, 2011 will apply and the 'person' concerned shall have to submit application in Form FC-10.

Yours faithfully,



(H.K. Kwalienthang)
Under Secretary to the Govt. of India
Tel.No.23387436

FCRA DILEMMA FOR CSOs

-Manoj Fogla, FCA

INTRODUCTION

1.01 The Foreign Contribution (Regulation) Act 2010 and the Foreign Contribution (Regulation) Rules 2011 have been enacted w.e.f. 01.05.2011. The old FCR Act and Rule, 1976 have been repealed. In this issue, we are discussing the major areas requiring clarity from the CSOs viewpoint.

WHETHER THE OLD FORM FC-3 OR THE NEW FORM FC-6 SHOULD BE FILED FOR THE YEAR ENDED 2010-11

2.01 To our understanding, for the year 2010-11 the old form FC-3 should be filed because the new law became effective only from 1st May 2011 which is 1 month after the end of

the financial year 2010-11. Moreover the new form FC-6 requires location wise reporting and such records may not be available with some organisations as it was not legally required to be maintained as per the earlier act.

IN THE NEW FORM FC-6, IS IT NECESSARY TO PROVIDE COMPLETE ADDRESS OF EACH ACTIVITY

3.01 The new form FC-6 has a column which requires address of specific activity. For a large NGO, it may not be practically possible to provide the village wise address of all activities spread across various states of India. To our understanding, the requirement and the intent of the

FCRA department is to have information on how the funds were geographically distributed. Therefore, a district wise details of fund utilisation should suffice.

WHETHER SALARIES OF SENIOR PROGRAMME STAFF ENGAGED IN IMPLEMENTATION OF PROGRAMMES SHALL BE TREATED AS ADMINISTRATIVE OR PROGRAMME EXPENDITURE

4.01 As per the proviso to Rule 5, all salaries of personnel directly engaged in implementation of programmes towards achievement of objectives shall be treated as programme expenditure. Therefore, such salaries and expenditures should be treated as programme expenditure.

WHETHER EXPENDITURE ON VEHICLE, CONVEYANCE, TRAVEL, RENT, TELEPHONE ETC. INCURRED DIRECTLY TOWARDS IMPLEMENTATION OF PROGRAMMES SHALL BE TREATED AS ADMINISTRATIVE OR PROGRAMME EXPENDITURE

5.01 As per the proviso to Rule 5 all expenditure on vehicle, conveyance, travel, rent, telephone etc. incurred directly towards implementation of programmes shall be treated as programme expenditure. Therefore, such salaries and expenditures should be treated as programme expenditure

HOW WILL ADMINISTRATIVE EXPENDITURE BE COMPUTED WHEN THE PROGRAMME IS IMPLEMENTED THROUGH OTHER FC REGISTERED PARTNERS

6.01 The FC rules are silent about the computation of administrative expenditure in case where the programme is implemented through multiple partners. To our understanding, the administrative expenditure in case of a multi partner programme shall be computed on the basis of the programme as a whole.

HOW WILL ADMINISTRATIVE EXPENSES BE REPORTED

7.01 The FC rules are silent about the reporting of administrative expenses. There is no separate column in the form FC-6 with regard to administrative expenses. To our understanding, the administrative expenditure should be reported under a separate schedule to the Income and Expenditure Account duly certified by the Auditor. The organisation may use the same schedule of expenditure as an Annex to the Form FC-6.

WHETHER TRANSFER OF FUNDS DIRECTLY TO END BENEFICIARIES SUCH AS SHG AND CBOS AT THE VILLAGE LEVEL IS PERMISSIBLE ?

8.01 Transfer of funds directly to end beneficiaries such as SHG and CBOs

at the village level is permissible only if it can be treated as end utilisation. Such groups are informal and the funds are transferred for the benefit/consumption of such groups only. It also noted that under FCRA 2010, transfer of funds to NGOs or any intermediary 'person' is not permissible. Any transfer of funds to NGOs or any intermediary 'person' should be done only with prior permission if such person is not registered under FCRA. Such prior permission can be obtained in Form 10 under Rule 24. It may further be noted that no prior permission is necessary for transfer of fund to FC registered organisations.

HOW WILL THE TRANSFER OF FIXED ASSETS TO ANOTHER FC REGISTERED NGO BE TREATED

9.01 The FCRA law is silent in this regard. It may be noted that the transfer of fixed assets to another FC registered organisation shall be treated as application of foreign funds in the books of the donor if the assets were purchased during the year. However, the problem comes in case of old FC assets transfer where such assets have already been shown as utilised in earlier years and do not form a part of the FC balance. It may be noted that many organisations reinstate the assets in the FC balance sheet by creating asset funds but such

assets are not a part of the FC closing balance. Therefore, they cannot be shown as utilised in the FC-6 statement, such assets should be shown as contribution given in kind both in the FC-6 and FC-7 statements. The Auditor should certify the approximate or written down value accordingly. For the recipient organisation, in both the cases it will be treated as contribution received in kind. The recipient organisation should file form FC-7 in both the cases.

HOW WILL THE TRANSFER OF FIXED ASSETS TO THE BENEFICIARIES BE TREATED

10.01 The FCRA law is silent in this regard. It may be noted that the transfer of fixed assets to the beneficiaries shall be treated as application of foreign funds in the books of the donor if the assets were purchased during the year. However if old FC assets are transferred where such assets have already been shown as utilised in earlier years and do not form a part of the FC balance, they cannot be shown as utilised in the FC-6 statement. Such assets should be shown as contribution given in kind both in the FC-6 and FC-7 statements.

CAN FC FUNDS AND ASSETS BE TRANSFERRED TO A PANCHAYAT

11.01 It may be noted that FCRA 2010 has included Panchayat under the

definition of 'legislature' U/s. 2(1)(k). Therefore, no FC funds or Assets can be transferred to a Panchayat as anyone forming part of the legislature is debarred from receiving FC funds.

HOW TO REPORT MULTIPLE BANK ACCOUNT OPENED EARLIER

12.01 Under the old FCRA law as per the FCRA department, multiple bank accounts were legally not permissible. Therefore any multiple bank account opened prior to 1st May 2011 shall be considered as violation of FCRA. Organisation may open new multiple bank accounts for utilisation purposes and report to the FCRA department within 15 days.

WILL NON-RECEIPT OF FC CONTRIBUTION FOR 2 YEARS RESULT IN CANCELLATION

13.01 The FCRA law says that if the organisation is not having any reasonable activity for 2 years then it could be considered for cancellation. This provision does not imply that there will be an automatic cancellation, since the department will provide an opportunity of being heard. To our understanding, if the NGO is having other activities from local income then it may not lose registration only because no foreign contribution was received for 2 years.

ARE BRANCH OFFICE AND LIAISON OFFICE OF FOREIGN AGENCIES COVERED UNDER FCRA

14.01 Under the FCRA law, all entities whether registered or not having a definite purpose in India shall be covered under the definition of the term "Association". Therefore, the branch office and liaison office of foreign entities will also be covered under the FCRA Laws if they receive foreign contribution in India. The clause No. 4(a) of form FC 3 also clarifies this aspect by including branch and liaison offices. All the branch and liaison offices working validly under the FEMA should also apply for FCRA registration if they receive foreign contribution in their Indian branch account. To our understanding FCRA registration would not be necessary in case of inward remittances from Head quarters (including the grant component). FCRA law becomes applicable only if there is a transfer, donation or delivery of foreign currency, article or security. In case of an inward remittance, there is no transfer as both the recipient and the transferor are the same person. Barring inward remittances, all other funds received shall be subject to FCRA laws.

WILL CONSULTANCY INCOME BE COVERED UNDER FCRA 2010

15.01 Under FCRA 2010, the term Foreign Contribution does not include commercial receipts. In other words, an NGO can receive consultancy or other commercial receipt from foreign sources even without having FC registration. FC registered NGOs should receive such contribution in their domestic account and such commercial receipt are not required to be reported to the FCRA department.

CAN AN NGO BE TREATED AS ORGANISATION OF POLITICAL NATURE IF IT WORKS WITH PANCHAYATS

16.01 Under FCRA 2010, Panchayats are debarred from receiving foreign contribution. However, any development work towards the objectives of the NGO should not be treated as political activity even if taken up at the Panchayat level. However, there should be no transfer of foreign contribution to a Panchayat. The circumstances under which an organisation can be declared to be an organisation of political nature are provided in Rule 3 and they do not include any genuine development activity at the grassroot level.

HOW A CHARTERED ACCOUNTANT WOULD CERTIFY CONTRIBUTIONS RECEIVED IN KIND

17.01 The new FCRA Rules under form FC-7 requires a certificate from a Chartered Accountant with regard to the foreign contribution received in kind. There was no such requirement in the earlier Act and Rules. A Chartered Accountant normally certifies only objective valuations. In case of contributions received in kind from foreign sources the authentic valuation in India is not normally available which may cause problems for the Chartered Accountant in certifying such valuations. In this regard, it is important that the FCRA department issues guidelines on the valuation of contributions received in kind and thereafter the Chartered Accountant can certify whether such processes were followed or not. Further, when FC assets are given by one FC registered organisation to another FC registered organisation. The written down value of the donor organisation may be considered as a basis for valuation.

DOES FCRA PROHIBIT INVESTMENT IN LAND AND MUTUAL FUNDS FROM PROJECT FUNDS

18.01 The new Act and Rule prohibit investment of speculative nature. Rule 4 specifies the circumstances under which an investment could be treated as speculative in nature.

18.02 Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund. This provision is in conflict with section 11(5) of the Income Tax Act, 1961 which provides investment in certain stock linked mutual funds.

18.03 Further Rule 4(1)(b) prohibits investment in high return schemes or in land if it is not directly linked to the declared aims and objectives of the organisation. To our understanding all investment in land in the normal course (which are not short term in nature) will not be affected by the new Rule.

**CAN ASSETS BE DONATED TO PANCHAYAT ?
OR HOW CAN ASSETS BE DONATED TO THE
VILLAGE**

19.01 The new Act has defined a Panchayat as a part of legislature, therefore no FC assets can be donated to a Panchayat. However, it does not seem to be the intent of the act to prevent any asset being gifted to the village or community. For instance donating black board and tables to the village school. Any such assets may be directly donated provided definite end beneficiaries are there.

**WILL BROADCAST UNDER COMMUNITY
RADIO BE TOTALLY PROHIBITED**

20.01 The new Act has specifically prohibited “persons” engaged in Audio/Visual Boardcast, therefore, charitable organisation formally owning community radios or video channels should not do such activities otherwise they will fall under the debarred category and cannot receive foreign contribution for any purpose.

**WILL UPLOADING OF AUDIO & VIDEO IN
THE ORGANISATIONS WEBSITE BE
CONSIDERED AS AUDIO/VISUAL
BROADCAST**

21.01 The new Act prohibits Audio/Visual broadcast to our understanding on website should not be considered as Audio/Visual broadcast. The organisation may also upload Audio or Video materials on their websites but such material should be confined to the permissible activities and objectives of the Society.

Checklist for Donors AFTER FCRA 2010

(Overview of the Law Donors Should Know after the Recent Legal Changes in India)

-Manoj Fogla & Sanjay Patra

INTRODUCTION

1.01 The age old Foreign Contribution Regulation Act which was enacted in 1976 has been replaced by the new FCR Act which was passed by both Houses of Parliament in August, 2010. Subsequently the Government 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 FCRA 2010 and Rules 2011 have been notified and have come into force with effect from 1st May, 2011. Similarly the Income Tax laws also have been amended considerably in the recent years. In this issue we

discuss certain issues which need to be kept in mind at the Donor Agencies level.

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

2.01 The Rule 3 of provides the guidelines for declaring an organisation to be of political nature. It may be noted that in the old act even organisations of political nature were eligible to receive foreign funds with prior permission. The new act completely prohibits organisations of political nature from receiving foreign contribution. Further the government has framed stringent rules under which it can declare any NGO to be of political nature. For

example, if an NGO engages in actions like 'bandh', 'hartal', 'rasta roko', 'jail bharo', it will be considered as an organisation of political nature.

Possible caution/actions by Donors :

- 2.02 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.
- 2.03 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.
- 2.04 While approving the project, it should be ensured that no activity in the project proposal as well as approved budget comes into the ambit of definition of 'Political Nature' under Rule 3 of FCR Rules 2011. Special care should be taken in supporting partners engaged in activism and advocacy.

ADMINISTRATIVE EXPENDITURE

- 3.01 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. Further, it states that any expenditure of administrative

nature in excess of 50% shall be defrayed with prior approval of the central government.

- 3.02 The definition of Administrative Expenditure briefly is as under:

- Remuneration and other expenditure to Board Members and Trustees
- Remuneration and other expenditure to persons managing activity.
- Expenses at the office of the NGO
- Cost of accounting and administration
- Expenses towards running and maintenance of vehicle
- Cost of writing and filing reports
- Legal and professional charges
- Rent and repairs to premises

- 3.03 The rule further provides that any type of expenditure expended directly on programme activities shall not be considered as administrative in nature.

Possible caution/actions by Donors:

- 3.04 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.

- 3.05 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 2011.

VALIDITY OF THE REGISTRATION CERTIFICATE

- 4.01 Section 11 of FCRA 2010 has restricted the validity of FCRA registration to a period of 5 years from the date of its issue. All organisations registered on the date of the enactment of FCRA 2010 will have to go for renewal after 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. In case of ongoing multi-year projects, NGOs shall be eligible to apply for renewal twelve months before the date of expiry of the certificate of registration.

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

Possible caution/actions by Donors:

- 4.03 The Donor Agencies should ascertain the status of registration

of the Organisation that they are funding or planning to fund and period for which it is valid.

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

- 4.05 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.

CHANGE IN MEMBERS OF EXECUTIVE COMMITTEE/GOVERNING COUNCIL

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

- 5.02 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.

5.03 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 any provision which stretches beyond the Act.

Possible caution/actions by Donors:

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

5.05 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.

CONSULTANCY INCOME OF AN NGO

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

6.02 Explanation 3 to Section 2(1)(h) of FCRA 2010 states that any amount received, by any person from any foreign source in India by way of 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.

6.03 However, the provision is in contradiction with the amended section 2(15) of the Income Tax Act, 1961 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 FCRA 2010.

Possible caution/actions by Donors:

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

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

6.06 Donors should avoid awarding similar type of contracts as commercial contracts to some partners and grant contracts to some other partners.

REQUIREMENT TO PUT INFORMATION IN PUBLIC DOMAIN

7.01 Rule 13 provides for requirement of keeping the information regarding receipt and utilization in public Domain.

7.02 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.

7.03 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.

Possible caution/ actions by Donors:

7.04 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.

7.05 Donor Agencies may ask the NGOs they are funding or planning to fund but do not have a website, to create a website and put its accounts on it if the amount of funds would be more than Rs 10 million in a year. Of course it needs to be kept in mind at this point that the phrase "Public domain" has not been defined in the Act/Rules.

INTER ORGANISATIONAL TRANSFER OF FC FUND

8.01 Rule 24 provides that an organisation shall not transfer FC fund to another organisation unless such other organisation is also registered under FCRA.

8.02 FCRA registered organizations intending to transfer funds to other FCRA registered organisations do not need prior approval of the Central Government subject to the condition that the recipient organisation has not been proceeded against under any provision of the Act.

8.03 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.

8.04 The organization 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.

Possible caution/ actions by Donors:

8.05 This Rule would be of much relevance in case of funding Network Partners. The Foreign Donor Agencies should ensure that Nodal/Principal Partner transferring foreign contribution to network

organizations has obtained prior permission from the FCRA department in case the recipient has been proceeded against under any provisions of the FCRA.

8.06 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 in case the organization has been proceeded against.

8.07 Annual declaration from the network organization must be obtained that they have not been proceeded against and in case it happens, they will inform the nodal/partner organization. This clause can be included in their grant contract also.

8.08 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 funds to be received by the Nodal Partner.

POWER TO PROHIBIT SOURCES FROM WHICH FC CAN BE ACCEPTED

9.01 The Act provides power to the Central Government under section 11(3) (iv) to notify such source(s) from which foreign contribution shall

be accepted with prior permission only. It implies that the Central Govt. may notify specific donors or countries from which foreign funds could not be received or shall be received with prior permission only.

Possible caution/ actions by Donors:

9.02 The donor agency should make a detailed study as to the objectives of the organisation to be funded so that they don't land in to the list of restricted donors or donors who require prior permission from Central Government before funding.

BANK ACCOUNT RELATED ISSUES

10.01 The FCRA and FCR Rules specify that foreign contribution should be received in the designated bank account only. However after receiving the funds in the designated bank account, the organisation may transfer funds to various bank accounts earmarked to specific donors or projects. This is a welcome change of FCRA 2010, since earlier multiple bank account were not permissible.

Possible caution/ actions by Donors:

10.02 The donor agency should ensure that the funds are transferred only in the approved and designated bank account and subsequently

the donor may ask the partner to open dedicated bank account for specific projects.

PROHIBITION OF SPECULATIVE INVESTMENT

11.01 The new law does not permit investment of surplus funds in risky or speculative assets. Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund.

11.02 Rule 4(1)(b) prohibits investment in high return schemes or in land if it is not directly linked to the declared aims and objectives of organisation. Basically the idea is to prevent investment of short term funds into risk bearing instruments or assets.

Possible caution/actions by Donors:

11.03 The donor should ensure that the balance of project fund available with the partner is invested in secured instruments. The donor should also ask for the details of investment against the available project balance at the end of each period.

SUSPENSION OF REGISTRATION CERTIFICATE

12.01 Section 13 of the new Act allows the power to suspend the

registration pending cancellation of certificate, for a period upto 180 days. During suspension the organisation cannot receive any foreign funds without prior approval. However, such organisation can utilise the existing foreign funds to the extent of 25%, with prior approval from FCRA department. Before suspending any organisation, the FCRA department shall record the reasons in writing. One very important issue under this section is the absence of any provision for an opportunity of being heard, before suspension which seems to be very harsh and unfair. An organisation's certificate may be suspended while cancellation proceedings are on. It may be noted that during suspension period the bank accounts are attached which will include the project funds also.

Possible caution/actions by Donors:

12.02 The donor should seek a declaration from the partner that its certificate of registration has not been suspended. Special care is necessary in case of 'networks' because if the lead holder's certificate is suspended, then the activity of the entire network will come to a halt.

PERSONS SPECIFICALLY DEBARRED FROM RECEIVING FOREIGN CONTRIBUTION

13.01 Section 3 of FCRA 2010 specifies that the following persons cannot receive foreign contribution:

- (a) candidate for election.
- (b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper.
- (c) Judge, Government servant or employee of any corporation.
- (d) member of any legislature
- (e) political party or office-bearer thereof.
- (f) Organisation of a political nature.
- (g) Association or company engaged in broadcast of audio or visual news.

(h) Correspondent, columnist etc. related with the company referred in clause(g)

13.02 In this context it is important to note that be clause(g) above prohibits an organisation engaged in broadcast of audio or visual news.

Possible caution/actions by Donors:

13.03 The donor should seek a declaration that the partner is not engaged in any broadcasting activity e.g. community radio. It may be noted that such activity is not permissible at all, whether from foreign or local funds.

(With input from Ms.Bushra Khan, FMSF.)

(Manoj Fogla - Senior Chartered Accountant and a Consultant with many Voluntary Organisations.)

(Sanjay Patra - Senior Chartered Accountant and Executive Director of FMSF.)

Role as an **AUDITOR**

-Miss R. Sivabhogam, B.A., F.C.A.

In this article, a verbatim of Miss Sivabhogam's speech delivered during the First Conference of Chartered Accountants of India in April 1954, the author analyses the conduct and functions of an auditor with special reference to four specific domains of existence—office, professional colleagues and Institute, clients and public. Some of the suggestions may appear trivial to our readers at surface, but these are fundamentally important, practical and inspiring. A must read, indeed.

When I was a young girl studying in school, my school motto was satyam vada, i.e. speak the truth. My College motto was Common Sense and Consideration. Now that I have taken the profession of a chartered accountant, I find how indispensable are the two mottos to an auditor, more so when they are read together with our Institute's motto ya yesu supthesu jagarathi (This is He that is awake in those who sleep).

The Oxford dictionary gives the meaning of 'Role' as one's functions, what one is appointed or expected or has undertaken to do, and 'Auditor' as one who examines officially. It goes to mean that auditing is a profession and not a business. In a business the primary object is money or profit,

whereas in the case of a profession the primary object is service, imparting knowledge to others, subordinating the element of profit which may be incidental.

I wish to analyse the role of an auditor under four main heads:

1. An auditor in his office
2. An auditor with other co-auditors and the Institute
3. An auditor with his clients
4. An auditor with the public.

An Auditor in his Office: He has several obligations to his articulated and audit clerks. The Regulations and the Articles of Agreement define the duties and the obligations. Besides what are constitutionally defined, I feel an auditor

must possess amiable qualities to make himself a successful auditor. He must have direct contact with his staff. He must first of all impress on them the necessity and the importance of cheerful appearances. He must teach them how to keep an office tidy, answer a phone call, take a telephone message, answer an enquiry in the office, speak courteously with a visitor or a client...

The auditor should meet his staff at regular intervals, say, over a cup of tea and instruct them regarding their work. He must give opportunities to apply theory into practice. They should be taught the 'ticks' peculiar to the auditor in whose office they are undergoing practical training. He must at first make them do routine work and then, step by step, teach them how to do more responsible work like vouching, checking of bank statements, scrutiny of subsidiary ledgers, general ledgers, etc. When he is satisfied that they are able to follow the regular work, he should teach them how to verify the assets and liabilities of a company, go through the minutes book and draft the account statements. He should instruct them that they should have no discussion whatsoever with the clients except it be to enquire about missing vouchers or any information or explanations of items which they do not follow. The auditor must so organise the professional side of his office that the work which he delegates to others is done as he would wish to do it himself.

The clerks should be taught to write up diaries every day and what queries to be written in the audit note-book and how those queries should be solved subsequently. Though in my own office when I was an articled clerk my master had drilled into my head times without number the importance of maintaining audit note-books and diaries, I could realise the seriousness of the same only when I happened to attend a disciplinary case against a member of our Institute and how the diaries and the audit note-books, which were exhibited in the court, were responsible to save the member from being convicted.

The diaries and the audit note-books are the most important documents to an auditor. The clerks should be taught that while writing diaries they should note down the times taken to do each work. This enables the auditor to have an idea of the time taken to do each audit. The time basis is very important especially when the auditor has to give the schedule of fees as per time-sheet with regard to court investigation work. Where he accepts engagements with a proprietary concern or a partnership, it enables him to quote his fees.

While being articled clerks they should be taught to file letters, despatch letters by post and personal delivery, to send telegrams, registered letters,

insured posts, to despatch parcels and to receive parcels, in other words, all the routine work conducted in the office. These points may be very elementary, but these small things go a long way to make a successful auditor.

AN AUDITOR WITH OTHER CO-AUDITORS AND THE INSTITUTE:

The auditors, as a class, should be devoid of pettiness, envy and jealousy. Live and let live should be his attitude. A senior auditor has duties towards a junior auditor and vice versa. He must take genuine interest in them, see that they are financially well off, pass on any small audits that come in his way and recommend them to small clients. He must apprise them of his varied experiences and see that they do not commit the same mistakes that he himself had committed. He must be a ready reckoner to his juniors, almost a walking encyclopaedia, must be up-to-date with all the information of the laws and by-laws of our constitution and the interpretation of the same. He must be in touch with the modern trends in the presentation of accounts and all current thoughts on these subjects.

A junior auditor need not feel shy of his inexperience and ignorance. He could freely converse with a senior and do all the work most cheerfully and willingly entrusted by the senior.

An auditor must be in constant touch with the co-members and also the new entrants to the profession. He must feel it his duty to deliver a series of lectures to the members and the students on the ethics of our profession. He should impress upon them the dignity and the prestige of our profession and that there should be no canvassing or undercutting. Advertisement in any form or of any kind should be strictly forbidden. The field is so vast that there is work for every member who is honest, trustworthy and painstaking.

The Institute is our Alma Mater and hence, the auditor should have a sense of duty towards it and zealously guard its interests. The first and the foremost aim should be to live in strict conformance with the rules and regulations and maintain the discipline himself. He should take interest in the various activities of the Institute and set apart some time for the work of the Institute. He should go through the curriculum and suggest all possible improvements. He should study the Act and the Regulations and see that our rights and privileges are properly safeguarded.

AN AUDITOR WITH HIS CLIENTS:

It is here that the significance of our motto comes in. Sri Ramakrishna says, 'No thief can enter the house when the master is awake'. The auditor is always alert. Sir Harold Howitt in one of his lectures on "Training for Accountancy" says that the qualities required for a professional auditor are "integrity,

ability, hard work, tact, common sense, balanced judgment, clear reasoning together with ability to be concise and lucid both orally and in writing.” He should carry out his work in a most dispassionate manner and if there is anything to report, he should say it without fear or favour. He must be skilled in his work and should have a thorough grasp of the subject.

A knowledge of the psychology of human nature is most essential. He must help to solve their difficulties. He must not frighten them away with his destructive criticism. He must infuse confidence in them so that the clients themselves disclose all the material facts. It is here that he requires lot of tact and diplomacy. The criticism should be so very constructive as to make the client feel that the concern has been benefited by the auditor.

As an auditor to a joint-stock company his duties and functions are defined in the Companies Act. In preparing the final accounts and drafting the accounts statements, the auditor has to direct his clients to disclose the correct position for the period covered, and that the fixed, floating and nominal assets are represented at their proper value. If there is any heavy secret reserve created either by undervaluation of assets or overstatement of liabilities, such facts should be disclosed. The profits available for distribution of dividends must be indicated by taking away from the profit and loss account surplus resulting from unrealised capital appreciation. Any unusual

or non-recurring sources of income must be indicated in the profit and loss account under separate heads so that the real business profits will be disclosed at their proper figures...

Though an auditor is a trustee of the shareholders, he has got equal obligations, moral and ethical, to some extent though not strictly legal to the creditors, debenture-holders, etc. The interest of the creditors, particularly loan creditors, must be safeguarded. The terms of the loan must be strictly adhered to, and as far as possible the liabilities should be properly, clearly and correctly disclosed.

An auditor should be a good report writer also. He should have good command over the language. A well-conducted investigation audit may sometimes lose its significance without a proper report accompanying it. The points to be reported should be clearly expressed and in good language. “Give unto Caesar what is due to Caesar and give unto God what is due to God” should be his frame of mind. He should distinguish between his report to the directors and that of the shareholders. He has peculiarly an enviable position in that he is supremely independent. In giving out his report boldly and fearlessly, he may lose some audits; but it should not matter. He must put duty before self and in the long run it will pay him to be truthful.

Though an auditor has no contractual

obligations with any department of Government, the accounts prepared by him must be relied upon by them so that the Government may make necessary adjustments to arrive at the figures they want. If the auditor undertakes a work in relation to the taxation authorities or any other department of Government, the role of the auditor is expanded and he will be obliged to observe all the rules and regulations framed by the department concerned and prepare the accounts accordingly. If there are any controversial points, the facts must be represented clearly and the reasons underlying the decisions taken by the auditor may be given. Under no circumstances should any item be suppressed to be found out by the departments under their scrutiny.

An Auditor with the Public:

The status of an auditor has been increasing by leaps and bounds and the public have always looked upon an auditor with high esteem and regard. An auditor has to be a public servant and a trustee of the people. The Chief Minister of Madras, while inaugurating the First Annual General Meeting of the Chartered Accountants of the Region, said, "Good and correct accountancy was essential to the administration of public or private affairs. You hold certainly a very responsible position in society. You can make or mar the fortunes of traders and other business men. The ethics of your profession are well known. You are the

agents of the nation and not of the firm that employs you. You must be just, upright and fearless. At the same time you should be humane. Your examination should be thorough and you must come to conclusions only after such an examination. You must be men of good conduct. You should not be persuaded to do things by others; but you must be independent. You should not be harsh and take pleasure in giving pain and distress to others. All the time you must be attached to dharma. You must be upright and have a love for uprightness."

The public expect an auditor to be above board. He is closer to the industrial and commercial world in his profession than any other. He has an admirable opportunity to assess and pronounce upon the various problems which perplex the business world and any such pronouncement by him will be accepted by the people as a balanced one, because it would be based not only on experience but on complete independence. The vast growth in industrial organisation, the expansion of the affairs of State and the keen competition of the modern world demand men of financial skill, integrity and sound business training.

An auditor should not confine himself to his profession alone. He should come out to do public service. When called upon by the state or public bodies to serve on the various committees, to give expert evidence, to advise on problems affecting industry, commerce and finance, to conduct

investigations and similar other public work, given him to be useful and serviceable.
he should accept them with a feeling of Even though the services may be honorary,
gratitude that such opportunities have been he should sacrifice for the sake of public
cause.

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Management Letter as a TEMPLATE

- FMSF Resource Team

1. Introduction

It was generally observed that once the audit process is completed the Auditors give their observations about the internal process of the organisation in a informal manner. The weaknesses were brought to the notice of the management but not formally and thus the action taken by the management could not be seen. Thus, to have a serious view on the auditors' observations it is recommended to issue a management letter. A management letter will be addressed to the management of the organisation outlining the observations upon the system of accounting and internal controls, together with a detailed list of any significant weaknesses that come to the auditors' attention during the course of the auditing. The letter will include

recommendations as to how these weaknesses may be eliminated and how controls and records might be improved. The management in response to this letter needs to provide a written Action Taken Report (ATR) to the auditors' comments.

2. 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 an audit. Some of the topics/issues a management letter should cover are listed below:

2.1. The letter should set out :

2.1.1.The weakness identified

2.1.2.The risk associated with that weakness

2.1.3.The possible consequences

2.1.4. Recommendations for improving the system

2.1.5. The likely outcome of implementing the recommendation

2.2. The management letter should also include the following:

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

2.2.2. The classification of possible causes of the audit findings.

2.2.3. Management comments/ response to audit findings and recommendations.

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

A suggestive management letter is attached which can be used as a guideline/checklist for issuing a management letter (Annexure A).

3. Management Letter v/s Notes to Accounts

Management letter is not a letter to be issued in lieu of notes to accounts. There is a clear difference in purpose of both these documents. The notes to accounts forms part of the final audited accounts. It provides crucial narrative information on accounting policies and other explanations on the accounts. The notes to accounts can greatly change one's interpretation of the financial statements. It has the nature of influencing the decision of

the stakeholders and persons associated/ likely to be associated with the organisation.

A notes to accounts is a mandatory requirement of the audit. On the other hand, a management letter is a tool for the management and is not a public document. It is issued with the objective of bringing to the notice of the management the weaknesses in the internal control systems, accuracy of the financial statements, non-compliances or any other issue which needs an action to be taken by the management. The sole purpose of issuing management letter is not only highlighting the weaknesses but also giving practical recommendations to overcome them.

4. 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 the 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.

Annexure-A

To,
The Governing Board/Chief Functionary of the Organisation

Name of the Organisation

Address

Sub: Management Letter for the year ending _____

Dear Sir/ Madam

As part of our statutory/Project/others (specify) audit of _____ for the year ended ____, we evaluated the systems of internal controls to the extent we considered necessary under generally accepted auditing standards. This is done to establish a basis for reliance on systems and determining the nature, timing and extent of other auditing procedures necessary to express an opinion on the financial statements. This study was conducted to determine whether the _____ system of internal controls is adequate and commensurate with the size of the organisation and its activities.

Our audit identified areas where financial management and internal controls could be strengthened. The attached memorandum of observations and recommendations is enclosed for your information and consideration.

We would be pleased to discuss this document or to respond to any questions at your convenience.

Sincerely,

XYZ Chartered Accountants.

PARTICULARS	WEAKNESS / RISK ASSOCIATED / RECOMMENDATIONS	ACTION TO BE TAKEN BY MANAGEMENT (To be filled in by management)
1. Accounting Policies Fixed Assets, Investments, Cash & Bank Management, Inventory, Any other.		
2. Accounting Record & Systems Books maintained, manuals, notional expenditure, and cost allocation.		
3. Internal Controls Authority for approvals, Measures taken to ensure safety of cash, cheque books and other valuables		
4. Legal Compliances Compliances & registration under Income Tax, FCRA and any other applicable		
5. Budgetary Control Budget monitoring system, variance analysis, annual/half yearly/ quarterly operational budgets.		
6. Own means of contribution Cash and Non cash reporting to donor		
7. Assets Acquisition, Insurance, Sale and Depreciation.		
8. Investments Compliance with regulations and donor requirements.		
9. Contingent Liabilities Case/legal dispute		
10. Any other issue		

A Handout on NOTIONAL EXPENDITURE

-FMSF Research Team

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

1. What are Notional Expenses?

Amounts that are reported as expense without actually being spent are notional in nature. Generally these amounts are shown as expenditure from the project funds but brought back into the organisational funds through journal entry. This is done by transferring the project fund to the general fund by charging for usage of facilities of the organisation. Thus it brings transaction of organisation with itself which is legally not tenable.

Matter of charging expenses on notional basis should be clarified with the donor at the time of submission of project proposal.

2. Common Instances of Notional expenses

2.1. Where the amount charged to project is more than the actual expense:

Meeting expense charged to project @Rs.100 for 50 participants whereas actual expense comes to, say, Rs.3900 (all inclusive)

Amount Charged Rs.5000
to Project

(Rs.100 x 50 participants)

Less: Actual Expense Rs.3900

Notional Expense Rs.1100

Where the salary charged to the project is more than actual salary paid.

Where the vehicle is hired for the

project purpose; if the amount charged to the project is more than actual amount paid to the vendor, the amount charged over and above the actual payment would be notional expense.

If the vehicle is owned by the organisation and used for the project purposes, the actual cost of running and maintenance should only be charged to the project.

Note: Even if the amount budgeted shows a fixed rate, the amount charged to the project should be actual expense. This is because; the budget is quantification of plan and not the authorization for charging of expenses.

- 2.2. Where a fixed amount is charged for administration by transferring it to pool but actual expense doesn't exhaust the pool then the amount remaining in the pool to the extent representing the project fund is notional expense charged to that project.

- Where the project is multi funded the expense legitimately chargeable to the project should only be taken into account.

1. Amount transferred from Y project fund Rs. 500
2. Amount transferred from project Z fund Rs.400
3. Amount transferred from Project X fund Rs. 100

a. Total amount transferred to Pool (1+2+3) Rs.1000

b. Total Actual expense charged to the Pool Rs.500

Total Notional Expense (a-b) Rs.500

The above determined notional expense of Rs.500 can further be segregated to various donors/projects fund. This should be possible by allocating the actual expense charged to the pool (b) on some logical allocation basis to various donors/projects.

So taking the above example further we can determine the notional expense charged to Project X

c. Amount Transferred to pool from project X Rs.100

d. Amount of actual expense chargeable to project x (on some logical allocation basis) Rs.75

Notional expense charged to Project X Rs.25

The same method can be applied for determining the notional expense charged to Project Y and Z.

- 2.3. Where the building is owned by the organisation and rent is charged to the project, the matter

should be further explored as given below;

- a. Where the building is partly purchased from the same donor fund
- b. Where the building is fully financed by concerned donor
- c. Where the building is fully financed by other project donors
- d. Where the building is fully financed by the organisation's unrestricted funds

In case of (b) above, no amount should be charged to the project funded by the concerned donor. In case of (a) and (c) normally the amount charged to the project would amount to notional expense unless otherwise clearly and specifically allowed by the donor.

In case of (d) above, the Organisation should provide the circumstantial justification to the donor at the time of submitting project proposal for charging of such notional rent.

However it is always advisable to budget for the repair and maintenance rather than to charge rent for the building if it is owned by the organisation.

Whatever is the case, the matter should be clarified and agreed upon at the time of project proposal and approval thereof.

- 2.4. Where an asset is owned by the organisation and used for the purpose of the project, no fixed rate should be charged to the project. Rather, the actual running cost can be charged. Further, it should be kept in mind to budget the same at the time of approval of the project.

For Instance:

Where the expense is charged to the project at a fixed rate for using the office equipments such as photocopier which however doesn't represent actual expense on the running and maintenance of the photocopier, such service charge would amount to notional expense.

3. What Organisation/NPOs should/may do?

- 3.1. Disclose all the relevant information at the time of project proposal regarding the existing facilities of organisation that would be used for the project
- 3.2. If the organisation is planning to book any expenditure on notional basis, say portion of rent of building owned by the organisation (not however funded by that donor only), the fact should be shared clearly at the time of project proposal.
- 3.3. The organisation should formulate policy for equitable allocation of common expenses to Donors/ Projects and prepare the budget taking that into account.

- 3.4. The organisation should ask all the Donors to contribute equitably to all legitimate expense of the organisation.
- 3.5. The organisation may negotiate with donor for recovery of administration cost at a fixed rate say 10% or 15% or 20% as may be determined by whatsoever method. However some donors fund the administrative cost specifically and in that case recovery on percentage basis is not allowed.
- 3.6. For sustainability of the organisation it is always better to raise unrestricted fund and form reserve rather than making of reserve in a non-transparent way. This would also be useful to cover the project cost not supported by grants from donors.

However, it is worth noting that formation of reserve in anyways would become practically not possible with the advent of Direct Tax Code from April 1, 2012.

4. What Organisation/NOPs should not do?

- 4.1. Organisation should not resort to non-transparent ways of formation of unrestricted fund.
- 4.2. Organisation should not charge any expense to the project that is not specifically allowed by the donor

- 4.3. Organisation should not charge inequitable portion of common cost to a donor. The portion not allowed to be charged to the donor who should have been charged on legitimate ground should be charged to unrestricted fund.
- 4.4. The Organisation should not charge any expense on notional basis without the same being agreed upon by the donor
- 4.5. The transfer of FC fund to local bank account by charging the use of organisational facilities as expense would amount to contravention FCRA Act along with illegality of transacting with oneself.

5. Own Mean Contribution

Own mean contribution is the project expense agreed to be borne by project partner NGO from its own resources. As seen in some cases, to show own mean contribution, expense are charged on notional basis which is then transferred to unrestricted general fund. The expenditure incurred from that is shown as own mean contribution. Thus the own mean contribution is in fact the donor's fund contributed for the project. This practice is illegal as well as unethical and should not be resorted to.

Concept Note on **NOTIONAL EXPENDITURES IN DEVELOPMENT PROJECTS IN GRANT BASED FORMS OF CO-OPERATION**

-FMSF Resource Team

1. UNDERSTANDING NOTIONAL EXPENDITURE

- 1.1. In this concept note we shall be discussing the concept and prevailing practices of Notional expenditures in development projects.
- 1.2. Notional income or expenditure generally denotes something which remains unutilized or accrued at the organization level even though it has been shown as utilized to the donors at project level through charging of expenditure where there was no actual cash outflow. For example, if an organisation charges rent in a particular project for the use of its own premises, such rent will result in a notional expenditure in that particular

project and at the same time will result in a notional income in the general fund / account of the organisation. Similarly notional expenditures can be created by various methods including charge of expenditure on approximate basis or even inflating the expenses.

- 1.3. Notional expenditure generally is also valued at the estimated difference between the market value of the goods or services provided and the actual cost incurred by the party.
- 1.4. It has been seen that some donors permit notional expenditure as a basis for recovering administrative expenses. For instance, a project budget may be allowed 10% of the project cost as administrative charge.

In such circumstances, the organisation will collect 10% of the project cost as administrative expenses but the actual administrative expenditures may be higher or lower than the amount charged.

- 1.5. In normal accounting parlance, certain legitimate non cash expenditures are also referred to as notional expenditures. Depreciation is an example of such non cash notional expenditure. In case of depreciation the term notional may not be entirely relevant because it actually denotes the wear and tear or the loss in the value of the asset. However, in development projects, normally non cash expenditures are not considered as a part of the budget as the project assets are also financed under the project cost. Therefore, the possibility of charging further depreciation to the same project does not arise.

2. DIFFERENCE BETWEEN COMMERCIAL CONTRACT & NPO PROJECT CONTRACT

- 2.1. In a commercial contract generally a client is billed against invoices at a predetermined rate of goods and services. For example, a commercial organisation may charge Rs. 5000/- per person per day but the actual expenditure may be much less than Rs.5000/- per day. In such cases, the commercial organisation will book actual expenditures against such

receipts and the profit and loss shall be automatically determined at the end of the year. However, in the case of an NPO, expenditures are charged at an estimated rate of, say, Rs. 5000/- to the project which may be much more than the actual expenditure, then it will result in notional expenditure as well as notional income. This is because the utilisation statement has been prepared on the basis of the estimated rate and not the actual expenses and being a nonprofit organisation, profit cannot be booked.

- 2.2. It may also be noted that, all NPO projects are subject to actual utilisation of funds. Therefore, in a project contract estimated or notional expenditure should not be booked as actual utilisation of funds. If estimated or notional expenditures are booked as actual expenditures, then, funds are not actually applied to that extent and would tantamount to diversion of project funds.

3. WHY LEGALLY NOTIONAL EXPENDITURE IS NOT PERMISSIBLE

- 3.1. To incur a valid expenditure, it is necessary that there is a valid transaction between two parties. All expenditures to be legally valid would require a valid legal transfer of funds against valid invoices for

goods or services. It is an established legal dictum that one cannot trade or transact with oneself. Therefore, whenever there is a transfer of funds from one project to the general fund or another project, the fact remains that there is no legal transaction as far as the organisation as a whole is concerned. The inter project transactions get nullified at the time of consolidation.

- 3.2. For Example: An NGO charges Rs.200/- per head towards the food provided to the participants in a Seminar conducted at its own building. The NGO transfers Rs. 10,000/- to its general fund from the project account as expenditure against fooding of participants. However, in its general account the actual expenditure against fooding is Rs.4, 000/- only. Therefore, there is a profit of Rs.6,000/- in a general account. In this case, in the project account Rs. 6,000/- was charged over & above the actual expenditure. Therefore there is a profit of Rs.6,000/- in the general account. In other words, the NGO as a legal entity does not gain or lose anything but there is a loss of Rs.6,000/- in one project and gain of Rs.6,000/- in the general account i.e. transferring funds from one pocket to another. Further, for greater clarity the following are the characteristics of such a transaction:

- 3.2.1. The service provider and the recipient are the same person.
- 3.2.2. No legal transaction or transfer with oneself
- 3.2.3. There is a notional charge of expenditure in one project to the extent of Rs. 6,000/-.
- 3.2.4. There is a matching notional profit in general account to the extent of Rs. 6,000/-.
- 3.2.5. For donor utilisation purposes, the utilisation statement shall be inflated to the extent of Rs. 6,000/-. However the consolidated accounts will show the correct expenditure as only actual expenditure is permissible under the Income Tax and Foreign Contribution laws. Therefore, Rs.6,000/- will be transferred from the project account to the general account without any legal implications.

4. COMMON PRACTICES OF NOTIONAL EXPENDITURE

- 4.1. Some of the common practices of notional expenditures in the NPO sector are as under:
- 4.1.1.Charge against use of own building
 - 4.1.2.Charge against use of infrastructure, convention centre etc.

4.1.3.Charge against use of vehicle

4.1.4.Charge against use of photocopier, telephone, computer etc.

4.1.5.Providing services at a pre-determined rate

4.1.6.Charge of salary of the same staff to various projects.

4.2. In the following paras some case studies and methodology of various common practices of notional expenditure have been discussed.

5. GOODS AND SERVICES PROVIDED AT A FIXED RATE

5.1. There are instances where the organisation provides goods and services at pre- determined prices. For instance, the organisation may charge for food against number of participants in meetings and training at a fixed pre-determined rate whereas the actual expenditure may be much lower.

5.2. The above example shows charging of notional expenditure which is not an acceptable Practice in a project contract. The expenditure is not actual to the extent transferred to the General Fund. A partner organisation is not allowed / supposed to make profit from development projects. From a legal perspective also such expenditures are not permissible since the law would allow only the actual expenditures as one cannot trade with itself. In such cases, one

Similar to the example discussed earlier, XX NPO conducts training and conference for the beneficiaries throughout the year. Its trainings are generally residential inclusive of food and accommodation. All participants stay in the building owned by XX. XX charges Rs. 200/- per day per participant towards food and Rs. 300/- towards accommodation. The money charged to the project is transferred to the general account. The actual expenditure on food and maintenance of property is incurred from the general account. It was found that the actual expenditure was Rs. 100/- per day per participant towards food and Rs.100/- towards accommodation. In this case, XX has charged notional expenditure of Rs.100/- per day per participant towards food and Rs.200/- towards accommodation.

project of the partner is the service provider and another project is the service recipient which is legally not permissible.

6. RENT AND SERVICE CHARGE AGAINST ASSETS

6.1. **There might be instances where the organisation charges the project against use of its assets.** The assets could be land and building, training and conference facilities, vehicles, telephone, photocopier etc. The following points needs to be kept in mind:

6.2. If the charge is against use of the

building, it should be seen whether the building is owned or rented: In case the building is owned by the organisation, it should be clarified whether the building has been created out of corpus funds or accumulated reserves or any other sources. The building or property even though owned by the NPO may have been created out of project funds also. Therefore, one may be subjected to three types of circumstances where rent or charges are collected against building or property:

- I. Building or property created out of corpus funds or accumulated reserves
- II. Building or property created out of the project funds or from past projects of the same donor.
- III. Building or property created out of funds provided by other donors.

6.3. Rent in case of self owned property created out of corpus funds or accumulated reserves: Any recovery made against such assets should be transparently disclosed at the project proposal stages and should be formally reflected in the project agreement. Further, the rent/charges recovered should be comparable with the reasonable market rent. In such cases, it is

necessary to assess the purposes for which the building is used i.e. for programme or administrative purposes. Further, normally, it is expected that the NPO should also contribute to the project. Therefore the clarity and rationale for such transaction needs to be established between the donor and the NPO.

6.4. Rent in case of self owned property created out of the project funds or from past projects of the same donor:

No recovery should be made against use of such assets for project purposes. However, actual reasonable expenses on maintenance and upkeep of the property can be charged if it is used for the project purposes. This should be provided for in the budget itself. The implementing partner should declare that no notional expenditure have been charged against the assets funded by the same donor.

6.5. Rent in case of self owned property created out of funds provided by other donors:

Normally no recovery should be made against use of such assets for project purposes. However, if there is a circumstantial justification for use of such assets, then the rent or cost charged against such assets should be transparently disclosed at the project proposal stages and should be formally reflected in the project agreement. Further, the rent/charges recovered

should be comparable with the reasonable market rent.

6.6. Rent against other infrastructure and assets such as training facilities, equipments etc.: When an organisation recovers the cost of the assets owned by it, then it becomes important that such cost recovery mechanism is transparently disclosed at the project proposal stages and is formally reflected in the project agreement. Any internal recovery/gain by the organisation is not permissible unless it is formally approved by the donor. The same rationale of the source of such assets is also applicable i.e. whether such assets are corpus assets or project assets needs to be seen and the treatment should be as discussed above with regard to self owned property.

6.7. Multiple Rent in case of a rented building: It should be ensured that the sum total of the rent charged to various projects does not exceed the total actual rent paid. If the rent charged to various projects exceeds the actual rent, then it will result in notional expenditure as well as income for the organisation.

6.8. Rent in case of self owned car/vehicle, photocopier and other assets: The same principle should be applied as has been illustrated in context of self owned building or properties. Further, the rent charged should be

comparable with the reasonable market rent and the permission from the donor in this regard should also be obtained at the proposal stages.

6.9. Rent and other charges paid to sister concerns of the organisation: Such conflict of interest transactions should be done with prior approval of the donor and should be declared and disclosed. Such transactions may also be in violation of the provisions of the local laws such as the Income Tax Act in India.

7. ADMINISTRATIVE EXPENDITURE AS A FIXED CHARGE

7.1. There might be instances where the organisation charges the administrative expenses as a fixed charge i.e the organisation may charge 20% of the project cost as administrative expenditure. In such circumstances, the project agreement needs to be adhered to for the approval of the donor in this regard. Any other administrative expenditure which is charged to the project over and above the fixed administrative charge is not admissible.

7.2. Some donors might permit such charges for some small or specific projects. However, legally such charges do not constitute valid expenditure and therefore, it is not permissible to treat such

expenditure as valid utilisation of project funds.

8. INFLATING SALARIES TO CREATE BOTH NOTIONAL INCOME AND EXPENDITURE

- 8.1. There might be instances where the organisation charges inflated salaries and subsequently the additional amount charged to the project is transferred to the general fund by creating notional income. This is not an acceptable practice.

YY NPO is having ten staff and pays Rs.1, 00,000/- per staff per month. However, in the project, the salary is charged @ Rs.2, 00,000/- per staff per month. On the same day of the salary payment, all the staff make donation of Rs. 100,000/- back to the organisation. In this way, YY is able to transfer Rs. 10, 00,000/- per month to its general funds by charging notional expenditure in the project and by showing notional income in the general account.

The case study in the box will clarify the issue further.

- 8.2. Apart from the above example, there may be various illegal or unfair ways in which payment of salaries could be charged to various projects.

Some instances are as under :

- 8.2.1. Charging the salary of the same staff to more than one project, where the sum total

of the amount charged is more than the amount actually paid.

- 8.2.2. The same staff taking two or more salaries budgeted in the project proposal by formally executing multiple fulltime tasks.

- 8.2.3. Payment of salaries to core staff and functionaries not related with the project or working under some other project.

- 8.2.4. Transferring the budgeted salaries to the general fund and paying lesser salary to the staff from the general fund etc.

9. INFLATING PROGRAMME EXPENSES TO CREATE BOTH NOTIONAL INCOME AND EXPENDITURE

- 9.1. There might be instances where the organisation charges inflated programme expenditures and subsequently the additional amount charged to the project is transferred to the general fund by creating notional income. This is not an acceptable practice. The case study in the box below will clarify the issue further.

10. CHARGING COMMON EXPENDITURE TO VARIOUS PROJECTS

- 10.1. There might be instances where the organisation charges common

ZZ NPO is distributing funds among beneficiaries for purchase of seeds and manure. It pays Rs.10, 000/- per beneficiary for 100 persons. However, on the same day of the payment to the beneficiaries, all the beneficiaries make donation of Rs.5, 000/- back to the organisation. In this way ZZ is able to transfer Rs.5, 00,000/- to its general funds by charging notional expenditure in the project and by showing notional income in the general account.

expenditure to various other projects. The common expenditure may be rent of premises, brochures and materials for similar programme etc. It may be noted that if the common expenditure has been already funded by one particular donor, the same expenditure should not be charged again to various other projects and donors.

- 10.2. In case the common expenditure is shared by various donors, it needs to be ensured that the sum total of the expenditures charged to various projects is not more than the actual expenditure incurred by the organisation. The policy of apportionment must be reasonable and logical, it must be formally decided within the organisation. Further, it must be ensured that it has been budgeted in the project. In

various instances, it has been found that the same programme or activity has been shown as expenditure to more than one project. In such circumstances it is important to ensure that if two projects of similar activities are implemented, then there should be adequate disclosure and internal control with regard to double booking of expenditures.

11. CREATING PROVISION FOR EXPENDITURE & SUBSEQUENTLY TRANSFERRING IT TO GENERAL FUND

- 11.1. There might be instances where the organisation creates provision for expenditure and charges it to the project. In other words, the reporting to the donor reflects a notional expenditure which is just the provision and has not been actually incurred. In the subsequent year, the same provision may be transferred as surplus to the general fund by reversing the entry. Wherever non cash expenditure is incurred or expenditure is charged based on accrual basis of accounting (i.e. where the cash is still with the organisation but utilisation is shown to the donor), it needs to be ensured that the amount so provided is actually paid out in the subsequent year.

12. CHARGING NOTIONAL CONVEYANCE AND ALLOWANCES AGAINST STAFF

12.1. There might be instances where the organisation charges notional amount as conveyance allowance and other reimbursements to staff. In other words, there is no actual expenditure but a considerable amount is charged to the project against various staff as daily conveyance, refreshment allowance and other permissible unsubstantiated expenditures. It needs to be ensured that there are no notional expenditures and matching notional income in this regard.

13. CONCLUSION

13.1. In a grant based contact, care has to be taken to ensure that only actual expenditures are charged to

the project.

13.2. In case of any assets or infrastructure being used for project purposes, it has to be first discussed with the donors and based on the agreement reached, other costs of maintenance can be covered out of project funds or rate for usage can be charged.

13.3. It has to be ensured that common expenses are apportioned in a reasonable and logical manner. Under no circumstances, the expenses can be charged twice to different projects.

13.4. Since the relationship between the donor and the NPO is based on mutual trust, care should be taken to ensure that there is enough transparency so that issues like notional expenditure are clearly discussed, understood and agreed upon.

(Based on the basic draft prepared by: Mr. Manoj Fogla, FCA)

Joint Framework on

OUTCOME AND IMPACT ORIENTATION IN

Brot Fur die Welt (BfdW) and Evangelischer Entwicklungsdienst (EED) January 2011

This paper introduces the outcome and impact orientation framework of BfdW's and EED's international work. It is summary of the internal paper of EED and BfdW approved in November 2010. The following pages are intended to provide information primarily for members for staff of partner organizations but may also, where relevant, be shared with communities and individuals with whom we and our partner organizations work.

1. Why deepening outcome and impact orientation?

In accordance with the long-term objectives of Churches' engagement in development cooperation (poverty reduction, peace, sustainable development, gender equality and integrity of creation) we strive for sustainable changes in the lives of communities and individuals affected by poverty and unjust power structures. We have committed ourselves to share our resources in the best possible way and therefore, it is only fair that we 'reflect... on our own effectiveness, share our learning with others and provide clear evidence of

our contribution to changes in the lives of those with whom we work". By exchanging information and stories on success and failure we can learn from experience, draw conclusions and further develop the cooperation with our partners.

2. Which contextual factors made us go ahead with this?

The effectiveness of its development cooperation projects has always been at the centre of attention within EED and BfdW. However, in the past five years demands for evidence of effectiveness increased both on the German level and on the

International level. At the international level the 'Paris Declaration on Aid Effectiveness' (March 2005) initiated by OECD-Development Assistance Committee (DAC) called for more concerted efforts to increase the effects of aid for the poor and vulnerable. Among other things Managing for Results was propagated as one of the key concepts in order to achieve more effectiveness. This initiative was followed by OECD-DAC meetings in Accra and London on the monitoring of the implementation of this agenda. EED, together with its partners (e.g. All Africa Conference of Churches), was actively engaging in the Open Forum for Civil Society Organisations Development Effectiveness.

In 2007 the ACT Alliance launched an impact assessment initiative. Brot fuer die Welt together with the Indian ACT Member CASA, took the lead on this initiative. The aim is to create a mutual understanding on the meaning of, and increased orientation towards outcome and impact as well as an increased knowledge on tools and instruments for the assessment of change. In 2009, "A Guide to assessing our contribution to change" was published.

At the German level it was mainly the German government (Ministry for Economic Cooperation and Development, BMZ) that urged EED to go ahead with improved outcome and impact monitoring. In addition, the German Public justifiably

asks not only the Government but also the NGOs to demonstrate their effectiveness. The independent fundraising certification body, "the German Central Institute for Social Issues", DZI demands NGOs to institute systems enabling them to demonstrate their contribution to change.

3. What are our objectives?

The outcome and impact orientation has the following objectives:

Learning: Initiating joint institutional processes of learning within BfdW and EED, its partner organizations and other stakeholders including beneficiaries for the sake of improving the work.

Evidencing: Reporting to stakeholders, in particular evidence effects of the work vis-à-vis private and institutional donors as well as other stakeholders such as partner organizations and beneficiaries.

Dialogue: The outcome and impact orientation provides BfdW and EED, its partner organizations and beneficiaries with useful information and in-depth knowledge for the policy discussions on development cooperation.

4. Which purposes does it serve?

Through the implementation of the outcome and impact orientation framework we expect the following:

1. Increased quality and better strategic

management. The learning culture in the organizations will be further developed.

2. Increased quality in the communication with private and institutional donors, Churches, media and other stakeholders.
3. The communications with partner organizations and their target groups will focus more on outcome and impact.
4. Success and failure will be better understood. Procedure for learning and decision making will be further developed.
5. Stronger recognition of our work and strengthening of brands leading to an increased availability of funds

5. How do we understand effects (outcome and impact)?

Despite efforts to harmonize terms in relation to outcome and impact on international consensus has not been fully reached. Many of our partner organizations cooperate with different donor agencies which lend a different meaning to the terms used by EED and BfdW. In addition different geographical regions and linguistic backgrounds give different meaning to terms or use different terms. In the definition of our understanding of outcome and impact, we mainly follow the language of OECD/ Development Assistance Committee. Although the understanding of EED and BfdW on the one hand and our respective partner organizations on the other hand may differ,

we hereby outline our understanding of effects.

Effects (Outcome and Impact) are changes due directly or indirectly to a project or intervention. The maintaining of status quo or the hindrance of deterioration may also be an effect.

BfdW and EED understand the work; Effect” as a meta-term for provoked changes comprising the two levels Outcome and Impact in the results/effect chain (see annex). For EED and BfdW the **Outcome** of projects forms the focus of observation. Outcome can be positive or negative, intended or non-intended, short or mid-term. The **Output**, the products or services resulting from activities, is not considered as effects in the view of EED and BfdW. However, when these products and services are being put to use (use of outputs) they are considered as effects. Impact (intended or non-intended, positive or negative) which is long-term and relates to overall goals also forms part of the effects orientation of BfdW and EED.

Long-term effect is not identical with sustainable effect. Sustainability relates to the persistence of effects-mainly after the end of an intervention or a project. In most cases sustainability can only be assessed through studies of evaluations ex post.

6. Who does it?

EED and BfdW have opted for a broad outcome and impact orientation in all areas of their work. This includes, in addition to international programmatic work development education and information, public relations, lobbying and advocacy, fundraising e.a. Both agencies are interested in information on achievements in the projects in order to feed them into lobby campaigns, fund raising and knowledge management. At the same time we also want to find out about the effects of those areas of work: Did the campaign reach its target group? Did the school project lead to increased grass root work in Germany? Etc. All stakeholders involved have different roles to play in our common efforts to increase outcome and impact orientation.

7. How is it done in the area of international programmes?

Information on outcome and impact is communicated with the help of our PME systems (standardized application and reporting formats). Apart from this the exchange of information on outcome and impact is a matter of dialogue between the responsible staff of EED and BfdW and the partner organization. The same applies to secondments of personnel. The communication is done via regular correspondence and in the framework of visits from both sides. In addition, evaluation generates information on outcome and impact. In the future we

request our partner organizations to emphasize outcome and impact in their regular evaluations. Furthermore, we are conducting so called cross-cutting evaluations dealing with defined topics and depending on the theme involving various groups of partner organizations.

In the field of scholarships tracer studies are common instrument for assessing the whereabouts of the scholarship holders in addition to regular alumni meetings.

8. How can partners get external support for better outcome and impact orientation?

Partner organizations play a key role in communicating the requirements of outcome and impact orientation to target groups of projects. Depending on the context and on the capacities of their organization they have to decide which methods are the most suitable ones. Therefore, in our framework on outcome and impact orientation we do not prescribe any methods to be applied in the field. The ACT publication: "A guide to Assessing our Contribution to Change" provides a selection of tools and instruments together with guidance on how to find a suitable tool or a mix of tools in a specific situation. The ACT Guide also provides a self appraisal tool for organizations or assess their institution capacities on outcome and impact orientation. This assessment guides decision making on capacities which need to be enhanced. This is one of many ways we offer our partners organizations support

for outcome and impact orientation. In addition:

EED: The Consultancy Desk of EED offers tailor made trainings on outcome and impact orientation in PME and the respective methods. These trainings which are the time of writing carried out as pilots are organized in cooperation with German and/or local consultants. The local Support Services (LSS) play an important role in this. EED also supports partner organizations in finding a proper consultant and /or trainings. In some cases EED respond to partners' need in this are by secondments of personnel.

BfdW: In addition to regular exchange between desk officers of BfdW, the BfdW officers and Transfer of Function (ToF) consultants assist partners in applying the understanding of BfdW on outcome and impact into change monitoring and evaluative systems. Specific support will be provided to partners seeking to enhance capacities on outcome and impact assessment.

9. How is information on outcome and impact being documented?

Through the reports from our partners we acquire a massive amount of data. Based on the reports our staffs have to assess to what extent objectives have been met and/or unintended effects, positive or negative, have occurred. In addition, information on outcome and impact is documented in travel reports, minutes of meetings, and in the

monitoring of the annual planning that EED and BfdW are doing on regular basis. Reports of the ToF (BfdW) and evaluation reports also serve as means of documentation.

10. What do we do with information on outcome and impact?

1. At the level of partner originations

Partner organization aggregate and disaggregate as well as analyze information at their level. Information on outcome and impact is used by partner organizations in their management and decision-making. In addition, partner organizations use the information in the dialogue with staff in BfdW and EED as well as their target groups and other stakeholders.

2. At the level of individual staff in BfdW and EED

Staff at BfdW and EED above all uses the information in relation to:

- Planning of further projects and activities (what are the lessons learnt and what does this mean for the future)
- Annual planning of their own area of responsibility.
- Their work in processes and projects at the level of their organizational units (for example in relation to the (further) development of strategies.

3. At the level of an orgainsational unit

This level refers to the different departments and sub-departments of BfdW and EED. Here the information on effects is above al used in connection with:

- The (further) development of programmes and campaigns.
- The (further) development of strategies.
- External communication.
- Reporting to private and institutional supporters and partners.

4. At the organizational level

The information gathered by different departments forms the basis for cross-cutting/thematic evaluations. Concentration on one topic per year (topic might be “access to health”, “food security” etc) will enable EED and BfdW to evaluate and analyses the information on outcome and impact that comes from the partners and other sources. Insights from those thematic evaluations will flow into the communication work, knowledge management, and into the further development of the agencies’ strategies.

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1. *Gemeinsames Konzept zur Verankerung und Ausrichtung der Wirkungsorientierung in der Okumenischen Diakonie (OED) und dem Evangelischen Entwicklungsdienst (EED), November 2010.*
 2. *ACT Development : A guide to assessing our contribution to change, p.7*
<http://www.actalliance.org/resources/policies-and-guidelines/impact-assessment>
 3. *ACT Alliance 2009*
 4. *See letter from Claudia Warning to EED partners in July 2010*
 5. *See Bread for the World’s Impact studies on : Communication Work; Rural Development” and Gender Justice” on the occasion of its jubilee in 2009.*
 6. *A guide to Assessing our contribution to change, ACT Alliance 2009*
 7. *on all levels our partners are requested to consider, what change means in the reality of men and women and in how far inputs, activities and outputs are of benefits to men or to women respectivately.*
 8. *See 7*

Annex: Table on 'Results/effect Chain'

	Results/Effect Chain	Planning table in line with the Logical Framework Analysis (LFA)
Effects	Impact Positive and negative, primary and secondary longterm effects produced directly or indirectly by an intervention, intended or unintended	Goal The higher-order objective to which a development project is intended to contribute.
	Outcome The likely or achieved short-term and medium-term effects of an intervention's outputs. These may be positive or negative, intended or non-intended.	Project objective The description of a situation strived for, which shall be reached through a concrete project.
	<i>Use of Outputs</i>	
	Output The products, capital goods and services which result from a project or activity	Output The immediate products and services produced by a project
	Activities Actions taken or work performed through which inputs such as financial means, services from technical cooperation and other forms of resources are mobilized to reach specific outputs	Activities The step taken by a project holder to reach planned outputs and objectives.
	Inputs Financial, human and material resources used for an activity	Input Resources needed in order to implement planned activities.

OUTSTANDING ANNUAL REPORT AWARDS FOR NGOS 2011

The CSO Partners' outstanding annual report award is an endeavor in creating benchmarks in the realm of NGO reporting and is the first and only annual report awards in the voluntary sector. It is an effort to build a movement for transparency to bring in accountability. This was the third time the award ceremony was organized. The award was instituted by the **CSO partners** jointly with the **Financial Management Service Foundation** & the **Credibility Alliance** & supported by **ICICI Foundation**. Not-for-profit organizations across India were invited to participate in the process. **The reports received were categorized into three different categories, 'Small' (Organizations with an annual income of less than Rs.50 lakhs), 'Medium' (Organizations with an annual income range of between Rs.50 Lakh to Rs. 5 Crore) & 'Large' (Organizations with an annual income of more than Rs. 5 Crore).**

The annual reports were judged by an independent panel of evaluators who analyzed and scrutinized the reports thoroughly. The annual reports and audited financial statements of the organization were evaluated on three main aspects of 'financial reporting', 'transparency' 'reader friendliness & effective communication'. The short listed annual reports were then presented to a Panel of Jury who then judged the reports and selected the winners.

The entire process culminated in an "award ceremony" that was organized on the 9th of April, 2011 at the India Habitat Centre in New Delhi where all the participants were invited and winners were felicitated. Shri. Jagadananda, State Information Commissioner, Government of Orissa & Shri. Subrata Mukherji, President, ICICI Foundation for Inclusive Growth, graced the occasion.

The overall response for the awards was extremely encouraging. The large number of reports received for the awards is **recognition of the effort by the organizers to create a platform to identify & showcase the good practices existing in the voluntary sector.**



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Annual Report
Awards 2011
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Winner

Dream a Dream

Runners Up

IBTADA

Akshara Foundation

LARGE ORGANISATIONS

Winner

Swami Vivekananda Youth Movement (SVYM)

Runers Up

The Akshaya Patra Foundation (TAPF)

The Evangelical Fellowship of India Commission on Relief (EFICOR)

Visit the website: www.annualreportawards.org for more details



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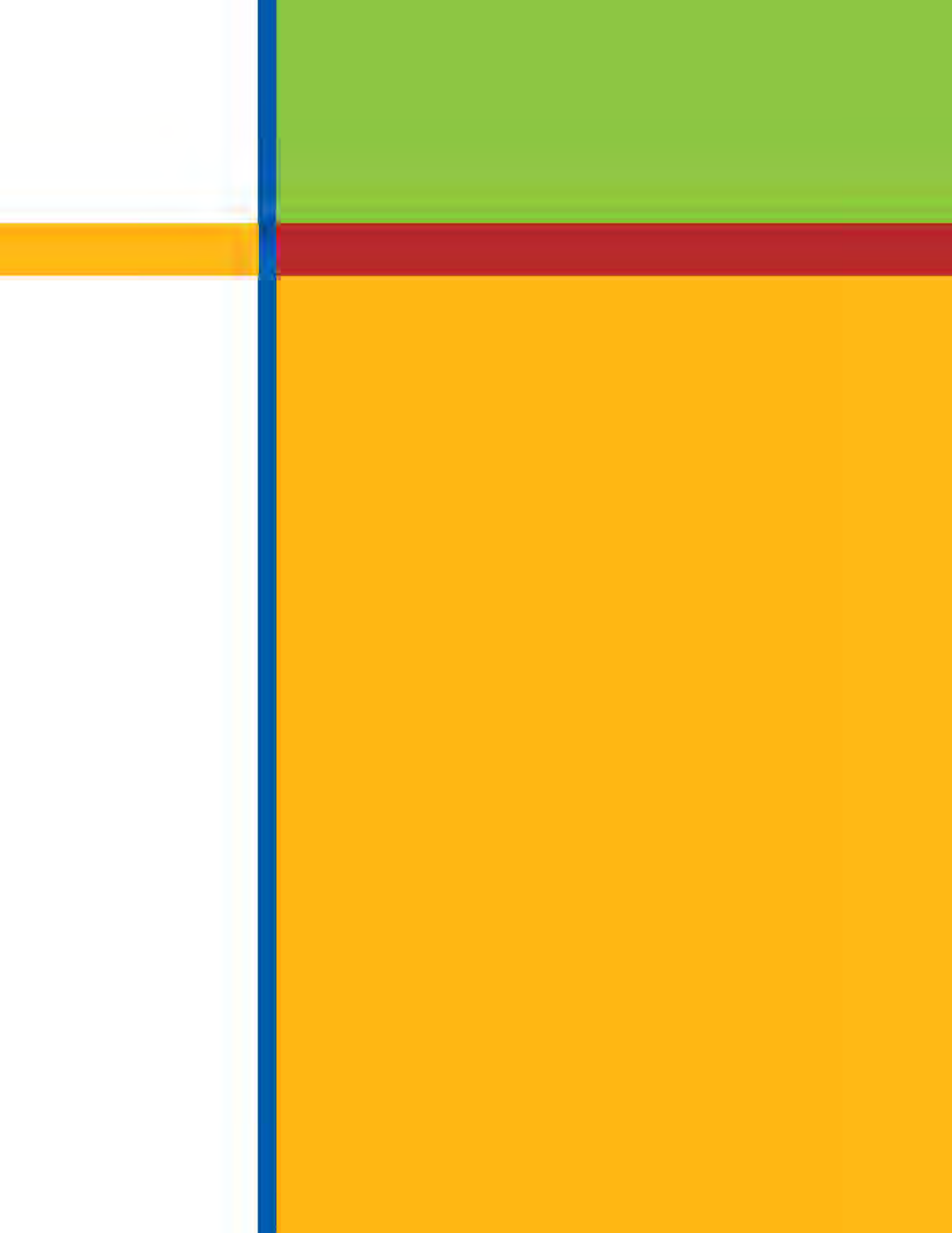
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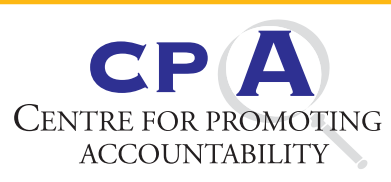
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