

INTERface

for private circulation only

Vol. IX

Issue I

October 09 - March 10



the 1990s, the number of people in the world who are under 15 years of age is expected to increase from 1.1 billion to 1.5 billion.

As the world's population grows, the demand for food and other resources will increase. This will put pressure on the environment and on the world's food supply.

One way to meet this demand is to increase the amount of food that is produced. This can be done by using more land for agriculture, or by increasing the productivity of the land that is already being used.

Another way to meet this demand is to reduce the amount of food that is wasted. This can be done by improving the way that food is stored and distributed, or by changing the way that people eat.

There are many ways to meet the world's growing demand for food and other resources. It is up to us to decide which way is the best.

One of the most important things we can do is to make sure that we are using our resources wisely. This means that we need to be careful about how we use land, water, and other resources.

We also need to make sure that we are producing food in a way that is sustainable. This means that we need to make sure that we are not using more resources than we can replace.

Finally, we need to make sure that we are distributing food in a way that is fair. This means that we need to make sure that everyone has access to the food that they need.

By doing these things, we can help to meet the world's growing demand for food and other resources. This will help to make the world a better place for everyone.

There are many ways to meet the world's growing demand for food and other resources. It is up to us to decide which way is the best.

between
us....

THE LIFE OF AN EAGLE

Bible speaks about the life of an Eagle. In the book of Isaiah 40:31 "but those who hope in the LORD will renew their strength. They will soar on wings like eagles; they will run and not grow weary, they will walk not be faint."

What is so important and about the eagle? How the eagle renews its strength? The eagle has the longest life span among its type of species. It can live up to 70 years. But to reach that age, the eagle must make a hard decision in its 40's. During the mid-life of the eagle, its long and flexible feet nails can no longer grab the prey which serves as food. Its old, aged and heavy wings, due to their thick feathers become stuck to its chest and make it difficult to fly. Then the eagle is left with only two options; die or go through a painful process of change which lasts about 150 days. The process requires that the eagle fly to a mountain top and sit on its nest. There the eagle knocks its beak against a rock until it plucks it out. After plucking it out, the eagle would wait for a new beak to grow back and then it plucks out its nails from the feet. Afterwards its new nails grow back. After that the eagle starts plucking its old, aged feathers and grows new feathers.

After five months, the eagle takes its famous flight of rebirth and lives for 30 more years. Why is the change needed?

Many times in order to move on, we need a change process. Sometimes, old habits, practices and certain way of life come as a hindrance to the change process. Innovations become traditions in due course of time and bind us. It is necessary to question the basic givenness in order to be free from them. That would be the path to renewal and greater effectiveness.



in this
Issue....

CONTENTS

Salient Features of Union Budget 2010	5
Conflict of Interest	12
Tax Deduction at Source	16
Corpus & Endowment Fund	24
ICAI Expert Advisory Committee Opinion - Income & Expenditure Account or Profit & loss Account for Section-25 Companies	28
Governance Insights	31
Since You Asked	37
Outstanding Annual Reports Awards for NGOs 2010	38
Report on Bangladesh Workshop	40

3

October 09 - March 10

Volume IX Issue I

INTERface

Editorial Team : Sanjay Patra, S. P. Selvi & Madhuchhanda Mishra.

Published by Sanjay Patra on behalf of
Centre for Promoting Accountability
"ACCOUNTABILITY HOUSE", A-5, Sector 26, NOIDA - 201 301

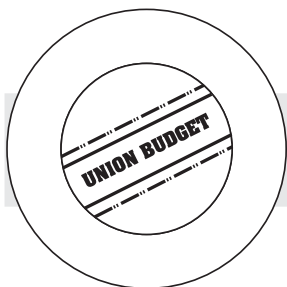
Tel: 00-91-120-2546732, 2546733, 2546744, 2546745

(For calling from Delhi - 95120 - 2546732/33/44/45)

Fax: 00-91-120-2546731

E-mail: cpa@cpaindia.in, Web-site: www.cpaindia.in

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



SALIENT FEATURES OF UNION BUDGET 2010

- FMSF Resource Team



INTRODUCTION

The Budget 2010 has been presented in the parliament by Honorable Finance Minister Sh. Pranab Mukherjee on Feb 26, 2010.

Budget 2010 has brought in some amendments which shall allow the organizations working under the last limb of the definition of "Charitable Purpose" to carry on business activities upto a certain limit. Further amendments have been made under section 10 (21) and section 35 to allow exemptions to Social and Statistical Research Associations along with Scientific Research Associations.

The Finance Minister has proposed concessions to the individual tax payers in the salaried category. He has also reiterated that the Direct Tax Code, having undergone the public debate and response, is getting ready to be implemented with effect from 1st April 2011.

BUDGET OUTLAY (SOCIAL SECTOR)

- Total allocation to the social sector comes to Rs. 137,674 crore which is 37% of planned outlay.
- Allocation to school education has increased from Rs.26,800 Crore to Rs.31,036 Crore.

- Allocation to Health sector is Rs.22,300 Crore.
- Allocation to NREGA has increased from Rs.39,100 Crore to Rs.41,000 Crore
- Allocation to Bharat Nirman; Rs.48,000 Crore.
- Allocation package of Rs.12,000 Crore towards assistance for drought in Bundelkhand
- Allocation to Indra Awas Yojna has increased from Rs.8,800 Crore to Rs.10,000 Crore
- Allocation for Rural Development has increased from Rs.51,769 to Rs.61,000 Crore
- Allocation has also been done to some new social scheme funds like that for workers in unorganized sectors and women farmers

REVENUE

There are some partial rollbacks of stimulus like;

- Increase of excise across the board from 8% to 10%,
- Increase in custom duty on crude oil to 5%, on diesel and petrol to 7.5% and other petroleum products to 10%

This may have ensuing negative effects on the revival of the economy. It may increase the inflation and reduce the liquidity which may again reduce the spending.

AMENDMENT IN FINANCE BILL

a. Section 2(15)

Prior to Finance Bill 2010

The Finance Bill 2009 had proposed amendment to the definition of 'charitable purpose' under section 2(15) after which it stood as under :

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

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

The words in italics above have been inserted by the Finance Bill 2009.

Amendments as per Finance Bill 2010

The Finance Bill 2010 has further made amendment to the definition of 'charitable purpose' under section 2(15) of the Income Tax Act and a new proviso has been added which provides that the last category of Trusts and NGOs will be allowed to have incidental business activity provided the total receipt from such activity does not exceed rupees ten lakh per annum.

In the proposed Finance Bill 2010 the following para is added to the above definition

Provided further that the first proviso shall not apply if the aggregate value of the receipt from the activities referred to therein is ten lakh rupees or less in the previous year.

This relief provided by Finance Act. 2010 is with effect from 01.04.2011 onwards.

Inference:

The above proposed amendment would imply that Non-Profit Organizations (NPOs) would be able to have activities in nature of trade, commerce, business or any activity of rendering any service in relation to any trade commerce or business for a value of Rs.10 Lakhs per year. This is at least some relief to the NPO sector and would help in financial sustainability of smaller entities. However, medium and large sized organizations would continue to have the limitation under this section.

In our opinion it would have been useful to have the threshold limit at Rs.25 Lakhs instead of Rs.10 Lakhs.

b. Section 12AA; (Applicable w.e.f 01.06.2010)

In section 12AA of the Income-tax Act, in sub-section (3), after the word, brackets and figure "subsection (1)", the words, figures letter and brackets "or has obtained registration at any time under section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996]" shall be inserted with effect from the 1st day of June, 2010.

Inference:

Section 12AA was inserted by Finance (No. 2) Act 1996. Before section 12AA came into existence the NPOs were being granted registration u/s 12A. When sub-section 3 to the section 12AA was inserted, it had limited power to cancel registration of entities prior to 1996.

With the insertion of this phrase that anomaly has been removed.

a university, college or other institution to be used for scientific research;

(iii) [an amount equal to one and one-fourth times of any sum paid] to a university, college or other institution to be used for research in social science or statistical research;

Provided that such university, college or other institution for the purposes of this clause,

c. Section 10(21)**Prior to Finance Bill 2010**

Under the above section the income of scientific research associations approved under section 35 (1) (ii) shall be exempt subject to certain conditions .

Amendments as per Finance Bill 2010 (Applicable w.e.f. 01.04.2011)

The words scientific research associations have been replaced by research association. Thus the income of Social and Statistical Research Association approved u/s 35(i) (iii) will also be exempted subject to certain conditions

(A) is for the time being approved, in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed; and

(B) such university, college or other institution is specified as such, by notification in the Official Gazette, by the Central Government.

(iv) in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the provisions of sub-section (2) :

[Provided that the scientific research association, university, college or other institution referred to in clause (ii) or clause (iii) shall make an application in the prescribed form and manner to the [Central Government] for the purpose of grant of approval, or continuance thereof, under clause (ii) or, as the case may be, clause (iii):

d. Section 35**Prior to Finance Bill 2010**

The sections 35 (1) (ii),(iii), (iv) read as follows:

(ii) [an amount equal to one and one-fourth times of any sum paid] to a scientific research association which has as its object the undertaking of scientific research or to

Provided further that the [Central Government] may, before granting approval under clause (ii) or clause (iii), call for such documents (including audited annual

accounts) or information from the scientific research association, university, college or other institution as it thinks necessary in order to satisfy itself about the genuineness of the activities of the scientific research association, university, college or other institution and that [Government] may also make such inquiries as it may deem necessary in this behalf

**Amendments as per Finance Bill 2010
(Applicable w.e.f. 01.04.2011)**

As per the amendments made the sections 35 (1) (ii), (iii) and (iv) will read as follows:

ii) [an amount equal to one and three-fourth times of any sum paid] to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research or to a university.

(iii) [an amount equal to one and one-fourth times of any sum paid] any sum paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research to a university.

[Provided that such association, university, college or other institution for the purposes of this clause (A) is for the time being approved, in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed; and

(B) such association, university, college or other institution is specified as such, by

notification in the Official Gazette, by the Central Government.]

(iv) in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the provisions of sub-section (2):

[Provided that the research association, university, college or other institution referred to in clause (ii) or clause (iii) shall make an application in the prescribed form and manner to the [Central Government] for the purpose of grant of approval, or continuance thereof, under clause (ii) or, as the case may be, clause (iii):

Provided further that the [Central Government] may, before granting approval under clause (ii) or clause (iii), call for such documents (including audited annual accounts) or information from the research association, university, college or other institution as it thinks necessary in order to satisfy itself about the genuineness of the activities of the research association, university, college or other institution and that [Government] may also make such inquiries as it may deem necessary in this behalf

Inference:

The effect of all the above amendments under section 35(1) (ii), (iii) and (iv) is that earlier the deduction was allowed only for approved scientific association however now the same shall be available to social science and statistical research associations also.

FOR SALARIED MEN

New tax slabs:

Slabs (Rs)	Rate
0 – 160000	0
160001 – 500000	10
500001 – 800000	20
800001 and above	30

Old tax slabs:

Slabs (Rs)	Rate
0 – 160000	0
160001 – 300000	10
300001 – 500000	20
500001 and above	30

Impact:

Taxable income (Rs)	Tax -before budget (Rs)	Tax after budget (Rs)	Saving (Rs)
200000	4120	4120	0
500000	55620	35019	20601
1000000	210120	158619	51501
1200000	271919	220419	51500
1500000	364619	313119	51500
2000000	519119	467619	51500
2500000	673619	622119	51500
4000000	1137119	1085619	51500

FOR SALARIED WOMEN

New tax slabs:

Slabs (Rs)	Rate
0 – 190000	0
190001 – 500000	10
500001 – 800000	20
800001 and above	30

Old tax slabs:

Slabs (Rs)	Rate
0 – 190000	0
190001 – 300000	10
300001 – 500000	20
500001 and above	30

Impact

Taxable income (Rs)	Tax -before budget (Rs)	Tax after budget (Rs)	Saving (Rs)
200000	1029	1029	0
500000	52529	31929	20600
1000000	207029	155529	51500
1200000	268829	217329	51500
1500000	361529	310029	51500
2000000	516029	464529	51500
2500000	670529	619029	51500
4000000	1134029	1082529	51500

FOR SENIOR CITIZENS**New tax slabs:**

Slabs (Rs)	Rate
0 – 240000	0
240001 – 500000	10
500001 – 800000	20
800001 and above	30

Old tax slabs:

Slabs (Rs)	Rate
0 – 240000	0
240001 – 300000	10
300001 – 500000	20
500001 and above	30

Impact

Taxable Income (Rs)	Tax before budget (Rs)	Tax after budget (Rs)	Saving (Rs)
200000	0	0	0
500000	47379	26780	20599
1000000	201879	150379	51500
1200000	263679	212179	51500
1500000	356379	304879	51500
2000000	510879	459379	51500
2500000	665379	613879	51500
4000000	1128879	1077379	51500

Further the amount of Weighted Deduction increased from 125% to 175% of the expenditure and the contribution to social science and statistical research associations.

Weighted Deduction increased from 150% to 200% of the expenditure on in-house research and development.

The above amendment would promote the research and development and would make the scope of the same broader.

Tax for Individuals:

The budget has also introduced a concession for salaried individual by broadening the three tax slabs which is as under

In addition to this, the Rs 1,00,000 tax exemption limit under section 80C, has been increased by Rs 20,000, allowing investments in long-term Infrastructure bonds to be considered for tax exemption.

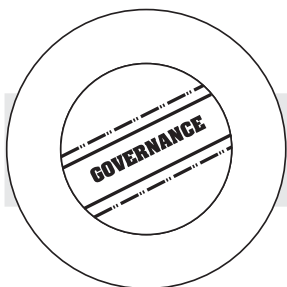
CONCLUSION:

The Budget 2010 has however given some welcome news to the social sector through the amendment in Section 2(15), even though it would have been better to have increased threshold limit. This relaxation should reach to more NPOs to promote their sustenance.

The change in the tax slabs for the salaried individuals too is a good step which will

certainly give reason to them respite from the present inflationary situation especially of the food items.

There is however also reason to worry as the increase in the excise duty and more so on petrol and diesel will fall heavy on the pocket of general public. There are chances of increase in inflation which may take away liquidity to some extent. The exact picture will however roll out only after few months into 2010-11.



CONFLICT OF INTEREST

- Sanjay Patra, FMSF

12

October 09 - March 10

Volume IX Issue I

INTERface



Introduction:

A non-profit charitable organization dealing with public funds is expected to demonstrate highest forms of accountability and commitment to operate with integrity. This also implies an inherent obligation to conduct all of its affairs transparently and above reproach. This would also help the organization to gain public trust and confidence as well as that of various controlling authorities.

The Board, office bearers and management have the responsibility of administering the affairs of the organization honestly and prudently and of exercising their best care, skill and judgement. They need to exercise utmost sincerity in the transactions and should not use their position or knowledge gained therefrom for their personal benefit. The interest of the organization must have the top priority and all the purchases of goods and services must be reflected on a basis that secures the organization full competitive advantages as to product, service and price.

2. What is Conflict of Interest?

Conflict of Interest is a situation in which a person has the responsibility for promoting an interest, but has another competing interest at the same time. When the

competing interest is exercised over a fiduciary interest, then it leads to Conflict of Interest. This means a person making a decision should not have any other interest in mind. It is also important to work for the best interest of the organization and not to have any other conflicting interest. Another issue that needs to be kept in mind is that there should not be an appearance of conflict of interest as well. Therefore, the circumstances should not appear as if there is a possibility of conflict of interest.

3. Persons Concerned:

The persons concerned in terms of conflict of interest are Directors, Officers and all the employees who have the potential to influence the action of the organization. Therefore, all people who make decisions and have proprietary information concerning the organization are included in Conflict of Interest.

4. Areas in which conflicts may arise:

Conflicts of interest may arise in the relations of directors, officers, and management employees with any of the following third parties:

- a) Persons or entities supplying goods and services to the organization.
- b) Persons or entities from whom the

- organization leases property and equipment.
- c) Persons or entities with whom the organization is dealing or planning to deal in connection with the gift, purchase or sale of real estate, securities, or other property.
 - d) Persons or entities paying honorariums or royalties for products or services delivered by the organization or its agents or employees.
 - e) Other non-profit organizations.
 - f) Donors and others supporting the organization.
 - g) Agencies, Organization and associations which affect the operations of the organization.
- involving the organization.
- d) Using personnel, equipment, supplies or goodwill for other than organization approved activities, programs and purposes.
 - e) Receiving personal gifts or loans from third parties dealing with the organization. (Receipt of any gifts of nominal value which could not be refused without discourtesy may be allowed in specific cases. No personal gift of money should ever be accepted.)
 - f) Obtaining an interest in real estate, securities or other property which the organization might consider buying or leasing.
 - g) Using staff time during normal business hours for personal affairs or for other organizations, to the detriment of work performance for the organization.

5. Nature of Conflicting Interest:

A material conflicting interest may be defined as an interest, direct or indirect, between any person or entity mentioned in Section 4 and a the person making the decision(director, officer or management employee), which might affect, or might reasonably be thought by others to affect, the judgment or conduct of the person (director, officer or management employee) of the organization. Such an interest might arise through:

- a) Ownership & other proprietary interests in any third party dealing with the organization.
- b) Holding office, serving on the Board, participating in management or being otherwise employed (or formerly employed) in any third party dealing with the organization.
- c) Receiving remuneration for services with respect to individual transaction

6. Indirect Interests:

As noted above, conflicting interests may be indirect. A director, officer or management employee will be considered to have an indirect interest in another entity or transaction if any of the following have an interest:

- a) A family member of a director, officer or management employee. (Family member is defined for these purposes as all persons related by blood or marriage.)
- b) An estate or trust of which the director, officer or management employee or member of his family is a beneficiary, personal representative, or trustee.
- c) A company of which a member of the family of the director, officer or management employee is an officer,

director or employee, or in which he has ownership or other proprietary interest.

7. Interpretation of the Policy:

The areas of conflicting interest listed in Section 4, and the nature of interest which may give rise to conflict, as listed in Section 5, are not exhaustive. Conceivably, conflicts might arise in other areas or through other relations. It is expected that the directors, officers and management employees will recognize such areas.

8. Managing Conflict of Interest:

Before undertaking a related-party transaction, an organization must meet all of the following criteria:

- a) It is ideal for the organizations to avoid related-party transactions that are conflicts of interest.
- b) Related-party transactions must be disclosed to decision makers and resource providers. The primary vehicle for disclosing related-party transactions to external constituents and resource providers is through the audited financial statements. In fact, disclosure of related-party transactions is also required by Generally Accepted Accounting Principles (GAAP). One of the benefits of requiring disclosure through the audited financial statements (at least to external readers of the financial statements) is that they have to be reviewed and verified by an independent auditor for completeness and veracity.

Obviously, related-party transactions should be disclosed to executive staff and the governing board. An essential part of this internal disclosure process is a written and distributed conflict of interest policy within the organization. Sometime this conflict of interest policy is part of the byelaws of the organization.

- c) To help ensure that the decision to approve a related-party transaction is made in an objective and fair manner, the party that has a related interest should not participate in the discussion or approval of the transaction. The other members of the board or staff involved in making a decision should have the freedom to discuss and act on the transaction without any degree of pressure generated by the related party's involvement in the entire process. For instance, board decision involving a related party who is also a board member or executive staff member of the organization should be adequately and appropriately discussed without the attendance or participation of the related party.
- d) A related party transaction can only be undertaken if there is evidence that the resource commitment (e.g., cost to the organization) is the best that can be obtained for the goods or services being procured. While competitive bids are the most common form of determining cost and benefit relationships, they may not always be practiced or appropriate.

The basic issue is to ensure that an organization performs the necessary evaluation, documenting its decision to

support the reasonableness of the related-party transaction. Since independent auditors will review the transaction in order to make proper disclosures in the financial reports, a formal internal procedure and record is needed to show that a thorough cost and benefit analysis was conducted. Normally this would include the governing board's review of the information before making a decision

- e) Although more subjective in nature, this final criteria is just as important as the previous four. After the governing board has disclosed all relations, discussed the transaction openly and without bias, and conducted cost/benefit evaluations, it needs to look at the transaction as a whole and determine the overall wisdom of entering into it. The board should ask such questions as: Will the transaction, when disclosed, raise more questions with external (and internal) constituents or regulatory groups than we can adequately answer? Will we set a precedent, making it difficult to respond negatively to future situations? Does this decision ultimately have the best long-term interest of the organization at heart, or will it give short-term gains only? Since the governing board will be held responsible for outcome of the transaction, it must exercise

utmost prudence in its evaluation and decision.

In determining independence, the general approach is to recognize both the appearance and reality of independence. Even if independence is the reality, this may mean little if appearance says otherwise. An organization should always give substantial weight to the appearance of things before deciding to enter into a related-party transaction. Therefore the transaction should be independent and it also should appear independent.

8. Conclusion:

While guidelines and practices can help an organization to avoid conflict of interest or determine whether to undertake a related-party transaction, this is obviously a complex issue. Many times it is a subjective determination involving personal intent, individual integrity, and conscience. To the extent that the board and leadership of an organization continually exhibit and practice sensitivity to these issues in all areas of decision making, the organization itself can develop a general atmosphere of high accountability. The best way for an organization to cultivate a sense of integrity and accountability is for the governing board and officers to give continuous attention to openness about their intentions and decision.



TAX DEDUCTION AT SOURCE

Prabhat Kumar, FMSF

16

October 09 - March 10

Volume IX Issue I

INTERface



We all may have experienced deduction of tax made on some income received and also might have deducted tax on some payments made by us. This deduction is commonly referred to us as Tax Deduction at Source (TDS).

Tax Deduction at Source (TDS) is an integral component of the Indian Tax System and is governed by the Income Tax Act, 1961. We are aware that one of the major sources of revenue for the Government is through Tax Collection from the public. This collection is sometimes received from the person directly and sometimes is deducted from the amount received or paid by a person.

Such collection of tax is effected at the source when income arises or accrues. Hence where any specified type of income arises or accrues to any one, the Income-tax Act enjoins on the payer of such income to deduct a stipulated percentage of such income by way of Income-tax and pay only the balance amount to the recipient of such income.

The tax so deducted at source by the payer, has to be deposited in the Government treasury to the credit of Central Government within the specified time. The tax so deducted from the income of the recipient is deemed to be payment of Income-tax by

the recipient at the time of his assessment. TDS can be deducted at the time of payment in cash, cheque or other mode or crediting the payee's account or creating provision or suspense account in that respect by the payer in his books of accounts, to be deposited with government towards the Tax Liability of the payee in accordance with procedure provided and within the time prescribed. The payment may be any of the following nature:

- Salary (Section 192)
- Interest on Securities (Section 193)
- Dividends (Section 194)
- Interest other than interests on securities (Section 194A)
- Winning from lotteries and crossword puzzles (Section 194B)
- Winning from horse races (Section 194BB)
- Payments to contractors and sub-contractors (Section 194C)
- Insurance commission (Section 194D)
- Payments to non-resident sportsmen and sportsmen associations (Section 194E)
- Payment in respect of deposit under National Saving Scheme, etc (Section 194EE)
- Payment on account of repurchase of units of Mutual Fund or Unit Trust of India (Section 194F)
- Commission etc. on the sale of lottery tickets (Section 194G)

- Commission, Brokerage etc (Section 194H)
- Rent (Section 194I)
- Fees for Professional and Technical services (Section 194J)
- Income in respect of Units (Section 194K)
- Payment of compensation on Acquisition of Capital Assets (Section 194L)
- Other Sums (Section 195)

The motive of Government is to collect Income Tax at the origin itself when payment is being made or expense bill is accounted for (whichever is earlier). This way the Government tries to bring more people under the Tax net who may possibly be left out when actual payment of tax comes into picture. As already listed above, TDS is applicable on various types of transactions and the rate of TDS varies for each of the above categories. The rate of TDS also varies on the constitution of the payee being dealt with (Corporate/ Non-corporate/ Firm etc). Further, TDS is liable to be deducted only when the amount of payment exceeds minimum limit for TDS category in one accounting year. Further in order to reduce hardship on smaller contractors, a provision is made under Income Tax rules to levy reduced TDS rate for certain period with due authorization.

For NGO sector, there are only few payments applicable in general. In special cases other payments and deduction of Tax at source may become applicable. However, in this article, only those payments that are generally made by NGOs on which provision of TDS may become applicable are discussed. They are;

- Salaries (Section 192)
- Payment to contractors (and sub-contractors) (Section 194C)
- Payment of Rents (Section 194I)
- Payment of Professional and Technical Fees (Section 194J)

SALARIES (SECTION 192)

Tax is to be collected at the rates prescribed for the financial year in which the payment to employee is made. However, the tax applicable is liable to change during the year due to change in the salary, salary structure (component), tax rates and applicability of exemptions and deductions as per Income Tax Act, 1961. Due to the above, TDS may be increased or decreased to adjust earlier (of the year) deficiency or excess deduction.

While calculating the salary for the year, all allowances and perquisites chargeable to Tax would be included. Income or part thereof exempt under Section 10 should however be excluded. Deduction under Section 80C, 80CCC, 80CCD, 80D, 80DD, 80E, 80GG and 80U should also be considered. However, deduction under Section 80G (donations to charitable institutions) should not be considered except that for donation towards Funds like Jawaharlal Nehru Memorial Fund, Prime Minister Drought Relief Fund, National Children Fund Etc. (when 100% deduction is available)

Total salary has to be rounded off to the nearest multiple of Rs.10. Thus if the total taxable salary comes to Rs3,27,254.00 it should be rounded off to Rs3,27,250. However if it comes to Rs.3,27,255.00 it would be rounded off to Rs.3,27,260.

If the employee is employed with two employers, he/she will give information about the salary paid or payable by one employer (as per the choice) in Form 12B to another employer whom he/she wishes to deduct Tax at source.

Employee may declare his/her other income (income other than salary) along with the details of tax already deducted (with proof of the same) thereon. However the loss can only be declared in respect of House Property and no other head. If the declaration of such other income (other than the loss from House Property) results in decrease in the tax deductible by the employer, such other income/declaration should not be considered by the employer. The example below illustrates this aspect further:

Profit in lieu of Salary in Form 12BA. This is in case the salary exceeds the exempt limit. Otherwise, the details of perquisite would form part of Form 16 itself.

The Tax has to be deducted at the average rate of tax applicable on the salary likely to be paid for the year. Thus, if the taxable salary does not exceed the maximum limit up to which the tax is not applicable (Rs.2,25,000 for individual attaining age of 65 anytime during the previous year, Rs.1,90,000 for women with age less than 65 years and Rs.1,60,000 for all other individuals), no TDS is deductible.

PAYMENTS TO CONTRACTORS AND SUB-CONTRACTORS (SECTION 194C)

It includes the payment to any resident for carrying out any work (including supply of

EXAMPLE: Declaration of other Income

Taxable Salary of Mr. X	Rs.300,000
TDS to be deducted	Rs.14,420 (calculated on the above salary)
Other income declared	Rs.20,000
TDS already deducted on other Income	Rs.4,000

If the other income thus declared along with the TDS deducted on that would be taken then the revised figure for TDS deduction would be Rs.12,480 (Rs.16,480 as TDS calculated on total taxable income of Rs.3,20,000 less TDS already deducted on other income, Rs.4,000)

Since inclusion of the other income so declared is resulting in the reduction of TDS to be deductible by the employer, the same should not be considered and TDS deductible would remain Rs.14,420.

With effect from June 1, 2001, sub-section (2C) has been inserted in section 192 which provides that person paying salary shall furnish to the person receiving salary a statement giving particulars of perquisite or

labour for carrying out any work) in pursuance of a contract. The contract would be between the payer (other than individual or HUF not falling under the categories of Section 44AB of Income Tax Act 1961) and

persons specified in the Act which includes 'Cooperative Societies', 'Societies registered under Societies Registration Act, 1860', 'any Public Charitable Trust' and 'Companies formed under Section 25 of Companies Act 1956'. The complete list of specified person can be referred under section 194C of the Act.

This section covers the payment by the contractor to the sub-contractors for carrying out full or part of the work originally to be carried out by the contractor under a contract. The work would include the supply of labour for carrying out any work as per the contract between the contractor and the sub-contractor.

Tax has to be deducted at the time of actual payment or accounting for the expense, whichever is earlier. Actual payment may be in cash, through issue of Cheque or Demand Draft or any other mode. Accounting of expense in general would be booking of expense in respective accounts. However, even if it is booked in some other account whether called 'suspense account' or something else, would attract TDS deduction.

The expression "Work" includes the following:

- a) Advertising,
- b) Broadcasting and telecasting including production of programmes for such broadcasting or telecasting,
- c) Carriage of goods and passengers by any mode other than by railways,
- d) Catering (excluding serving in hotels and restaurants),
- e) Manufacturing of supplying a product

according to requirement or specification of a customer by using material purchased from such customer.

Tax has to be deducted at source for the applicable payments provided at least one of the following conditions is satisfied;

- The single payment itself exceeds Rs.20,000.00 (Rs.30,000. w.e.f July 1, 2010)
- The aggregate payment for the previous year is supposed to exceed Rs.50,000.00 (Rs.75,000 w.e.f July 1, 2010)

Tax should be deducted from each payment to the contractor if the aggregate payment for the previous year is supposed to exceed Rs.50,000.00 and one should not wait for the amount to actually exceed the said amount.

However, if no tax is deducted on payment of less than Rs.20,000 presuming that there would be no other payments and eventually aggregate of payments in the year exceeds Rs.50,000, tax calculated on the aggregate amount has to be deducted from the payment with which the aggregate exceeds Rs.50,000.

Rate of tax applicable for deduction at source is being attached as Annexure – 1

PAYMENT OF RENT (SECTION 194I)

For the purpose of this section, 'Rent' means any payment, by whatever name called, under any lease, sub-lease, tenancy of any other agreement of arrangement for the use of any land, building (including factory building), together with furniture,

fittings and the land appurtenant thereto, whether or not such building is owned by the payee.

Tax has to be deducted at the time of actual payment or accounting for the expense, whichever is earlier. Actual payment may be in cash, through issue of Cheque or Demand Draft or any other mode. Accounting of expense in general would be booking of expense in respective accounts. However, even if it is booked in some other account whether called 'suspense account' or something else, would attract TDS deduction.

The tax has to be deducted if the aggregate of the sum to be paid in the previous year is likely to exceed Rs.1,20,000.00 (Rs.1,80,000. w.e.f July 1, 2010).

As per circular no. 4/2008 dated 28.04.2008 of Central Board of Direct Taxes (CBDT) service tax paid on rent should not be considered while calculating the TDS. Thus tax should not be deducted on the service tax paid on Rent.

Rate of tax applicable for deduction at source is being attached as Annexure – 1

PAYMENT OF PROFESSIONAL AND TECHNICAL FEES (SECTION 194J)

For the purpose of this section, "Professional Services" means services rendered by person in the course of carrying on

- Legal,
- Medical,
- Engineering or Architectural profession
- Profession of accountancy

- Technical consultancy
- Interior decoration
- Advertising
- Authorized representative (one who represents any other person on payment of any fees or remuneration)
- Film Artist
- Company secretary
- Professional of Information Technology

Technical fees, as per explanation 2 to Section 9(1)(vii), means fees for any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

Tax has to be deducted at the time of actual payment or accounting for the expense, whichever is earlier. Actual payment may be in cash, through issue of Cheque or Demand Draft or any other mode. Accounting of expense in general would be booking of expense in respective accounts. However, even if it is booked in some other account whether called 'suspense account' or something else, would attract TDS deduction.

Tax would be deducted from source only if the sum paid or accounted for, as the case may be, exceeds Rs.20,000.00 or aggregate of such sums for the year is likely to exceed Rs.20,000.00.

Thus, if first payment to a consultant is Rs.15,000 without any idea of any more payment during the previous year, no tax

has to be deducted. However, if another payment of more than Rs.5,000 is made eventually, Tax has to be deducted from that payment calculating TDS on total amount including the first payment of Rs.15,000

However, if the assessing officer is satisfied that the payer's total income would be low and may not be liable to much tax, may issue certificate for deducting tax at lower rate or even not deducting tax.

DEPOSIT OF TDS DEDUCTED IN GOVERNMENT ACCOUNT:

last day of the accounting year, it has to be deposited within two months from the day of such deduction.

Thus if the TDS is deducted on August 21, 2010 the same should be deposited by the end of first week of Sep 2010. However if the tax is deducted on Mar 31, 2011, the same can be deposited by May 31, 2011.

ISSUE OF TDS CERTIFICATE:

The person deducting TDS is liable to issue certificate to the person from whose payment the tax is deducted (Section 203).

ISSUE OF TDS CERTIFICATE

Nature of Payment	Other condition	Specified Form	Timeline for issue of Certificate
Salary	Taxable salary not exceeding Rs.1,60,000.*	16AA	Within one month of end of the year
Salary	In all other cases	16 and 12BA	Within one month of end of the year
All other payment		16A	Within one month from the deduction of Tax

* Rs. 1, 90,000 incase of the individual being a resident women

TDS deducted from the payments made has to be deposited with the Government account within the specified date. This deposit can be made in various specified nationalized banks including Reserve Bank of India along with the TAN (Tax Deduction Account Number) challan issued by the Income Tax Department. TAN should be mentioned on every challan used for deposit of TDS deducted.

The Tax thus deducted should be deposited within a week from the end of the month in which it is deducted. However, except in the case of salary, if the Tax is deducted on the

The certificate is to be issued in the prescribed form and within stipulated date.

TDS RETURN TO FILED WITH INCOME TAX DEPARTMENT (Section 206):

All organizations deducting TDS have to file periodical return with the specified Income Tax Authority in the prescribed form and within the specified limit. The same is summarized in the below table;

PENALTY, INTEREST AND PROSECUTION:

Failure to deduct TDS or payment of same to the government as per law and within

Filing of TDS RETURN

Quarter	Period Covered	Last date of submission	Specified Form
1 st	Apr – Jun	15 th July	Salary: 24Q and 27A Other than Salary: 26Q and 27A
2 nd	July – Sep	15 th October	
3 rd	Oct – Dec	15 th January	
4 th (Final)	Jan – Mar	15 th June	

time stipulated may attract penalty, interest and even imprisonment.

section 206 is not filed within the time stipulated.

- Under Section 201(1A) an interest @1% per month would be levied on the TDS amount thus not deducted or deducted but not deposited within time prescribed.
- Under Section 271C a penalty of amount equal to the amount of TDS not deducted may be levied by the Income Tax Authority.
- If the Tax is deducted but not deposited, the principal officer of the organization may face an imprisonment of minimum 3 months and maximum 7 years.
- A penalty of Rs.100 per day may be imposed for each day of default if the return required to be furnished under

CONCLUSION

Under the present Income Tax Act, 1961, every person making payment or crediting income of specified types to another person is required to deduct a specific proportion of amount payable / creditable at the time of making payment or giving credit, whichever is earlier and deposit the amount so deducted with the Government. As this provision includes NGOs as well, all organizations responsible for deduction of tax at source are required to submit to the income tax authority respective returns within the stipulated period after the end of the financial year. Hence much caution has to be exercised by organizations so that there is no lapse or failure to deduct tax at source while making various payments.

Rates of TDS for Financial Year 2010- 11

Payments Made To resident		Thresholds		Rate in %	
Section	Nature of payments	up to 30.06.10	w.e.f 01.07.10	Company, firm. Co- operative Society, Local authority	HUF , Individual
194C	Payment to Contractors , Pay to Advertiser/Sub Contractor , Payment to Transporter	Rs 20,000 (Single Payment) (Rs. 50,000 per contract in a year)	Rs. 30,000 (Single Payment) (Rs.75,000 per contract in a year)	2	1
194I	Rent - Property	120000	180000	10	10
194I	Rent-Plant / Machinery	120000	180000	2	2
194J	Professional Fees	20000	30000	10	10

Note 1: No deduction shall be made from any payments made to the contractor during the course of business of plying, hiring, or leasing goods carriages, on furnishing his pan to the deductor. The deductor will have to file a separate return giving details of such transporters.

Note 2: Surcharge and Cess is not applicable on TDS from 01.04.2009 onwards on any payment made to resident

Note 3: If PAN is not provided by the deductee then rate as per above table or 20% of the amount that is to be paid which ever is higher, is to be deducted.

Disclaimer:

*This is not the actual Act and actual Act should be referred for complying with the law of the land.
The Author/Publisher would not be responsible for any non compliance of any law by the reader.*



CORPUS & ENDOWMENT FUND

- Manoj Fogla, Consultant

24

October 09 - March 10

Volume IX Issue I

INTERface



CORPUS FUND

WHAT IS A CORPUS FUND?

The term '*corpus*' is often confused and misunderstood. The literal meaning of the term '*corpus*' is the main part/organ of a body. The term '*corpus*' also denotes the sum and substance of an issue/entity. From a layman's point of view a corpus fund should be understood as the capital of the organisation ; the funds generated and kept for the existence and sustenance of the organisation.

For a charitable organisation, corpus fund are of paramount importance. Normally a corpus fund denotes a permanent fund kept for the basic expenditures needed for the administration and survival of the organisation. The corpus fund is generally not allowed to be utilised for the attainment of the purposes, but the interest/dividend accrued on such fund can be utilised as well as accumulated.

Corpus funds are generally created out of corpus donation. A donation will be treated as corpus donation only if it is accompanied by a specific written direction of the donor. In the absence of any written direction of the donor, a contribution or grant cannot

be transferred to corpus fund. It is important to understand that in case of a corpus fund, the funds are restricted but the purposes are not restricted. Corpus fund is an unrestricted permanent fund. The restriction is on the use itself rather than the type of use. A corpus fund may be used in exceptional circumstances, where the survival of the NGO is at threat. Such decisions are rarely taken and should be taken at general meetings. As such there is no legal bar on application of corpus funds for charitable purposes. However, for all practical purposes corpus fund is a permanently closed fund with no strings or restriction for future application attached.

As discussed above, it is difficult to create a corpus fund unless a written consent is received from the donor because creation of a corpus fund implies reduction of program activities to that extent. Therefore, the law does not encourage creation of corpus fund. For instance, under the Indian Income Tax laws 85% of voluntary contribution received are required to be applied for charitable purposes. In other words, only 15% of the income is available for accumulation every year. If the board of an NGO wants to create corpus fund then it cannot go beyond 15% of its income even if it is available for accumulation.

DONATION RECEIVED THROUGH CHARITY BOXES

Any donation received through charity boxes will not be considered as corpus donation even if the donation box is marked with the word '*corpus*'. Suppose, an NGO puts a donation box with an inscription '*all donation will be towards the corpus of the organisation*', the donation so collected will not be considered as corpus donation because a specific direction from the donor has to come in writing in order to constitute a corpus donation.

INTERNALLY GENERATED CORPUS FUND

The board of an NGO may create corpus fund from its internal accrual and surpluses. It is not necessary that a corpus fund will be created out of corpus donation only. A corpus fund can be created from the current year's income or other available UFs. To create a corpus fund from the current year's income, the prevailing legal provisions and the bye-laws of the organisation have to be kept in mind. For instance, under the Indian Income Tax Laws maximum 15% of the income can be transferred to the corpus fund each year.

INCOME FROM CORPUS FUND

The income generated from corpus fund is treated as a part of the income of the charitable organisation along with other grants and incomes. Therefore, the income from corpus fund is also subject to the condition of applying 85% during the year as per Income Tax laws.

RELEVANCE OF CORPUS FUND

Building of a corpus fund is important, in order to ensure smooth sustenance of an organisation. If a sizeable corpus exists, the core activities of the organisation can still continue in the period when grants and external help are not available. A sizeable corpus fund reduces the financial vulnerability and thus assures long term existence. At the same time a large corpus or the tendency to pile corpus fund may not be in the interest of the objectives of the organisation. Therefore it is necessary that a judicious balance is maintained between a corpus fund and the funds that are utilised, keeping in view the current and future activities of the organisation.

ENDOWMENT FUND

An endowment fund, hereinafter referred to as EF, is similar to a corpus fund but it comes with the restriction of certain specific purposes. For example, a donor may create an endowment for the maintenance of a monument of historical or religious importance. The income from the endowment so created would go towards the maintenance of the said monuments. The EF so created may be permanent and perpetually available to the trustee organisation like a corpus but the use of its income is restricted for a specific purpose. Therefore, it can be seen that unlike corpus fund an EF is a restricted long term fund.

These funds account for resources that may not be expended currently. The principal of this fund may be preserved. The income out of this fund is usually available either for a restricted or for a general purpose. The EF obtains resources from gifts, investment

income and appreciation of principal and transfers from other funds, if any. Income from these funds usually are transferred to another fund where it may be expended. Decrease in fund balances occur from the termination of endowments and also from the transmission of endowments resources to other funds in accordance with endowment agreements.

Interest revenue out of such fund is accrued at the end of accounting year. The fund is usually invested in some securities and such investment is valued at cost price. If the income out of such investment is available for unrestricted purposes, it is recognised in the unrestricted fund. On the other hand, if the income is to be used for some specific purpose, it is transferred to that specific fund.

The only time, the investment income is recognised in the EF is if the terms of agreement specify that the income must be added to the endowment principal. There may be two types of endowments-perpetual endowment and term endowment. In the first case, such endowments are given in perpetuity and the fund principal is never spent or repaid. Term endowments are gifts for which the donor has specified a date or event after which the funds may be spent.

TERM ENDOWMENT FUND

A term endowment fund is similar to an endowment fund apart from the fact that it is not perpetual and expires after a specific time period or event. For example, a donor may identify 50 slum children and create an endowment for their education. The income from the fund may be used for the education of the children for a period of, say, 10-15

years. After the expiry of the endowment period, the donor may specify the residual use of such funds. For instance, it may go to the corpus or general fund of the organisation or the donor may specify the distribution of the fund amongst the 50 beneficiaries.

In the above example the endowment is for a specific period, which can be related to a future event. The endowment fund may expire on the completion of certain educational degree or on the completion of certain age of the beneficiaries. For all other practical purposes, a 'term endowment' and an endowment are similar in nature, barring the fact that a term endowment fund expires on the happening of a definite future event or at the expiry of a definite period. Other endowments are open-ended without any time limitation clause.

RESTRICTED ENDOWMENT FUND

An endowment is termed as '*restricted endowment fund*', hereinafter referred to as REF, when the source is external in nature. If an endowment is created out of donors contribution as per the conditions and limitations attached by the donor then the EF so created is restricted in nature. Such EF may be for a fixed period or perpetual in nature. A REF is distinguished from other endowment funds on the basis of the source of the funds. The distinction is technical in nature but for all procedural purposes it is similar to other endowment funds. However, it may be noted that a REF cannot be revoked under any circumstances as the restrictions come from an external source. However, a designated endowment fund may be revoked by the general body or the board provided the constitution and the by-laws permit such a revocation.

DESIGNATED ENDOWMENT FUND

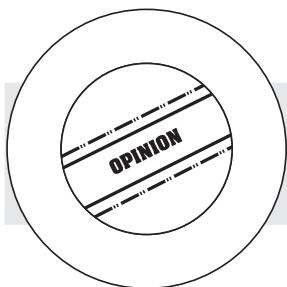
When an EF is created out of internal accruals and unconditional voluntary contributions received, it is known as Designated Endowment Fund, hereinafter referred to as DEF. The board of an organisation may designate certain funds for long term activities. The EF so created may be for a fixed period or perpetual in nature. A DEF is a discretionary long term fund created by the

board/trustees of the organisation. Such funds are bound by the norms and regulations approved by the board. Generally such funds are also permanent and not available for the general activities of the organisation. But since the designation is created by the NGO itself, therefore there is a legal possibility of revocation of such designation. But in a Restricted Fund and such revocation is not possible under any circumstances unless permitted by the respective donor.

SUMMING UP NOTES :

- An endowment fund is similar to the corpus fund but it comes with certain restrictions.
- The fund is usually invested in securities. If the income from such investments is available for unrestricted purposes it is transferred to the unrestricted fund and if it is available for specific purposes it is transferred to the specific fund.
- There may be two types of endowment funds- perpetual endowment and term endowment. Perpetual endowment funds are never spent or repaid. Term endowment funds have to be spent by a specific date or event.

(Extracted from the Revised Finance Handbook for Voluntary Organisations,
authored by Mr. Manoj Fogla, published by FMSF)



ICAI Expert Advisory Committee Opinion - Income & Expenditure Account or Profit & loss Account for Section-25 Companies

Whether a Company registered under Section 25 of the Companies Act, 1956, should prepare Income and Expenditure Account or Profit and Loss Account. The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

28

October 09 - March 10

Volume IX Issue I

INTERface



Facts of the Case

1. company is a non-profit organisation registered under section 25 of the Companies Act, 1956, with the Central Government holding its 100 per cent shares. It is presently working under the Department of Scientific and Industrial Research, Ministry of Science & Technology, with the objective to develop, promote and transfer technologies emanating from various National Research and Development (R&D) institutions. It has been offering the services in improving the manufacturing base in India with innovative technologies and, as per the querist, is acting as an effective catalyst translating innovative research into marketable industrial products. The querist has stated that the company is being used by the Government of India in spreading technical knowledge and providing financial aids to new entrepreneurs. It is also conducting different educational and promotional programmes on behalf of the Government of India. In doing so, the company has been receiving government grants/aids.

2. The company has been licensing indigenous technologies. It has occasionally sold compact disks containing blue print of

technologies. But, as per the querist, the sale has not been substantial and did not result in profits.

3. The company had also been entering into transactions of the nature of 'sale'. It was purchasing 'Unani' products from another company, which is using the licensed technology of the company. The product was further sold in market. The querist has stated that the main motto of such trade is to promote its technology and the product produced from the said technology, but it may result into some profit element. The company has, however, stopped these purchase and sale activities in the current year.

4. Since its incorporation, the company has been preparing Income and Expenditure Account. As per the querist, the auditors have stated that they cannot express their opinion in the statutory audit report on the Income and Expenditure Account. The auditors have stated that as per section 227(2) of the Companies Act, 1956, the auditor of the company has to express his opinion on the Balance Sheet and the Profit and Loss Account and any other document declared by the Companies Act to be part of or annexed to the Balance Sheet and the Profit and Loss Account.

5. The querist has further stated that as per clause 117 of the Articles of Association of the company, "at every annual general meeting of the Company held in pursuance of article 58, the Board of Directors of the Company shall lay before the Company a Balance Sheet and Income and Expenditure Account and Profit and Loss Account", and clause 119 of the Articles of Association prescribes the contents of the Income and Expenditure Account and Profit and Loss Account. Thus, according to the querist, as per the Articles of Association, the company is also required to prepare Income and Expenditure Account.

B. Query

6. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) Which financial statement should now be prepared by the company – whether the company should prepare 'Profit and Loss Account' or whether it should continue to prepare 'Income and Expenditure Account'.
- (b) Whether there is any violation of or deviation from the Companies Act, 1956 or any Accounting Standard.

C. Points Considered by the Committee

7. The Committee, while answering the query, has considered only the issues raised in paragraph 6 above and has not examined any other issue that may arise from the Facts of the Case. From paragraph 5 above, it appears to the Committee that as per its Articles of Association, the company is required to prepare both Income and

Expenditure Account and Profit and Loss Account. However, the company is preparing only Income and Expenditure Account.

8. The Committee notes from the Facts of the Case that the company is registered under section 25 of the Companies Act, 1956. The Committee also notes clause 113 of the Articles of Association of the company (separately provided by the querist for the perusal of the Committee) which states as below:

"113. No dividends in any form or shape shall be paid to members so long as the licence granted by the Government of India under section 25 of the Act remains in force and is not rescinded or withdrawn." From the above, the Committee is of the view that the objective of the company is not to earn profits for distribution among its members. The profits earned, if any, will be used for the furtherance of the objectives of the company. The Committee is also of the view that even a not-for-profit organisation may earn profits for its sustenance. Accordingly, even if the company in the present case earns profits, in the view of the Committee, the company is not carrying on business 'for profit'.

9. The Committee notes section 210(2) of the Companies Act, 1956, which states as below:

"(2) In the case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of a profit and loss account, and all references to "profit and loss account", "profit" and "loss" in this section and elsewhere in this Act, shall be construed,

in relation to such a company, as references respectively to the "income and expenditure account", "the excess of income over expenditure", and "the excess of expenditure over income".

" From the above, the Committee is of the view that reference to 'Profit and Loss Account' in section 227(2) of the Companies Act, 1956, shall be construed, in the case of the present company, as reference to 'Income and Expenditure Account'. Accordingly, the company should prepare only the Income and Expenditure Account instead of the Profit and Loss Account even though the Articles of Association of the company require

preparation of the both.

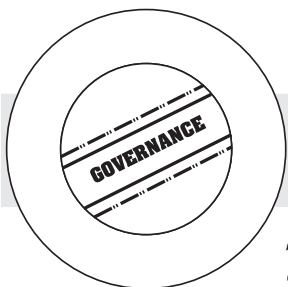
D. Opinion

10. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 6 above:

- (a) The company should prepare Income and Expenditure Account in place of Profit and Loss Account.
- (b) Preparation of Income and Expenditure Account in place of Profit and Loss Account by the company, will not tantamount to violation of or deviation from the Companies Act, 1956, or any Accounting Standard.

1. *The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.*
2. *The Opinion is based on the facts supplied and in the specific circumstances of the querist.*
3. *The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty six volumes. A CD of Compendium of Opinions containing twenty five volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.*
4. *Recent opinions of the Committee are available on the website of the Institute at URL: http://www.icaai.org/category.html?c_id=146*

(This article is reprinted from from ICAI'S journal, The Chartered Accountant, Volume 58, No. 7, January 2010 Issue with permission)



Governance Insights

Sanjay Patra, Executive Director, FMSF has been involved in the training and capacity building of NGOs in the areas of financial management, legal regulations & NGO Governance for over a decade. Here are some of the common NGO Governance Questions answered by him in a recent interview with the Indianngos.com

2

1. What steps should be taken to form a board of any NGO?

The board should be ideally between five to ten members unless the legal requirements are different. The board should not have members who are permanent in nature except the case of institutional nomination. In case of a trust normally a clause regarding permanent trustees is found. However, in such instances it is desirable that the total voting right of the founder trustees is less than 50%. The composition of the board should be clearly defined in terms of the diversity of the skills required for discharge of the board functions. The balance of the board should be maintained in terms of gender, finance & other specialized skills, stakeholders and distance & availability. There should be a clearly defined policy for recruitment, election of trustees or board members. The induction of new trustees should be through an open process providing the opportunity of being elected/selected from a wider group of stakeholders.

The process of formation of the Board should be an independent one & it should be ensured that there are no apparent conflicts of interests within the Board.

There should be a nomination committee and it should be the responsibility of the

Nomination Committee to bring in names of potential board members who have vast experience and in depth understanding of the areas in which the organization is involved in. The staff members should not be a part of the Nomination Committee. Ideally, even the CEO should not be a part of the Nomination Committee.

Q2. How roles and responsibilities of board should be designed?

The board is responsible for the ultimate governance of the organization and has legal, fiduciary, and ethical responsibilities: developing and maintaining the organization's mission and annual plans; raising money; managing the organization's resources; providing oversight, determining policy, and evaluating the chief executive; and acting as ambassadors within the community. Although the day-to-day management responsibilities lie with the Executive Director, the board holds the ultimate decision-making powers for the organization.

Boards tend to work effectively when they are structured. There should be a process for orientation and sensitization of the trustees regarding their responsibilities. A clear distinction between strategic issues and operational issues should be made.

Areas like the vision, mission of the organization, core values, strategic direction, major policy decisions are some of the strategic matters that should be dealt primarily by the Board. Hiring, termination and supervision of staff, work allocation, managing and implementing the overall program are few of the operational matters that should be taken care of by the CEO/ Leadership team. A position paper on this issue (commonly known as Governance Manual) should be drafted which should be revisited annually.

The board should formulate the mission statement of the organization and should revisit it every three years in order to ensure that the programs and resources are in consonance with it.

The board should;

- Formulate the structure of authority and responsibility to be delegated to the CEO and other staff.
- determine the procedure of selecting the CEO and the compensation thereof.
- Formulate important policy documents and guidelines on gender, human resource, finance etc.
- Appoint the statutory auditor and the internal auditor if required. Both the auditors should directly report to the board.
- Determine and approve the annual budget and allocations.
- Determine and approve the bank accounts to be operated and the signatories thereof.
- Develop proper policy and systems regarding the title, safeguard, location and verification of fixed assets.
- ensure strict adherence with all statutory compliances
- Ensure that requirements/ obligations towards other stakeholders is diligently done.
- Constitute advisory committees for special functions or for specific purposes.
- Review the performance of the CEO and other senior management staff on annual basis.

The board should prepare a position paper every three years on issues such as

- (i) Financial Sustainability
- (ii) Institutional Sustainability
- (iii) Programmatic Sustainability
- (iv) Corpus, endowment and general funds
- (v) Risk and contingencies.

The board should carefully position its involvement in the management of the affairs of the organization. Generally the board should not be interfering in nature, but certain powers of approval should be retained by the board depending on the size of the NGO. A suggested list of the additional functions of board could be as under:

- approval of projects and activities to be undertaken
- periodical perusal of the reports from the Secretary and other key functionaries
- approval for purchase of assets for large financial transactions
- approval of project budgets and investments
- finalizing annual financial statements
- staff capacity building measures
- appointment of staff
- internal control measures
- resource mobilization, etc

Another important task is to elect the key office bearers. A chairperson has to be selected for leading the Board. A treasurer should also be selected from among the board members to handle the basic financial management.

Formation of various committees: The idea behind forming sub-committees is to delegate some of the Board's authority & responsibility to various small groups. A committee may also be formed to handle a specialized management function that the board decides not to delegate to the Chief Functionary. Sometimes, committees are also formed to mirror the work of the organization. They are designed to monitor management decisions and to maintain a familiarity with the daily issues the organization faces. Such committees are helpful in keeping the board members more closely informed on the changing environment in which the organization is operating.

Committees are a useful structure for working efficiently. Dividing the board into working committees is a common mechanism for:

- Organizing the board's work to accomplish the NGO's mission.
- Preparing board members for making informed decisions.
- Using board members' skills and expertise
- Providing opportunities to become involved and serve the organization.

Generally, board members are part of such committees along with other senior staff of the team. Each committee needs clear instructions about what it is to accomplish. Ideally, it should take the form of a written

mandate, which includes meeting and membership guidelines and reporting timeframes. Some of the commonly formed committees are: Executive Committee, Finance Committee, Purchase Committee, HR Committee, Audit Committee, Standing Committee, Board Development Committee, Advisory Committee etc.

Q3. What are the most experienced practical lacunas in board processes and how to overcome the same?

- **CEO's Board** - one of the major practical lacunae faced by the NGOs is the problem of CEO's Board. This is a typical situation where the Board is completely directed by the CEO. Since in many cases, majority of the Board members are appointed by the CEO, it is quite possible that it is in fact the CEO who governs the organization by influencing the decision making processes of the Board.
- **Family Board:** This is a commonly found problem in NGOs. There are many organizations where the family members of the CEO are serving in the Board of the organization. This is clearly a case where vested interests of the board members can outrule the organizational wellbeing.
- **Induction of board members:** After the selection of board members, many a times the new board members are not oriented thoroughly with the organization's vision & mission; its area of activity & its values. The internalization of the organization's vision & mission; its values & culture is extremely important for any board member. This would

provide them a clear picture about the organization & its positioning vis-à-vis its goals & objectives. It is only after this internalization process that a board member can truly contribute & make value additions in the area of strategic direction.

• **Lack of involvement:** In many organizations, the board members meet just once or twice a year. Therefore, they don't have a clear picture of the organization's work. This lack of involvement can be a potentially hazardous situation where key decisions are taken at the management level and are later just informed to the board members. If the board members are kept at bay from the important decisions of the organization, it leads to weak governance and hence causes damage to the organization in the long run.

• **Conflict of interest:** Conflict of interest is a situation in which outside interests affect or are perceived to affect the ability of an individual to make fair and impartial decision on behalf of the NGO. Conflict of Interest can exist when

- opportunities for direct material gain are involved;
- when close associates or family members stand to benefit
- personal interests or loyalties conflict and compete with those of the NGO

There should be a clear conflict of interest policy in place in the organization. Board members who have an actual or potential conflict of interest should not participate in discussions or vote on matters affecting transactions

between the organization and the other group. Staff members who have an actual or potential conflict should not be substantively involved in decision-making affecting such transactions.

• **Lack of distinction between governance & Management:** The lines of distinction between Governance & Management should be clearly drawn. However, very often, this is not the case. At times the over involvement of the Board members in the running of the organization clearly defies the principle of keeping governance & management as separate areas. When the board tries to manage the organization, it fails to govern it effectively. Thus, the board should always keep itself limited to the area of Governance and not get involved in day-to-day management of the organization. However, it is advisable that the board members should keep themselves informed about the key management decisions.

Q4. What is the significance of Board in NGO sustainability?

Sustainability is one of the critical issues facing the Non-profit organizations today. Even though financial resources are extremely crucial for the survival of NGOs, Sustainability of NGOs should not be equated with availability of financial resources only. Three crucial factors contributing to NGO sustainability are:

- Program Effectiveness
- Financial Security &
- Long term impact.

The interplay of all these factors contributes to the overall sustainability of the organization and the Board through its governance plays a crucial role in the interplay of all these factors.

For instance, if the governance of an organization is weak, it will eventually lead to lack of clarity & direction in achieving the vision and mission which will have a direct impact on the program effectiveness. This may lead to loss of credibility of the organization amongst the stakeholders including donor organizations which can impact the funding of the organization.

In other words, an organization can only be sustainable if it is relevant in the given context. It is the primary responsibility of the board to ensure that the organization retains its relevance and serves the need and purpose for which it exists.

Q5. How board can become more effective in order to achieve the goal of organization?

One of the basic responsibilities of the board is to identify, articulate, safeguard, and promote the NGO's mission. In watching over the mission, the board, in a sense, protects the very heart of the organization. The board should also ensure that the mission of the organization is in line with the need of the community. At the same time care should also be taken to ensure that the mission is realistic in scope, cost, and expected output as well as impact.

- **Review the Mission:** The board should review the mission regularly to ensure it

aligns with existing or planned activities. The board should confirm periodically that the NGO is still carrying out the original purpose expressed in the basic documents—and, of course, that the organization is not engaged in any illegal, unethical, or non-permitted activities. Through a regular review of the mission statement, the board can determine if a misalignment exists and what steps can be taken to bring mission and programs back in line with each other.

- **Planning:** Planning is a mission-directed activity that enhances accountability. Planning is a process of setting goals and articulating a strategy to achieve them through the acquisition and disposition of resources. The board discharges this duty by making sure the staff sets realistic goals for itself and formulates logical steps for achieving those goals within a reasonable period of time. In other words, the board usually oversees and monitors the planning process rather than engaging in the fine details of planning directly. Since board is distant from the daily operations, it can provide inputs on the “larger picture” or wholistic perspective to the process. After the plan is clearly charted out with verifiable & measurable indicators, the board should then ensure on the plan being implemented effectively.

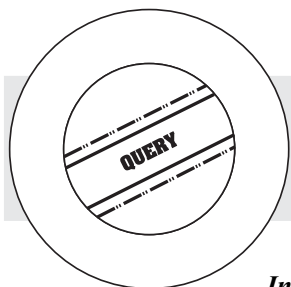
- **Monitoring the Progress of the Plan:** Once the implementation of plan is done, the board can now monitor or oversee progress in the implementation. That can be done through interaction with the staff members as well the CEO.

- **Evaluation:** Evaluation is the means by which the board confirms that the organization is fulfilling its non-profit mission effectively. The evaluation is usually performed by an external consultant. The board can ensure that right questions are asked and the results are appropriately applied. The board should ensure that a comprehensive, organization-wide evaluation is undertaken and not just a single component, such as finances, is assessed for efficiency or impact.

During an evaluation, the board should make sure that the reasons for conducting the evaluation are clear, relevant factors are assessed, and meaningful measurements are consistently applied. The board should review the outcomes of an evaluation and verify that recommendations, if appropriate, are implemented. The board should also consider whether the outcomes have any implications for the

NGO's overall direction, thus ensuring that a good evaluation feeds back into the planning process.

- **Ensuring CEO's Accountability:** The board delegates authority to the CEO for the overall management of the organization. The board hires the organization's CEO, and monitors his or her performance. The CEO is a key decision making authority and is answerable to the Board. The Board should also ensure that a mechanism for CEO's accountability is in place. The CEO owes the board accurate, thorough and timely information about the organization, its environment and its activities. The CEO should also provide quarterly/ six monthly reports to the Board regarding his/her work and involvement in the work of the organization. Further, processes like evaluation and appraisal of the CEO can also act as mechanisms for ensuring his/ her accountability to the board.



Since You Asked

In this section we deal with various legal issues on which opinion has been sought by our readers. As these issues emerge from the non profit sector, we would like to share these with our readers .Proper legal advice may be sought before applying the above opinion.

You Asked:

What are the depreciation rates for fixed assets in NGO? Is it compulsory to deduct depreciation on the assets of NGO ?

Our Response:

* Depreciation as you may be aware is an accounting term used to describe the wear and tear of assets over a certain period of time. Depreciation is written-off against the income statement, based on a certain rate, and reduces assets on the balance sheet. It normally implies reduction / loss in the value of assets due to regular usage and efflux of time.

* The basic quantum of charging depreciation depends on the nature of the asset, its original cost, estimated useful life and residual scrap value at the end of the working life. Depreciation is normally charged on "Straight Line Method" or "Written Down Value Method". It is to be noted that in order to claim depreciation for the complete year, the asset should have been used for atleast six months in a year.

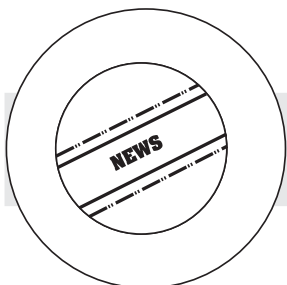
* Regarding if it is compulsory for NGOs to charge depreciation, it is not stated as compulsory as per any statute. As stated earlier, the principle of charging depreciation is to spread the cost of an asset over its useful working life. Generally, the assets purchased

by NGOs are project assets from the current year's income, then the entire amount is treated as valid application of fund. In such circumstances it becomes difficult to charge further depreciation as the value of the assets is reduced to nil by treating them as application of fund in the Income & Expenditure Account.

* Where the project assets are treated as application of fund, it is advisable that the assets (which are written off in the year of purchase) should be reflected in the Balance Sheet at their normal value by creating an Asset Fund on the Liability Side and the asset on the Asset side is reduced to the extent of depreciation, to provide a true and fair view of the assets.

* Regarding the rates of depreciation, generally the rates prescribed by the Income Tax Act, 1961 is followed and present prevailing rates for the following assets are given below :

Sr. No.	Particular of Assets	Depreciation Rates (in %)
1	Building: •Residential •Factory	05 10
2	General Plant & Machinery	15
3	Motor Car	15
4	Motor Buses/Lorries Used in Hire	30
5	Computer including Software	60
6	Furniture	10
7	Patents, Know-How, Copyrights, Licenses etc.	25



Outstanding Annual Reports Awards for NGOs 2010

38

October 09 - March 10

Volume IX Issue I

INTERface

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. The award was instituted by the **CSO partners** jointly with the **Financial Management Service Foundation, Spatial Advertising Consultancy (SAAC), & the Credibility Alliance**. Not-for-profit organizations across India are invited to participate in the process. The annual reports were judged in 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*).

As an effort to promote transparency and accountability within the sector and promote better standards in financial reporting as well as preparation and presentation of annual report, CSO Partners award for "Outstanding Annual Reporting Award" has been instituted by Financial Management Service Foundation (FMSF), Spatial Access

Advertising Consultancy (SAAC) & Credibility Alliance (CA)

The entire process culminated in an "award ceremony" that was organized on the 6th of March, 2010 at the India Habitat Centre in New Delhi where all the participants were invited and winners were felicitated. Mr. Amarjit Chopra President, The Institute of Chartered Accountants of India (ICAI) & the Chief Guest of the evening graced the occasion with his presence.



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

CSO Partners' **Outstanding**
Annual Report
Awards 2010
for the Voluntary Sector

And the Winners of the CSOP Outstanding Annual Reports Awards 2010 are....

Category I - Small Organizations

Winner

Ashadeep

Runners Up

Diya Foundation

Foundation for Initiatives in Development and Education for All

Category II - Medium Organizations

Winner

Udayan Care

Runners Up

Dream a Dream

MUSKAAN

Category III - Large Organizations

Winner

Childline India Foundation

Runners Up

Swami Vivekananda Youth Movement

The Akshaya Patra Foundation

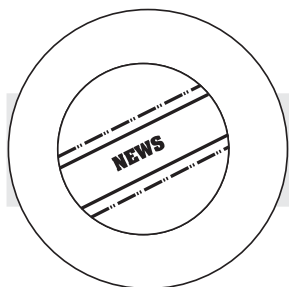
39

October 09 - March 10

Volume IX Issue I

INTERface

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



Report on Bangladesh Workshop

FMSF organized a two day workshop on Governance and Financial Management for EED partner organizations based in Bangladesh. The workshop was held on 17th & 18th November, 2009 at CCDB, HOPE Centre near Dhaka, Bangladesh.

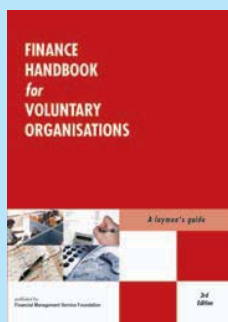
The objective of the workshop was to:

- To Provide an overview of the Accountability dimension concerning the Voluntary Sector
- To develop clear understanding on the importance of Effective Governance for Promoting Accountability
- To develop basic understanding on the various aspects of Financial Management in Development sector

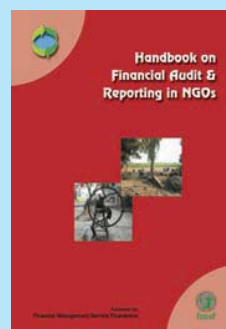
The resource team comprised of Ms. Edda Kirleis from EED and Ms. S.P. Selvi and Mr. Sandeep Sharma from FMSF. The workshop was attended by the Heads of the Organization and Finance personnel. About 22 participants had participated in the workshop. The sessions included discussions and inputs on Governance and Board Processes, Basic Financial Management, Budget and Variance Analysis, Internal Control Procedures, Reporting aspects. The workshop also had a session on EED requirements and related compliance.

The workshop was well appreciated by all the participants. There was also demand for a follow-up workshop to ensure that the learning from the workshop gets internalized. It was decided that a follow-up workshop on Governance will be organized by FMSF in the later part of 2010.

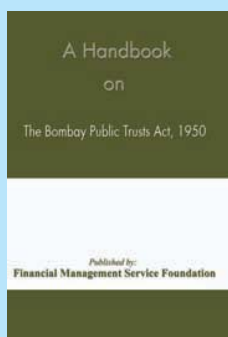
Publications of FMSF



Contribution Price:
Rs.250 /-



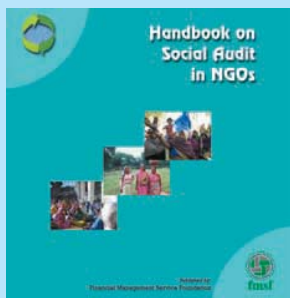
Contribution Price:
Rs. 200/-



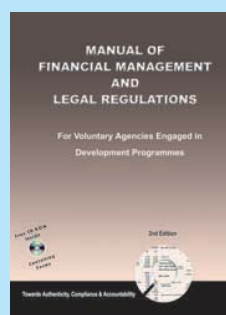
Contribution Price:
Rs. 100/-



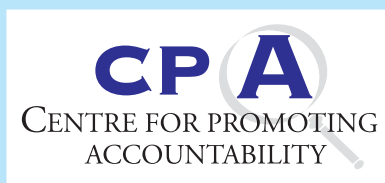
Contribution Price:
Rs. 250/-



Contribution Price:
Rs. 200/-



Contribution Price:
Rs. 100/-



Centre for Promoting Accountability

"ACCOUNTABILITY HOUSE"

A-5, Sector 26, NOIDA - 201 301

Tel: 00-91-120-2546732, 2546733, 2546744, 2546745

Fax: 00-91-120-2546731

E-mail : cpa@cpaindia.in

Website : www.cpaindia.in

