

# INTERface

**CPA**  
CENTRE FOR PROMOTING  
ACCOUNTABILITY

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## In Memory of...

Dear Friends & Colleagues,

With profound grief, we would like to inform you that one of our founding trustees, Mr. J.B. Singh passed away on 04th September, 08.

Mr. J.B. Singh was a great NGO leader, a visionary and had made tremendous contribution in setting up of FMSF in India. A simple man who tried to lead a simple life inspired by the Gandhian philosophy was a role model to many. His demise has caused a vacuum among the civil society organizations in India and particularly in FMSF.

FMSF mourns the demise of Mr. J.B.Singh. & remembers with fondness his contribution to FMSF.

*Between Us ....*

## **The Story of the Beautiful Necklace**

*Once upon a time, a queen had a beautiful necklace. The necklace had precious stones in it and when exposed to sunlight, it would reflect gorgeous colors. The queen really loved it.*

*One day, when she was holding it at the terrace, an eagle took it away from her hand. She was shocked and started shouting. The king came out and saw the necklace hanging from the flying eagle. He started chasing the eagle. Immediately, his associates and other employees joined the chase. After some time, the eagle disappeared into a mountain. People started searching the mountain, but finally one person saw the necklace in the river flowing next to the mountain. Many people tried to retrieve it, but the moment they would reach near the necklace in the river, they were not able to pick it up. Every one who tried failed. The king announced an award for the person who can retrieve the necklace. Finally, one person came from far away. When he was explained the problem, he wanted to have a look. He looked at the necklace in the river, he walked towards the mountain and picked up the necklace.*

*What people saw in the river was an image of the necklace in water. Many times, in our lives, we run after something which is just the image of the reality and spend all our energy after it. We need to decipher as to what is real and what is an image of the reality.*

*Sanjay Patil*



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# Governance Controls

- Sanjay Patra, F.C.A.  
&  
- Madhuchhanda Mishra, FMSF

## 1. Introduction:

Not-for-Profit Organizations (NPOs) are made up of people who share common values, a vision for future and a commitment towards fulfilling its purpose of existence. In view of the above, the Governing Body of NPOs plays a crucial role in casting the vision and translating the vision into action. The primary role of the governing mechanism is derived from the legal and statutory requirements articulated at the time of its legal incorporation. The overall statutory requirements from the Governing Body are in terms of ensuring effective management, audit and the reporting of its program and activities to its constituencies/ stakeholders. As the apex policy making body of the organization, it should ensure that effective policies are in place to guide the organization towards its goals in a systematic way. Finally, one of the most important roles of the Governing Body is to ensure accountability of the leadership of the Organization to which they delegate their authorities. John Carver's 'Policy Governance Model' needs a special mention here. According to John Carver, "*Policy Governance refers to a governance system that enables boards to focus on ownership (moral or legal), the future of the organization and its own governance processes, while empowering the CEO and his/her staff to manage the organization within pre-defined boundaries. The system strengthens the*

*organization through board adoption of a comprehensive set of policies and protects the organization through board monitoring of policy compliance*". Therefore, it is essential for the Board to ensure accountability of the leadership of the organization through appropriate '**Governance Controls**'.

## 2. Why Is It Important to Ensure Accountability of The Leadership?

Les Stahlke & Jennifer Loughlin, in their book 'Governance Matters' have talked about seven deadly sins of organizations which have the potential to affect the core processes of the organizations. One of the deadly sins as described by them is '**Weak Governance, Leadership & Management**' which will eventually lead to poor quality & inefficiency in service delivery of the organization. In fact, weak governance leads to ineffective leadership & poor management. On the other hand, a governance mechanism that ensures accountability of the leadership helps in establishing efficient leadership and eventually effective delivery of services to the beneficiaries.

### 2.1. Ownership Vs Trusteeship

An organization is an artificial legal entity (artificial person) distinct from its members. Thus, an organization can sue and be sued in its own name;



has its own rights and duties; can enter into contractual relations of its own accord; own properties of its own distinct from its owners and so on. When in certain cases, this concept of an organization's artificial personality is abused or misused, the judiciary has the right to disregard the corporate identity and **'lift the corporate veil'**. The usage of the concept has acquired various names like 'lifting the curtain', 'piercing the veil', 'breaching the wall of the corporation' etc. 'Lifting the Corporate Veil' describes a legal decision where a shareholder or director of a corporation is held liable for the debts or liabilities of the corporation despite the general principle that shareholders are immune from suits in contract or tort that otherwise would hold only the corporation liable. This doctrine is also known as 'disregarding the Corporate Entity'.

Thus, the judiciary may on its own accord crack open the corporate shell in circumstances it deems fit in the interest of justice. Now the circumstances under which the Corporate Veil can be lifted are many. Some of them are:

- a. Reduction of the number of members below minimum
- b. Misdescription of the Company's name
- c. Fraudulent Conduct
- d. Evasion of tax
- e. Contempt of Court
- f. Fraud

The circumstances given above are some of the situations in which the Corporate Veil may be lifted. There are many other such circumstances in which the Corporate Veil may be lifted. This device merely

seeks to strike a balance between the interests of the public and the concept of a separate entity and is desirable in certain cases to ensure accountability of the organization.

Now, let us try to draw a parallel here in the Not-for-Profit Sector. An NPO primarily operates on the basis of donation and grants received. The fund on which NPOs primarily operate is for a specific purpose and the NPO is merely a custodian of the funds & the Governing Board, on behalf of the NPO is entrusted with the task of carrying out a specific development activity or activities. Therefore, trust plays a crucial role in the operation of the Not-for-Profit organizations. Since the Board is entrusted with the task governing the organization, parallel can be drawn from corporate practices regarding **'lifting of the Corporate Veil'**. Therefore, it is the primary obligation of the Board to ensure that the organization operates in a free and fair manner & is serving the purpose for which it was created.

## **2.2. Derived Authority Demands Accountability:**

The authority of the Chief functionary of an NPO is a derived one. The Board assigns him/her with the authority as well as the responsibility of managing the organization. Thus it follows that the Chief Functionary is accountable to the Board for his/her performance & conduct. Accountability of the Chief Functionary plays the crucial role of balancing the authority that rests with him/her.

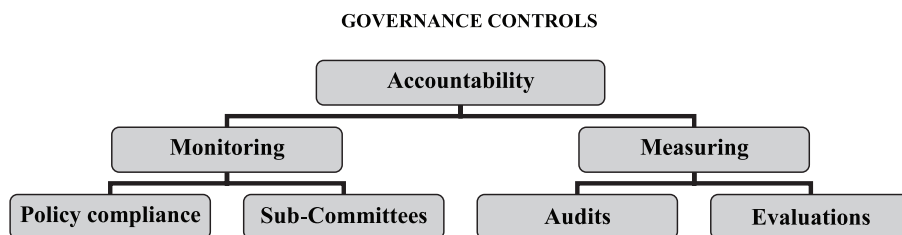
## **3. How can it be done?**

It is now clearly understood that it is extremely important for the Board to ensure the accountability of the leadership.



But the question that emerges at this juncture is how does the Board go about it or to put it in other words, what are the basic 'Governance Controls' in the context of Not-for-Profit Organizations?

**Monitoring & Measuring** are the two components of the Accountability Process. Therefore, the Governance controls in any organization should address these two components.



In the context of Not-for-Profit Organizations, the four basic areas through which accountability of the leadership can be ensured are:

- Policy Compliance
- Sub-Committees
- Audit
- Evaluations

***The areas of policy Compliance & sub-committees take care of the component of monitoring whereas the areas of audits & evaluations involve the component of measuring.*** Together, they would ensure the accountability of the leadership of the organization. Each of these areas will be dealt with in greater detail in the succeeding section.

**3.1. Policy Compliance:** A Governing board is a board that controls the organization through policies rather than managing the daily affairs of the organization. The Chief Functionary should operate & function within the policy framework set by the Governing Board of the Organization. In general, the policy framework should include;

- **Finance Policy:** The finance policy of an NPO can include its travel, payment, support documentation, advance, investments, and audit policies of the organization.
- **Program Policy:** The program policy should include the key objectives stated in the vision & mission of the organization and the activities planned to achieve them.
- **Human Resource Policy:** This would include personnel recruitment, staff appraisal, staff salary, staff welfare schemes like P.F, Gratuity, etc.
- **Administrative Policy:** The administrative Policy should include the details of maintenance & use of office equipments, leave procedures, internal discipline & overall office management.

It is the responsibility of the Chief Functionary to adhere to the policy framework and prepare a report on the policy compliance. The policy compliance report should be submitted to the Board along with the supporting evidence. This would ensure that all the policies set by the Board are being complied with. If not, the reasons for doing so have to be explicitly stated in the report. Apart from the Chief Functionary, the Policy Compliance Report should be signed by two other employees of the leadership level.

**3.2. Sub 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. Some of the common sub committees are finance committee, board development committee, advisory committee etc. It has to be ensured that some of the board members are part of these sub-committees. This will help them monitor the work of the committees from close quarters & help the board to be abreast with developments therein.

**3.3. Audits:** An audit is an independent assessment of the fairness by which an organization's financial statements are presented by its management. Audits are performed to ascertain the validity and reliability of information and also provide an assessment of an organization's internal control. It is important to recognize that it is the board which is primarily responsible for the preparation of financial statements. The duty of the auditor is to express his/her opinion on the financial statements. The audit report should be submitted to the Board with a Management Letter.

Apart from the mandatory statutory audit, the board should also ensure regular Internal Audits. Internal Audits are not statutory. The internal audit keeps a check on the systems of the organization. The internal

audit report should be presented to the Board of the Organization. This would provide a clear view of the internal state of affairs. It would be advisable if the internal audit is not conducted by the auditor who conducts the mandatory external audit.

**3.4. Evaluations:** Evaluation in the context of development work refers to a systematic and objective assessment of an on-going or completed operation, program or policy, its design, implementation and results. Any evaluation should aim to assess or measure the **relevance, effectiveness, impact, efficiency, sustainability & replicability** of the concerned development program.

The effectiveness of evaluation as a tool lies in its vast scope. Evaluations can cover **financial, programmatic, governance** as well as **administrative** aspects of an organization's operation. An evaluation that covers all these aspects would provide a wholistic view of the organization's work and operation. In other words, evaluations of development programs & projects is basically about describing, judging and explaining what has been done, how activities have been performed, what has been achieved and what should be the future course of action. It is the primary responsibility of the Board to have evaluation at regular intervals. This would act as a reality check and provide a clear picture of the organization's standing vis-à-vis its vision & mission. However, an evaluation should not be seen as a threat by the Board but as an opportunity to have an independent external view of the organization.

**4. Conclusion:** If a Board truly chooses to govern, then it will delegate the authority to the Chief Functionary for

managing the organization while setting the boundaries through appropriate policy framework. Because the board's governance function is distinct from the staff's management function, the board must determine its own definition of governance and then decide how it will actually govern. All board members should clearly understand why the board exists; the purpose is not to oversee staff but rather to define the future on behalf of the moral ownership and to ensure that the future is achieved in a legal, ethical, and

prudent manner. The board must be accountable for its own performance & make the leadership of the Organization accountable for their performance. Some of the tools to ensure accountability of the leadership are already mentioned in the article. Apart from these, there are other tools like appraisals, interaction with Staff & other stakeholders that can be used for ensuring the effective functioning of the organization.

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# “Evaluation as an Empowering Process” - Myth or a Reality?

- R. Bhakther Solomon

Chief Executive Officer, Development Promotion Group (DPG)

**Introduction** – ‘Empowerment’ is a concept, and we hear a great deal about it today. It is a buzz word and from the 1970s in the development sector, this word has been very liberally used. In recent times, any activity or intervention which brings about a small change in the socio-economic lives of people is termed as empowerment programme. Earlier any programme planned for the betterment of people was called development programme. The content of the programme and inputs broadly remain the same, only the term by which it is called has changed. However, the result / outcome is claimed to be far-reaching! The behaviours or attributes that signify empowerment in one situation often has different meanings elsewhere. Empowerment is a relative term. No wonder, even project evaluation studies by consultants are now considered to be partly an empowerment process. The questions are: *By whom? For whom? Is it a myth or reality?* No one can categorically reach a conclusion. Nevertheless, based on the approach one adopts in the evaluation process, it is possible to establish empowerment to be either myth or reality.

**Definitions** - Before getting into the topic of Evaluation as Empowerment, let us first define the terms – Empowerment and Evaluation.

**Empowerment** - The term ‘empowerment’ covers a vast landscape of interpretations and disciplines ranging from psychology, philosophy and sociology to the just popularized Self-Help Group’s movements. In simple parlance, ‘empowerment’ means the process which enables one to *gain power, authority and influence over others, institutions or society.*

**Evaluation** – ‘Evaluation’ is a systematic collection and analysis of data to make decisions. It is a process of assessing the strengths and weaknesses of programmes, policies, personnel, product, services and organizations to improve their effectiveness. Rossi and Freeman (1993) define evaluation as “the systematic application of social research procedures for assessing the conceptualization, design, implementation and utility of programmes”.

**Outcome** - Empowerment is the process that allows one to gain the knowledge, skills-set and attitude needed to cope up with the changing societal circumstances in which one lives. The changing circumstances may have been an autonomous one or may be an induced one. Again, perception of being empowered vary across groups,

generation, time and culture. In essence, empowerment speaks **self-determined change**. Empowerment is a cross-cutting issue. For example:

- A **marginalized community** which had been denied access to the street tap water for ages when suddenly been allowed to have complete access, feels very empowered.
- In the Indian context, a **low caste woman** feels empowered when she is given a fair hearing in a group or when officials lend their ears to her complaints or when she is being enabled to open a bank account or even taught to write her name, etc.
- In an organisation, an **employee** feels empowered when he/ she is made to feel that he / she is responsible and is allowed to make his / her own decisions.
- In a joint / nuclear family, a **woman** feels empowered when she is allowed free movement outside the family like her male counterparts and is given the right to make decisions about her own life.
- Marginalized communities owning business establishment is considered in India to be socio political empowerment.

**Development interventions** - Empowerment originates in the existence of marginalized groups / sections / vulnerable communities in their aspirations to change their situations for a better standard of life. Taking this as a God given opportunity, many development planners enter into the field with their long drawn-out development programmes and in the implementation of the same. This leads the next level of enquiring whether these development programmes have brought about the desired changes in the community.

Here, the need arises for evaluation. Evidently, this leads to the entry of consultants and their role of making things more fashionable in terms of jargons or complicated in terms of understanding their perception. In the end whatever they do is labeled as empowerment process!

**Process** – Since the 1960s, development interventions have seen various phases of thrust areas. During the last two decades, so-called development planners give much importance to “empowerment” aspect. Naturally all the activities / interventions - be they conducting a literacy class for an illiterate or conducting health camps for teenage children, helping a marginal farmer to use his dry land with improved technology, organising SHGs for women / of late men and Federation, etc. are all considered “empowerment”. Even the provision of making micro finance functional is now considered empowerment. The activities / interventions are limitless and so are the interpretations of the possible empowerment. While the development project is being implemented by the project staff / project holders with or without people’s involvement, the evaluation of the programme most often than not is conducted by the consultants. In many instances, these are conducted by outsiders to explore the reality ! Here, when we discuss “Evaluation as an Empowering Process”, it is not the project impacts that are viewed as empowerment but the varying processes / tools by which the review / evaluation study is being viewed / conducted. This is now considered empowerment! The hardware and the software are given the least importance, the packages gets the name! What a great change in approach! In this process not only are the project workers considered “**change agents**” but even outside consultants become **empowerment agents** !

**Tools of Analysis** - Let us now examine how these empowerment agents unfold the methodology. The so-called consultants, when they are given an assignment to evaluate

a project, look for some information and key important factors. These are:

- Whether free access of data / information is available about all aspects of the project.
- The inclusion and participation of all the key players (stakeholders) in the implementation
- Local organization's capacity to deliver the planned activities
- Whether the project is accountable to someone for all its omissions and commissions
- The feel of the target group on the interventions and their present impacts.
- Will the evaluation process enable the people to understand all the above ?
- Will the enhanced learning allow them to ask for revisions in the activities or in the mode of implementation ?
- Will it even allow them to network with others on their own terms and conditions ?
- Will it allow them to seek redressal of their problems based on their enhanced understanding?

The tools the consultants use in going about examining the above factors and the participatory nature of the tools determines, whether this is a myth or reality. If the tools applied by the consultant allows free flow of information / discussions on all the above, then it is reality and not wishful thinking. Otherwise it is not.

**In practice**, while fathoming the above process, as far as possible, the empowerment-based evaluation should enable people to fully participate in all the exercises. They must not only own the process but also honestly seek corrections if something is found wanting.

- For example, a collection of simple data regarding the number of supplementary tuition classes

conducted / children attended can directly be obtained from the field worker or directly from the project holder or from the report earlier submitted. The data is reported as an achievement against the planned activities.

- In an empowerment mode of evaluation, the same data thus obtained can again be validated in one or two focus group discussions with the communities, parents / supplementary school students, which will clearly bring out the reasons for conducting the class, the participation level of children / parents in the programme, the efficiency which the programme is operated and above all the real impact of the programme on the immediate clients and then on the community. It is nothing but a proactive exercise !
- Another example would be any land development activity. The data can easily be obtained by asking the field workers the number of farmers who adopted different kind of land based activities like field bund, recharge pits, farm pond, boulder check, diversion channel, nala bund and revetment, rain water harvesting, mini percolation tanks, check dam, sunken pond, agro forestry, foreshore plantation, etc., the areas covered and the present land utilization pattern. On the other hand, an empowered empirical enquiry will take the form of appreciative enquiry / focus group discussions wherein the farmers would reveal the past and the present land conditions, the difference that was noticed on account of the new interventions on the fertility of soil, in terms of water holding capacity or new crop is grown etc. and other kinds of related information.

Any normal evaluation will rely hugely on qualitative data whereas an empowerment-based evaluation will give equal

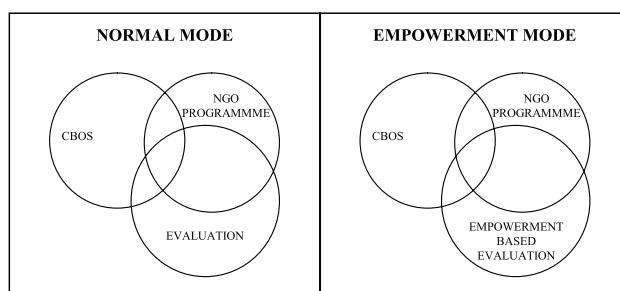
importance to both quantitative and qualitative data. The process will help all the stake holders to reassess the issues / problem at hand, review the efficiency of the activities undertaken to solve the issues and will also go through the best cost alternative options. In fact, evaluation conducted in the empowerment mode will recognize only the means adopted to reach end product. It is not the end but the means by which the end is reached that matters. The process adopted, the actual people met, the programmes reviewed and discussed are the features that determine quality and decide whether the evaluation is myth or reality.

If the consultant is serious and wants the assignment to be an improvement process, he / she has to use reality check as demonstrated above viz. a participatory approach by involving all the stake holders in the exercise. Even if it hurts the ego of a few, the consultant should not be worried. The consultant should lend his / her ears to all the voices right from the bottom up to the top for the evaluation to provide space for everyone. This kind of an approach bordering on the empowerment mode will be in keeping with the following precepts -

- Empowerment-based evaluation will emphasize collaboration between the consultants and communities and increase self-esteem and build solidarity.
- The exercise proposed to be done to collect data / information from the clients / communities / project holders will not only transform the process into being a collaborative, self-reflective, pro-active, but will also decide the nature of the empowerment process to be adopted by the consultants.
- Focus on activities learning, success, failures and alternative ways of doing things.
- Enable the workers / target group to gain a higher level of understanding about issues.
- Enable all the participants to use the data /

information throughout the implementation of the project and not at the end of the project.

- Recognise the progressive changes needed which would work for betterment.
- Recognise shared interests among those doing the work by having access to information and resources for taking proper decisions based on positive thinking.
- Work in partnership with the community groups



and use focus group discussion to obtain indepth understanding of behaviour, impressions and insights on a variety of issues from the group's perspective.

- Empowerment probably enhances the capabilities of a person assuming decision-making power of his / her own accord.
- People develop, as the evaluation proceeds, confidence and self-esteem as they discover their achievements as individuals and as groups.

Regardless of the kind of evaluation, all evaluations use data collection both quantitative and qualitative. Successful evaluations often blend quantitative and qualitative data collection and interpret those in a way that would reveal whole truth of the activities undertaken. The choice of which one to be used should be made with an understanding of the role and with clarity of the aim of the evaluation. It is here that the inner intuition which is always true, sets in.



“Where there is empowerment, work becomes more stimulating, more exciting, more fun. People become immersed in their work, doing it not because they have to but because they want to”.

**Caution** – Failures at the time of the evaluation to recognize the conflicting views of vulnerable groups and the difficulties they face in gaining equal access to appropriate services, or in appreciating one community against the other with similar status can result in the target group getting further marginalized than empowered. Although access to timely information about programmes is a necessary precondition for action, marginalized groups may not take action because there is no institutional mechanism that demands accountable performances or because the costs of individual / poor groups action may be too high. Similarly, experience shows that poor people do not participate in activities when they know their participation will make no difference to service / products being offered or decisions made because there are no mechanisms for holding providers accountable. Even where there are strong local institutions, they may still be disconnected from local institutions and the private sector and lack access to information. It is here that the consultants need to play an active role and must relieve them from all the misgivings about the exercise in its inputs and outputs.

**Myth** – On the other hand, if the consultants take up the assignment purely as an remunerative / academic exercise, the chance of their work remaining a myth is great! Many will dispute this contention of mine! Let me explain. If this is the case, the sole concern of the consultants is to remain neutral, neither to harm the fund receipts nor the donor who provided the assignment, nor the field workers who toiled in the field with less salary and more often without

proper guidance, nor the passive target group that receives everything as “manna” from someone, and not as a matter of right. When this is the mindset of the consultant, the data collection will remain more at the surface level. The idea of “stretching out” to the required level in to depths of the matter will remain just a wish. Naturally, all involved will feel happy because the evaluation did no harm to anyone but only fulfilled the obligation of all of having an evaluation study on the project.

**Conclusion** – In the end, if evaluation is to be a tool of empowerment, it should not be a stand-alone activity, initiated at the end of a programme as many of us would like and also feel comfortable with! Ever since the commencement of the programme, all the stake holders, from time to time, should consider it to be an integrated part of the project, providing important information about the activity proposed, its relevance, programme management and service delivery decisions. It should be an ongoing exercise and occur at every phase of a project’s development, from pre-planning to start-up to implementation and even to the expansion or replication phases. For each of these phases, activities may differ and accordingly, the data / information to be gathered may vary, so too the tools and the nature of empowerment. Active involvement of all the stake holders will increase the participation level of all during the evaluation study. If the Evaluation is conducted on a participatory mode, it will become an empowerment process where the people are empowered to make decisions and “other players” have to relinquish power and control. Relinquishing power and giving up control is not easy but in empowerment-based evaluation, this is a natural outcome. What remains the same, however, is that the evaluation will empower all to take appropriate decisions at the proper time to strengthen and improve the initiative.

# Internal Control Procedures

- FMSF Resource Team

## 1. Introduction

Internal Control implies development of systems within the organisation to ensure efficient functioning and minimise the possibilities of mismanagement and inefficiency.

The nature and extent of Internal Control can be developed on the size and activities of the organisation. It is very difficult to recommend any universal system for all organisations, therefore it is important to understand the features and mechanism of Internal Control. All organisations should develop their own systems of Internal Control depending on their needs and resources.

## 2. Basics of Good Internal Control System

- i) Proper allocation of functional responsibilities within the organisation.
- ii) Proper operating and accounting procedures to ensure the accuracy and reliability of accounting data, and safe guard of assets.
- iii) Quality and competence of personnel with regard to their duties and responsibilities.
- iv) The review of the work of one individual by another whereby the possibility of fraud or error is minimised.

## 3. Important Features of Internal Control

- i) An organisational chart depicting the hierarchy of the authority and responsibilities should be prepared:
- ii) The organisation chart should show a clear definition and allocation of duties and responsibilities of officials and employees.
- iii) Rotation of duties of employees dealing with cash, stocks, stores and other valuables and also at various projects.
- iv) Preparation of an accounting manual.
- v) The budget, to cover all aspects of expenditure/ allocation of funds and receipts of funds.
- vi) System of budgetary control, periodical review. Actual expenditures and receipts should be compared with the budgeted figures.
- vii) Where an organisation has more than one project or office expending or receiving funds, all the above six points stated are required to be adhered to at each centre/office.
- viii) Further the branches or smaller offices are required to send at pre determined intervals i.e. depending upon the size of the organisation daily/weekly/fortnightly/ monthly/statements of all receipts, expenses, stocks etc.
- ix) Complete reconciliation of figures between different

project offices and head office. Any unreconciled element should be looked into immediately.

- x) Surprise verification of cash, stock, assets, investments etc. by the internal auditor, the organisation executives.
- xi) Maintenance of records as per the requirements of statute in force and as directed/desired by funding agencies, government grant authorities.
- xii) All the work should be completed within the time frames stipulated and records should be authenticated by proper authorities.
- xiii) All the surplus funds should be properly invested keeping in view the provisions of income tax as well as the safety and return on investments.
- xiv) The organisation should have adequate insurance cover for all its assets including cash in safe and in transit. It is advisable to get fidelity cover for employees handling cash.
- xv) Regular board meetings and the involvement of the board members in decision making and review of work.

#### **4. Cash & Liquid Funds**

With regard to cash in hand and bank the following points should be considered :

- i) The physical custody of cash should remain in the hand of a responsible person and if possible cash in hand should be kept under dual custody.
- ii) The amount of cash in hand should be kept at minimum possible level, all surplus cash should be immediately deposited into bank.
- iii) Payment as far as possible should be made through account payee cheques/drafts only.
- iv) The authority to make payments should be defined in relation to the amount involved. For bigger amount the authority to approve should lie with the senior functionary of the organisation. The name of the officials and the limits upto which they are authorised to sign

cheques and approve payments should be specified.

- v) The bank accounts should be operated jointly by two or more persons.
- vi) All payments and expenses should be supported by bills, cash memos, invoices, challans and the authorisation of the competent authority.
- vi) The internal auditor or the management should carry out random physical verification of cash in hand, fixed deposits etc., periodically.
- vii) The monthly reconciliation of all bank transactions should be made.

#### **5. Salary & Wages**

The employment should be approved by competent authority and the pay structure and all other perks of each employee should be given in writing to the accounts departments.

All adjustments from payroll on account of new appointments, leave, all allowances, recoveries, deductions, termination, suspensions etc., shall be made only after receiving proper authorisation from the competent authority.

The Account Department/Head of Accounts/Accountant shall be responsible for accounting of all payroll adjustments, monthly payroll processing and payment of salaries to the staff.

All information relating to the payroll is confidential and care must be taken to maintain confidentiality.

Records for each employee showing following particulars should be kept :

- i) Date of Employment
- ii) Complete resume of employee with references.

- iii) Rates of pay
- iv) Increments & promotions
- v) Leave availed/encashed
- vi) Retirement/dismissal
- vii) Advances outstanding

Attendance Register with checking in and out time.

All payments of salaries and wages is preferably to be made in account payee cheques or otherwise cash. Salary register is to be maintained.

## 6. Capital Expenditures & Fixed Assets

Purchase of fixed assets and capital expenditures should be approved by the board and should be as per the budget. The purchase should be done after inviting tenders/quotations. The most suitable supplier should be identified and accordingly purchase order should be issued.

The fixed assets should be recorded at actual cost in the books of accounts. The following are a part of the actual cost of a fixed asset :

- i) Taxes, Customs/Excise Duties and or other Duties/ Levies incurred on the asset.
- ii) Cost of Insurance and Freight.
- iii) Cost of Commissioning and erection, if any.
- iv) Legal Charges.
- v) Consultancy Fees.
- vi) Architectural Fees.
- vii) Interest on Loans taken specifically for the project until completion of the Project.

When land is purchased the actual cost of land shall include stamp duty, legal fees and cost of development of the land.

In case of additions or repair to the assets it should be noted that large amounts which result in creation of new asset or increase the capacity of the asset should be added to the actual cost. Small amounts spent on repair maintenance etc. should not be capitalised and should be treated as revenue expenditures.

Record of fixed assets should be maintained in a register.

The location of each asset should be explicitly mentioned in the register and any changes therein should be noted.

Physical verification of all assets, with correctness of location is to be annually made by the internal auditor or organisation personell.

All assets requiring insurance are to be insured and periodically renewed.

## 7. Investments

All NGOs should pay careful attention with regard to the investments. Firstly under section 11 (5) of the Income Tax Act investments are to be made in specified securities only. Secondly judicious planning and use of funds depends largely on proper investment decisions. It has been seen that huge amount lie in savings bank and current account yielding negligible interest.

An investment register should be maintained, showing :

- a) the nature and description of the investments.
- b) in the case of investments in companies, the name of company in which the investment has been made.
- c) certificate numbers.
- d) distinctive numbers.
- e) cost, amount paid-up and face value.
- f) the names in which the investments have been made.
- g) due dates for receipt of interest.

- h) date on which dividends are ordinarily received.
  - i) maturity dates.
  - j) All the investments kept by an authorised official with adequate security measures.
  - k) All investments should be periodically verified physically with the Register.
  - l) Periodic review of all investment income, to ensure timely receipt.
  - m) All transactions of investments should be authorised by the board or a person to whom power has been delegated.
-

# Charities Need Charitable Amendment

- K. Shivakumar, B.Sc., F.C.A., F.I.C.W.A.,  
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**T**he pink portion of the Budget is appreciated, enjoyed and discussed, but the shades of the grey and harsh amendment made to affect the Charities still remains. Though there were positive factors for Corporates, Agriculture and other sectors, the tint of the negative features have been given to the genuine charities. The Finance Minister in his budget speech has indicated that some entities carrying on regular trade have sought to claim that their purposes would also fall under charitable purposes and hence proposed to amend the law to exclude the aforesaid cases. He has also given an assurance 'that genuine charitable organizations will not in any way be affected'. But, on re-reading the actual paragraph in streamlining the definition of charitable purpose, enough damage has been done and even genuine organizations for whom the Finance Minister has given an assurance may have to face difficult times from the respective Assessing Officers.

The Voluntary Organizations (VOs) have been representing that they have been left out in the reform process and no sustained benefit has been extended to them especially under the Income Tax Act. The laws relating to VOs are allowed to continue with cumbersome procedures and complications and in fact certain concessions given have been modified in

the recent past which put the sector into a disadvantageous position. There is no separate recognition for them in the Income Tax Act and they have been included in the extended definition of "Trust" with a focus on charitable activity. The Government normally takes cognizance of the court verdicts and often makes amendments to substantiate its stand and in the process puts the charities in the dock. VO's are taking many of the developmental works like health, education which are the main responsibilities of the government and in recognition of such support, the government should reciprocate and support the VO's with an enabling legal framework, thereby, continuing the exemptions and liberalizing them. The Finance Minister gave an assurance to the genuine organizations and indicated that the intention is not to affect entities which are engaged in activities such as relief of poor, education, medical relief and any other genuine charitable purpose and the exemption will be denied only to purely commercial and business entities which wear the mask of charity. There were many cases which were responsible to force the Government to take such a decision.

There is clear distinction between the objects/purpose of the trust and powers conferred upon the trustees as incidental to the carrying out of the purpose which has

been held in many cases and the one being the decision in the Bombay High Court *Deccan Gymkhana Vs. CIT* [2003] 262 ITR (St).

Since the language used in the Act was different from time to time there were different treatment and each year the provisions applicable were different. If the business is held as property, the income would be exempted as income from the property and not under section 13(1)(bb) or 11(4)(a) before or after the amendment. A distinction was also made between the provision relating to the business income carried out by a trust and where the business itself is a property.

The ambiguity in the language employed has been well clarified by the Supreme Court in the *Assistant Commissioner of Income Tax vs. Thanthi Trust* [2001] 247 ITR. This well often quoted and contested case is an outcome of such ambiguity. The Supreme Court finally held that if there be any ambiguity in the language employed, the provisions must be construed in a manner that benefits the assessee. The trust therefore is entitled to the benefit of section 11 for the assessment year 1992-93 and thereafter. It held that “we should not add a dispute that the income of the newspaper business has been employed to achieve its objects of education and relief of the poor and that it has maintained separate books of accounts in respect thereof.”

It was held in *Aryan Educational Society vs. CIT* (2005) 93 ITD 546/ Delhi that because the Educational Institution made a profit, exemption/ registration should not be denied. If the Institution complies with the provisions of Sec. 11, 12 and 12A, the exemption cannot be denied. It was also held that element of profit is not explicitly excluded from the definition of Charitable purpose in Sec. 2(15) of the Act. In another case, *CIT vs. Samyuktha Gowda Sarasvatha Sabha* (2000) 245 ITR 242, it was held that letting out of Kalyana

Mandapam even though was not one of the objects of the assessee, an activity carried on to fulfill the objects of the Trust and the income earned by the Trust by such activity cannot be construed as its business income but it is property income and therefore the same is entitled to be exempted under Sec. 11 of the Act. The Privy Council has taken a decision in the *Tribune's trustees* case that where certain purpose is of public benefit, the clause must in general apply to the standard of customary law and common opinion amongst the community to which the parties interested belong. It was held that the object of supplying a state with an organ of educated public opinion is an object of general public utility and it is a charitable object in the absence of a motive of private profit, even if the newspaper charges its readers and advertises at ordinary commercial rates. The exemption from income provided the business is incidental to the attainment of objects has been confirmed under section 11(4) and 4(A).

The amendment is based on the above old cases and also the following recent cases. The judgment of the Gujarat High Court in the case of *CIT vs. Gujarat Maritime Board* (2007) 289 ITR 139 is one such case. In the case, the question that arose for the consideration before the Supreme Court was as to the assessee, a statutory authority constituted under the provisions of the Gujarat Maritime Board Act, 1981 was entitled to the status of a charitable institution under section 11 after it ceased to be a local authority under section 10(20). The Supreme Court has referred that the present case in their view was squarely covered by the judgment of the Court in the case of *CIT vs. Andhra Pradesh State Road Transport Corporation* (1986) 159 ITR 1, where it was held that though it earned income in the process, having no profit motive, it is not liable to income tax. Applying the rationale of the said judgment, they have indicated the income earned by the Board is deployed for the Development of Minor Ports in India and are entitled



to be registered as Charitable Trust under section 12A. There was another similar case decided in the High Court of Bombay in Commissioner of Income Tax vs. Agricultural Produce and Marketing Committee. In this case also it was confirmed that the assessee was established for the advancement of the object of general public utility which was a charitable purpose under Sec. 2(15) and it was entitled to registration under section 12A. In all the above cases, the Honorable Courts have clearly defined and interpreted the meaning of 'general public utility' and mentioned that if the profits are deployed, the institutions are eligible.

In the light of the above judgments and to protect the genuine charitable institutions, it is hoped that Sec.2(15) is amended in such a way 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 any service in relation to any trade, commerce or business for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income by the concerned entity".

The amendment is certainly a bolt from blue for genuine charitable institutions, working in remote villages and which would like to earn income on self-sustaining basis and with self-respect.

#### **Some noteworthy examples of business activities:**

- Take a case of a charitable institution involved in printing and distribution of greeting cards either for children or for old or for physically challenged with participation of the same persons for part financing its activities and to help maintain the home.

- In the case of an organization distributing agricultural inputs to rural farmers and in turn collecting a very nominal fee for the same.
- Organisations registered under Khadi and Village Industries Commission provide employment opportunities for rural artisans.

The above are only illustrative examples. The Assessing Officer may even construe a training course or capacity building programme for Self Help Groups as a commercial activity if nominal fee is collected, making the transaction taxable. There is a very thin line demarcating the Act of Charity & the Act of Service and this will certainly cause problems in accounting and would affect the programmes!

Any income that is given as tax goes to the Government and a part of it is returned to the villages by way of so many programmes. The cost of taking the taxes up and then the cost of returning the same to the beneficiary is enormous and thus the net amount that reaches the downtrodden will be less. Here is a case where 100% of the surplus is pledged by these charitable organizations for development purposes and still they have to face the obstacles. When these NGOs take the Government's role and lessens its burden, it is expected of the Government to lend a helping hand too.

It is true that influential people and organizations should not misuse this tax shelter and evade taxes, thereby depriving the Government of its dues. At the same time, really deserving organizations should not be denied this benefit too.

A World Bank Report also discusses two important tests, which should be taken into consideration for exempting

lawful, economic, business or commercial activities. The first is the test of “principal purposes” which looks at whether the principal activities and the expenditure of the organization are for non- commercial purposes. They may be permitted, provided: (i) no profit or earnings are distributed to founders, members and so on and (ii) the NGO is organized and operated principally for the purpose of conducting appropriate (not for profit) activities. The other is the test for “Destination of Incomes”. Here if the surplus earned from the activity of trade/business is committed for and actually utilized for the activities of NGO the organization should be entitled to the advantages of tax exemption. But unfortunately the use of words “irrespective of the nature or use of application or retention of the income” is diametrically opposite to the views.

The genuine Charitable organizations deserve encouragements from the Government and they are thought of mostly at the times of Natural Disasters like Tsunami and earthquakes and forgotten during other times like the Budget formulations. The Finance Minister has taken care of the interest of Agricultural Marketing Committees and Chamber

of Commerce, but the interest of the Charity sector is alone not taken care of. Though even at the time of the reply to the budget debate, the Finance Minister has indicated “I once again assure the House the genuine charitable organizations will not in any way be affected”, the sector still has its own apprehensions. The Finance Minister has also indicated that the Central Board of Direct Taxes will be following the usual practice and issue explanatory circular containing guidelines for determining whether an entity is carrying on 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. The sector is still having their own apprehensions about the validity of the circular overriding the provisions, since there are many cases, where courts have supported the provisions of the Act and not the interpretations of the circulars. But the Charitable organizations can still utilize the option and can request to issue detailed guidelines about the fourth arm of Charities “**advancement of any other object of general public utility**” and exempt fully any activity undertaken by the genuine charitable organizations, irrespective of the amendment.

# Foreign Contribution (Regulation) Act, 1976

## - Key Areas

- Manoj Fogla, F.C.A.

*Income Tax Act, 1961 & Foreign Contribution (Regulation) Act, 1976 are two enabling laws under the present legal framework for Voluntary Organisations in India. This article aims to discuss some of the key areas of Foreign Contribution (Regulation) Act, 1976 where many organisations often seek clarification.*



One of the sources of contribution for a Voluntary Organisation is receipt of funds from overseas donors. However receipt of funds by a voluntary organization in India from overseas is governed by a specific law, Foreign Contribution (Regulation) Act, 1976 (hereinafter referred as 'FCRA'). FCRA was passed by the Indian Parliament and received the assent of the President of India on 31st March, 1976. The preamble to the Act reads as follows :

"An Act to regulate the acceptance and utilization of foreign contribution or foreign hospitality by certain persons and associations, with a view to ensuring that parliamentary institutions, political associations and academic and other voluntary organisations as well as individuals working in the important areas of national life may function in a manner consistent with the values of a sovereign democratic republic, and for matters connected therewith or incidental thereto."

### Genesis

The main purpose behind the enactment of FCRA was to curb the use of foreign funds and hospitality for nefarious and anti-national activities or purposes. The idea was to regulate the acceptance and use of foreign contribution so

that the recipient institutions and individuals function in a manner consistent with the values of a sovereign democratic republic. The Ministry of Home Affairs, Government of India was assigned the responsibility of implementing FCRA. The protection of sovereignty, democracy and republican nature of the Indian Government forms the basis of FCRA.

The need for having such regulatory law was felt in the late sixties when foreign agencies including CIA were suspected of having links with various trade unions, student bodies, youth organisations, political organisations etc. The then Home Minister in 1969 raised this issue in both the Houses of Parliament and the need to regulate foreign funding was discussed. It was agreed that the government would not allow foreigners or foreign money to dictate or influence the functioning of the Government, Political Parties and Other Institutions of India.

Some of the essential compliance required under FCRA are :

In order to receive foreign funds, a voluntary organization has to obtain either a permanent registration or a prior permission with the FCRA Department under the Ministry of Home Affairs (MHA), Government of India. An organization has to apply for registration in the prescribed

form (in Form FC 8 for permanent registration or in Form FC 1A for prior permission as the case may be.)

Such funds are to be received in a designated bank duly approved by the MHA. Change of this bank account is not possible without prior approval of MHA.

Separate Books of Account is required to be maintained by the organization receiving Foreign Contribution.

Annual filing of Balance Sheet and Receipts & Payments Account for Foreign Contribution in Form FC-3 on or before 31<sup>st</sup> July.

#### **Some of the key areas :**

#### **□ Business / Consultancy Receipts of Charitable Organisation**

##### **- Should Business/Consultancy income be considered as a part of Foreign Contribution**

Consultancy fees received by an NGO is not a grant or a voluntary contribution. It is received against services rendered, therefore, the question arises whether it should be considered as foreign contribution or not. The FCRA does not specifically say that, 'foreign contribution' shall not comprise transaction of commercial or professional in nature, further the purpose of FCRA is to restrict foreign receipt to certain categories of persons and organisation. NGOs belong to one such conditional category of receivers of foreign funds i.e. NGOs in order to receive foreign funds have to comply with the provisions of FCRA. On the other hand, private individuals are not required to comply with any conditions to receive foreign contribution except in the nature of scholarship or stipend exceeding

Rs.36,000/- per annum. NGOs in receipt of foreign funds are subject to regulation of FCRA. In our opinion, even the business receipts/consultancy fees of an NGO should be shown as foreign contribution income in Form FC-3.

#### *Interpreting the definition of 'Foreign Contribution'*

Further, section 2(1)(c) defines foreign contribution as follows: " foreign contribution" means the donation, delivery or transfer made by any foreign source —

- (i) of any article, not being on article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, does not exceed one thousand rupees :
- (ii) of any currency, whether Indian or foreign;
- (iii) of any foreign security as defined in clause (i) of section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973)

On analysis of the above definition, we can have the following possible modes of foreign contribution:

- (i) Donation of any article
- (ii) Donation of any currency
- (iii) Donation of any foreign security
- (iv) Delivery of any article
- (v) Delivery of any currency
- (vi) Delivery of any foreign security
- (vii) Transfer of any article
- (viii) Transfer of any currency
- (ix) Transfer of any foreign security

The above modes are wide enough to include any conceivable form of foreign receipt by an NGO. Further, the intent of FCRA to include all kinds of receipts under 'foreign contribution' is also emphasised in section 8, which applies to restricted individual like political, journalist, government servant, etc. This section provides that receipt such as salary, wages, business, remittances, commission, gifts can be accepted without the prior permission. The moot point here is that, even though the aforesaid receipts are excluded, but, they are considered as 'foreign contribution'. Otherwise, the question of exclusion would not have arose.

*No exceptions provided for NGOs*

The FCRA does not provide any exceptions to the foreign contribution receipt of NGOs as it does for restricted individuals under section 8. Under the provision of section 8, the individuals restricted from receiving foreign contribution (under section 4) are allowed to receive certain kind of foreign contribution, such as salaries, business receipts etc. The provision of section 8 are as under :

*“ Persons to whom section 4 shall not apply*

The provisions of Section 4 of FCRA shall not apply to the acceptance of any foreign contribution by any person specified therein if such contribution is accepted by him :

(a) by way of salary, wages or other remuneration due to him or to any group of persons working under him, from any foreign sources or by way of payment in the ordinary course of business transacted in India by such foreign source;

**or**

(b) by way of payment, in the course of international trade

**or**

commerce or in the ordinary course of business transacted by him outside India;

**or**

(c) as an agent of foreign source in relation to any transaction made by such foreign source with Govt.

**or**

(d) by way of gift or presentation made to him as a member of any Indian delegation, provided that such gift or present was accepted in accordance with the regulation made by the Central Govt. with regard to the acceptance or retention of such gift or presentation;

**or**

(e) from his relative when such foreign contribution has been received either with the previous permission of the Central Govt. or where it does not exceed Rs.8000 per annum and an intimation is given by him to the Central Govt. as to the amount received, its source and the manner and purposes for which same was utilised by him;

**or**

(f) by way of remittance received in the ordinary course of business, through any official channel, post office or any authorised dealer in foreign exchange under FCRA”

There is no provision under FCRA, which allows NGOs to receive any kind of foreign contribution without having FCRA registration. Therefore, NGOs cannot be equated with private individuals or commercial organisations who are entitled to receive foreign contribution in the normal course of business, trade, employment, etc.

In the light of the above discussions, it seems that NGOs should not accept even consultancy fees or any other business receipts without having prior permission or FCRA registration. Further, such receipt should be shown/reflected in the Form FC-3 return as well as in foreign contribution Cash book.

#### □ **Course Fee/Consultancy Charges from NRI's and Foreigners**

In India many NGOs provide consultancy and training courses to foreign clients and students. An NGO without FCRA registration should be careful about receiving course fee/training charges from foreign nationals. It may be noted that, even if such fees are received in Indian Rupees in India, they will be treated as foreign contribution. On the other hand foreign currency received from NRI's may not be considered as foreign contribution. Therefore, it becomes important for the organisation to properly segregate the domestic and foreign component and there should be no inter-mingling of funds.

#### □ **Other Aspects of FCRA**

##### - **Second and Subsequent Recipient**

Under Section 2(1)(c) of FCRA, “foreign contribution” means the donation, delivery or transfer made by any foreign source of any currency whether Indian or Foreign.

The above definition of foreign funds was enlarged by FCR (Amendment) Act 1985 wherein an Explanation was inserted which is as follows :

**Explanation :** A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause;

The effect of this explanation has brought the subsequent receipt of foreign funds within the scope of foreign contribution. Therefore if an organisation receives funds which are foreign funds received by another organisation, they still will be considered as foreign funds even if they are received locally in Indian currency. Thus, organisations have been debarred from making contribution to organisation not registered under FCRA. It is mandatory for the second or subsequent recipients to possess FCRA registration or prior permission.

##### - **Revolving Funds**

Another aspect that most organizations deal with is about the Revolving Funds. We all are aware the NGOs provide loans to the communities and self-help groups (SHGs) through Revolving Funds.

The implication of this fund under FCRA is another area where many organisations seek further information.

As already discussed, the second or subsequent recipient is also required to possess FCRA registration or prior permission. Therefore on strict interpretation of FCRA laws, it is not possible to give revolving funds as loans to community based organisations not possessing FCRA registration. The intent of statute does not seem to be in favour of preventing deserving village based organisations from availing funds meant for them. The amendment made in FC-3 vide GSR 557 (E) dated 36th July, 2001 has specifically included Micro Finance Projects and SHG as purpose of utilisation of foreign funds.

In our opinion and in the light of the amended FC-3, funds disbursed for revolving funds and micro finance activities should be shown as utilisation in FC-3 and also as expenditure in the Income and Expenditure Account. When loans are recovered the money should be re-deposited in the FCRA bank account and should be considered as foreign contribution received and when the loans are given out again the same should be considered as utilisation and expenditure in the year of the disbursement. For control purposes, separate records of the disbursements or receipt of the revolving funds should be made.

For large organisation having project in various parts of India it may be difficult to redeposit in the designated bank account. But under the prevailing provisions of FCRA, it is advisable to receive all such recoveries in the designated bank account only.

#### **- *Transfer to general fund***

It has been seen that, many NGOs transfer the surplus of income over expenditure to the general fund in the domestic books of account. A general fund being an unrestricted fund at the discretion of the organisation is at times confused to be a domestic fund. But, all funds created from foreign contribution should be reflected in FC books of account only. As a result, an organisation can have two general funds, one, created from foreign funds and other from domestic funds. The same is true for the corpus and other funds also.

#### **- *Activities of NGOs in other countries***

One of the senior NGOs leaders once remarked that “Foreign funds are like toothpaste coming out of the tube, once it is out, it is virtually impossible to put it back”. To do activities in other countries an NGO may have to transfer funds in foreign currency to another country. Such transfer, would be subject to Foreign Exchange Management Act. Further, it may be noted that even if an NGO is entitled to transfer funds to another country under Foreign Exchange Management Act, the NGO may be under a threat of losing exemption under section 11 of Income Tax Act, 1961, because under section 11(1)(c), NGOs are not allowed to spend money outside India, unless, it helps in promoting international welfare in which India is interested. In the light of the above difficulties, NGO should be careful in initiating activities outside India.

#### **- *Treatment of small donations and grants***

Many charitable organisations receive voluntary grants and donations in small amount from various domestic and international sources. Normally small



contribution do not come with any specific instructions regarding the manner in which they should be utilised. In that sense, they are discretionary and general in nature. Many organisations have practice of treating such small donations as corpus donations. But under Income Tax Laws, irrespective of the amount involved a corpus donation should always be supported by the written consent of the donor. Further, it is not advisable to treat small donations as corpus donations. Small grants or donations should be treated on par with other income of the organisation and accordingly should be utilised for the purposes of the organisation.

**- *Mingling of small domestic contribution with foreign contribution***

The organisation should distinguish between domestic and foreign contribution. Only foreign contribution should be received in the designated bank account. Possibility of mingling of domestic donation with foreign contribution is there because even funds from overseas in foreign currency may be domestic

donation. For example, donation received from an NRI in foreign currency is not a foreign contribution if the NRI holds a valid Indian passport. On the other hand donation received from foreigner in India in Indian rupees is a foreign contribution.

So an organisation should take great care and caution in segregating the foreign contributions and domestic contribution. Accordingly only foreign contribution should be received in the designated bank account and reflected in the FC books of account.

**- *Treatment of undisclosed/anonymous donations***

Many organisations, at times, receive funds through direct credit in their bank account from various overseas sources where the donor's identity may not be available. In such a case the organisation should ask its bank to trace the source of donation i.e. identity of donor, origin of country. The details if obtained from the bank should be reported in the Form FC-3 else the organisation should report in Form FC-3 all such anonymous donations on the basis of bank advices.

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*For any further details regarding FCRA , you may log on to the web-site [www.fcraforngos.org](http://www.fcraforngos.org)*

# Creation of Specific Funds and their Investment in Voluntary Organizations in India

- Sanjay Patra, F.C.A.

## I. Introduction

Voluntary organizations are generally dependent on grants and donations to undertake their activities. The whole area of generating resource in order to implement the program is still an evolving area.

## 2. Types of Income

Ideally an organization needs to have a good mix of

- Grants and Donations
- Income earned/ generated from income generating activities
- Return on Investment

### □ **Grants and Donations**

These funds are generally ear-marked funds for a particular project which also specifies activities in the region. Non ear-marked grants and donations are increasingly becoming rare nowadays.

### □ **Income earned/ generated from income generating activities**

Many voluntary organizations undertake income generating activities which are incidental to their

own activities, for e.g. if an NGO is working with a particular tribal group, they may market the various goods produced by them and earn some revenue. This surplus can be ploughed back into their activities. However, with the latest amendment of Section 2(15) of Income Tax Act in 2008, these kinds of commercial activities will now come under the scanner of Income Tax department.

### □ **Return on Investment**

Many voluntary organizations as an approach to self reliance create various corpus, endowment and other funds. Here the organization receives a substantial sum of money as one time grant/ donation with the rider that the capital amount will be protected and not be used. This amount will be invested and the return on the investment will be used for the activities of the organization.

## 3. Various Funds and their Treatment

We will examine the issue of various funds and the option for the investment in greater detail under the following categories:

- Restricted and Unrestricted Funds
- Designated and Undesignated Funds
- Corpus and Endowment Fund

#### □ **Restricted and Unrestricted Funds**

A restricted fund is generally provided as a grant for undertaking specific project activities by the organization. These funds cannot be used for any other purpose except what has been specified in the strict sense of the term by the donor. Restricted fund can be both capital as well as revenue in nature. Therefore, endowment funds as discussed below can also be categorized as restricted fund.

Unrestricted funds are donation / grants given by the donor without any restriction and therefore they can be used at the discretion of the organization.

#### □ **Designated and Undesignated Funds**

Designated fund is a fund set aside by the trustees/ governing board out of unrestricted or general fund of the organization for future projects. Designated fund is different from restricted fund, in the sense that the restrictions are not external or imposed by the donors. Therefore, designated funds should be shown separately from restricted funds in the balance sheet of the organization.

Undesignated funds are those funds which are general in nature and are available for use at the discretion of the organization.

#### □ **Corpus and Endowment Fund**

The term corpus denotes the sum and substance of an issue/ entity. From a layman's point of view, a corpus should be understood as the capital of an

organization, i.e. the corpus is kept for the existence and long term sustenance of the organization. For voluntary organizations, corpus funds are of great significance. Normally corpus fund is a permanent fund kept with the organization on long term basis. It is not allowed to be utilized, but the interest / dividend accrued on such funds can be utilized as well as accumulated. Under section 11(1) (d) of the Income Tax act, any voluntary contribution made with a specific direction that they will form part of the corpus, shall not be included in the total income of the organization. Therefore, to claim a donation to be a corpus donation, it is necessary that a written direction from the donor is obtained. In the absence of a written direction from the donor, the donation would not be treated as a corpus donation and consequently will form a part of the total income of the organization. So, corpus donations are not included in the total income of the organization and therefore, are exempt from tax which means that the condition of utilizing 85% during the years as per Income Tax Act is not applicable

An endowment fund is similar to a corpus fund and at times it is even considered as a synonym of corpus. The only difference between corpus and endowment is the manner of the use of endowment fund. An Endowment fund can be created for specific purposes and can be used for them. An endowment fund is also created under a specific direction from the donor. Both corpus and endowment fund are represented by permanent assets which can be investment, deposits, properties etc. In case of endowment fund it should be noted that the funds should be kept intact and the income generated can be utilized for specific purposes.

#### 4. Mode of Investment

The mode in which these funds can be invested is already defined under section 11(5) of Income Tax Act. A list of such investments is given at the end of the Article. All funds of the organization need to be invested according to the mode specified in the above section.

However, the challenge for voluntary organizations is to protect the real value of the investment in the face of varying interest rates and devaluation of currency. For example if an organization invests Rs 1000 for a year, assuming that the interest is 8%, it will get Rs 80 at the end of the year. However, if the whole of Rs 80 is utilized, then the value of the initial investment i.e. Rs 1000 will be eroded year after year due to devaluation of the currency. So, in order to protect the real value of investment, a part of the return needs to be ploughed back into the investment. Generally it is suggested that 50% of the return on investment should be ploughed back into the investment and the rest 50% should be utilized by the organization. Therefore, in the above example only Rs 40 would be available for use by the organization.

*To work out a simple formula for the above, let us calculate, for receiving Rs 100 for the activities of the organization what will be the capital fund required to be invested, assuming the rate of return is 8 %.*

*If we invest Rs 2500 for 1 year then at the rate of return of 8% per year, we would receive Rs. 200 at the end of first*

*year. As discussed above we have to plough back 50% of Rs. 200 into the initial investment, we are left with Rs 100 for the use of the organization. Therefore, as a thumb rule, for requirement of Rs. 100, we need to invest Rs 2500. In other words the investment has to be 25 times of the amount required.*

#### 5. Method of Reporting

It is suggested that the organizations follow a fund based accounting and reporting system. This will clearly show the size of the fund as well as the mode of investment in the balance sheet. It is also recommended that for a fund size of more than Rs. 1,00,00,000/- a separate audited statement needs to be prepared showing clearly the fund balance in the beginning of the year, movement of funds during the year and the balance at the end of the year. Further, how the closing balances have been invested along with investment details should be furnished as part of the above mentioned audited statement.

#### 6. Conclusion

As can be seen from above, whereas the investment in long term funds helps the organization in attaining self reliance, the challenges are many. Firstly, for every Re.1 to be made available to the organization, it requires Rs 25 to be invested, which is a very high ratio. Secondly the falling interest rate and devaluation of currency is another challenge to cope with. Further the funds and investment need to be managed in a scientific manner within the parameter of section 11(5) of Income Tax act in order to get the maximum return.

## **Annexure A**

### **Modes of Investment of Accumulated Income under section 11 (5)**

The income accumulated under section 11(2) shall have to be invested in the modes specified under section 11(5) in order to avail exemption. The difference forms and modes of investing or depositing the money referred to it in clause (b) of sub-section(2) are provided as follows:

- (1) Investment in savings certificates as defined in clause (C) of section 2 of the Government Savings Certificate Act, 1959 (46 Of 1959) , and any other securities or certificates issued by the central government under the Small Saving Schemes of the Government:
- (2) Deposit in any account with the Post Office Saving Bank;
- (3) Deposit in any account with a scheduled bank or co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).

Explanation.- In this clause, "Scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955(23 of 1955), a subsidiary bank as defined in State Bank of India (Subsidiary Banks) Act, 1959(38 of 1959), a corresponding new bank constituted under section 3 of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970(5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980(40 of 1980), or any other

bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

- (4) Investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);
- (5) Investment in any security for money created and issued by the Central Government or the State Government.
- (6) Investment in debentures issued by , or on behalf of ,any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central or by a State Government.
- (7) Investment or deposit in any public sector company:  
**Provided** that where an investment or deposit in any public sector company has been made and such public sector company ceases to be public sector company –

- (A) such investment made in shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;
- (B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

**(8)** Deposit with or investment in any bonds issued by a financial corporation which is engaged in providing long term finance for industrial development in India and which is eligible for deduction under clause (8) of subsection (1) of section 36;

**(9)** Deposit with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long –term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (9) of subsection (1) of section 36;

**(9a)** Deposit with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long term finance for urban infrastructure in India.

Explanation- For the purposes of this clause,-

- (a) “long-term finance” means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.
- (b) “public company” shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);
- (c) “urban infrastructure” means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers for urban transport.

**(10)** Investment in immovable property.

Explanation.-“immovable property” does not include any machinery or plant (other than Machinery or Plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

**(11)** Deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);

**(12)** Any other form or mode of investment or deposit as may be prescribed. [See sub- section (5) of section 11]

Rule 17C of the Income-tax Rules, 1962, prescribes the following forms or modes of investment or deposits by a charitable or religious trust or Institution under this Clause :

**(1)** Investment in the units issued under any scheme of the mutual fund referred to in clause (23D) of section 10 of the Income tax Act, 1961;

**(2)** Any transfer of deposits to the Public Account of India;

**(3)** Deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for the

# Since you asked...

## Queries on various issues related to Provident Fund and Gratuity

- FMSF Resource Team

*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 .We have tried to address these issues from our point of view. However please note that the above opinion of ours may not be construed to be conclusive legal status on the issue. It is advised that appropriate Acts, Rules and other pronouncements may be referred. Proper legal advice may be sought before applying the above opinion.*



**YOU ASKED:** How do you calculate Provident fund contribution under Employee's Provident Funds & Miscellaneous Provisions Act 1952 and matters relating to Gratuity?

**We wrote**

### **I. Computation of Provident Fund.**

The Employees' Provident Fund & Miscellaneous provisions Act, 1952 is applicable to every establishment which is engaged in specified industries, employing 20 or more persons and drawing up to Rs. 6500/- p.m.

However, it should be noted that in the 183<sup>rd</sup> meeting of the Central Board of Trustees in July 2008 it has been reduced from 20 persons to 10 persons.

The contribution to the provident fund under the EPF& Misc. Provisions Act, 1952 shall consist of two components i.e. employer contribution and employee contribution.

The employer contribution to provident fund as per the EPF Act, 1952 shall be calculated on the Basic Wages, Dearness Allowance (D.A.) and Retaining Allowance payable to each employee. So, it will include Basic salary, D.A. and retaining allowance (retaining allowance is an allowance payable in order to retain the services of an employee).

The employer contribution shall be 10% of the Basic, D.A. and retaining allowance payable to the employee, and the employee's contribution shall be equal to the contribution payable by employer in this respect. Employee may contribute more than 10% of the Basic, D.A and Retaining

Allowance but Employers are not obliged to pay more than 10% of the Basic, D.A. and retaining allowance.

**For e.g.**

<b>Basic Salary</b>	<b>Rs. 5000/-</b>
<b>D.A.</b>	<b>Rs. 2500/-</b>
<b>Total Salary for P.F contribution</b>	<b>Rs. 7500/-</b>

<b>So, Employer contribution @ 10% of Basic &amp; D.A</b>	<b>Rs. 750/-</b>
<b>Employee contribution equal to employer contribution</b>	<b>Rs. 750/-</b>
<b>Total P.F contribution</b>	<b>Rs. 1500/-</b>

## 2. Computation of Gratuity.

Gratuity under Payment of Gratuity Act, 1972 is payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years, on superannuation, retirement or resignation or his death or disablement due to accident or disease. However, completion of five years of service will not be necessary in case of discontinuity of service arising from death or disablement.

Payment of gratuity shall be made at the rate of fifteen day's wages for every completed year of service or part thereof in excess of six months. Gratuity computation shall be based on the rate of wages last drawn by the employee concerned.

'Wages' shall mean all emoluments which are paid or payable to him in cash while on duty or on leave and will include D.A. It will not include any other allowance.

**For e.g.**

<b>Completed year of service</b>	<b>15 years</b>
<b>Wages last drawn by employee</b>	<b>15,000/- p.m</b>
<b>(Basic +D.A)</b>	
<b>Fifteen days salary</b>	<b>15/26*15,000 = 8,654/-</b>
<b>Gratuity for payment</b>	<b>8,654* 15 = 129,810/-</b>

As per the Payment of Gratuity act, 1972, maximum limit of gratuity payable to an employee under the Act is Rs. 3,50,000/-.

*Please note that the above opinion of ours may not be construed to be conclusive legal status on the issue. It is advised that appropriate Acts, Rules and other pronouncements may be referred. Proper legal advice may be sought before applying the above opinion.*



# Memorandum to the Central Board of Direct Taxes (CBDT)

**Dear readers,**

**You are already aware that section 2(15) of the Income Tax Act, 1961 has been amended by the Finance Act, 2008 whereby certain group of NGOs will not be allowed to have any business activity whether incidental or otherwise.**

**The Central Board of Direct Taxes (CBDT) is supposed to issue explanatory circular containing guidelines on it. This memorandum may be sent to:**

**The Chairman  
Central Board of Direct Taxes  
North Block  
Delhi - 110001**

Dear Sir,

The Finance Act, 2008 has amended the definition of "Charitable Purpose" under Section 2(15) and consequently certain specific group of NGOs will not be allowed to have any business activity whether incidental or otherwise. The amended section is as under:

*"Charitable purpose includes relief of poor, education, medical relief, 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 activity in the nature of trade, commerce or business, or any 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"*

In effect the above amendment has excluded the organizations registered under the forth limb from carrying any kind of trade or business related activities.

Further in his reply to the debate in the Lok Sabha on 29<sup>th</sup> April, 2008, the Honorable Finance Minister had said "...The CBDT will, following the usual practice, issue an explanatory circular containing guidelines for determining whether an entity is carrying on 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"

In light of the above, we would like to bring to your notice the following issues:

1. The current amendment speaks of business and commercial activity unlike the pre-1983 position of Income Tax Act, 1961 where it was only about “activity for profit”. This is a very fundamental shift and therefore would affect various important as well as integral activities of the voluntary sector which are done without profit motive. Some examples are
  - marketing the produce of beneficiary community
  - agricultural rural development work including vermi compost, neem-based pesticides etc.
  - small cottage industries
  - khadi production and sale
2. If some insignificant portion of the total activity is such that it can be argued as commercial activity in nature, then the entire charitable status of the voluntary organization will be in danger.
3. This amendment is going to create undue hardship to thousands of small genuine organizations working in rural areas. For example, a Gandhian organization producing and selling khadi is a case in point. Therefore, it is imperative that a base limit of commercial activity is set say Rs. 25, 00,000/- up to which incidental business activity shall be permitted.
4. It is also a very harsh provision which threatens to take away the charitable status of an organization if it is found to be carrying on commercial activity. It would be more reasonable if only the income out of business activity is taxed rather than taking away the entire tax exemption status.

5. The applicability of the provision is practically from 1<sup>st</sup> April, 2008 since it applies from assessment year 1<sup>st</sup> April, 2009. It is pertinent to note that the Finance Act, 2008 was passed only on 12<sup>th</sup> May, 2008. Therefore, it would be unfair to make it applicable from 1<sup>st</sup> April, 2008. This technical problem needs to be addressed by making it applicable from 1<sup>st</sup> April, 2009 (Assessment year 2010-2011).
6. It is absolutely necessary to clarify and exclude certain activities like workshops, trainings, incidental consultancies, capacity building, accompaniment, charity events, rural marketing meets etc. from business activities must be kept outside the ambit of business activity.
7. The objective articulated in “National Policy on voluntary sector” prepared by Planning Commission, Government of India and adopted by the Union Cabinet states
  - To create an enabling environment for voluntary organizations that stimulates their enterprise and effectiveness and safeguard their autonomy;
  - To enable voluntary organizations to legitimately mobilize necessary financial resources from India and abroad.

This amendment would work contrary to the above objectives and would seriously jeopardize the efforts for self reliance of voluntary organizations.

Sir, the Finance Minister had also assured on the floor of the Lok Sabha on 29<sup>th</sup> April, 2008 that “.....I once again assure the house that genuine charitable organizations will not in anyway be affected”

Therefore, we urge you to kindly keep the above issues in mind and issue the necessary explanatory

circular to clarify them so that the noble cause for which these NGOs are working will not be affected.

Yours Sincerely

---

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## Launch of “Standards & NORMS” !!!

Dear Readers,

We are happy to announce the launch of Standards & Norms, a monthly communiqué which aims to provide relevant information and guidance on NGO Governance, Financial Management & Legal Regulations.

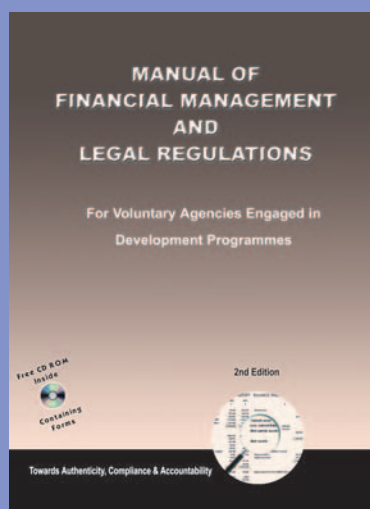
Standards & Norms is a joint initiative of FMSF, VANI & Indianngos.com.

Henceforth, **INTERface** will now be published as a six monthly journal and along with this journal, you will receive the copies of the Standards & Norms published during that period.

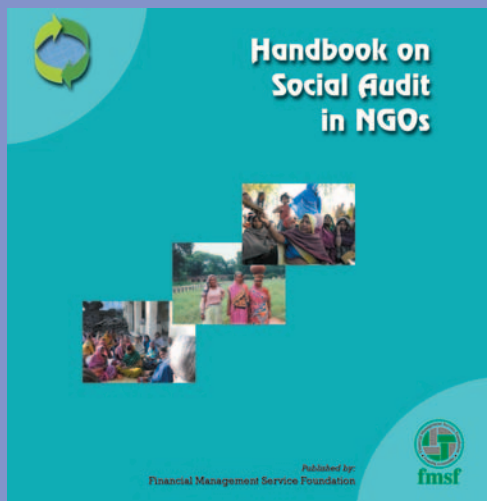
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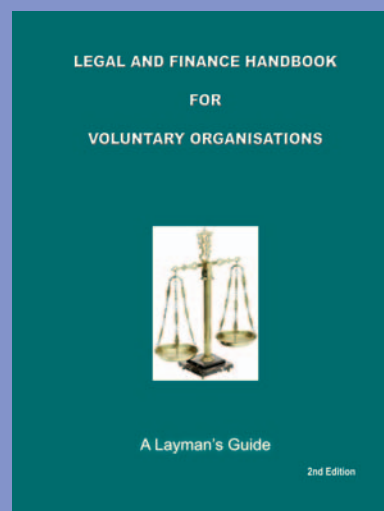
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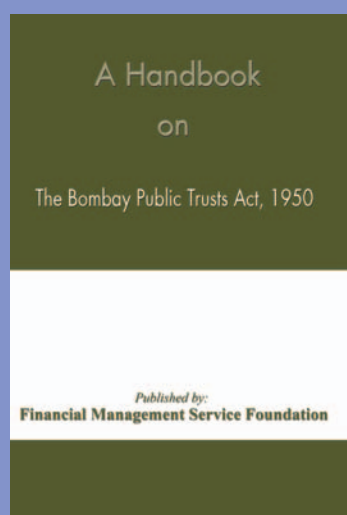
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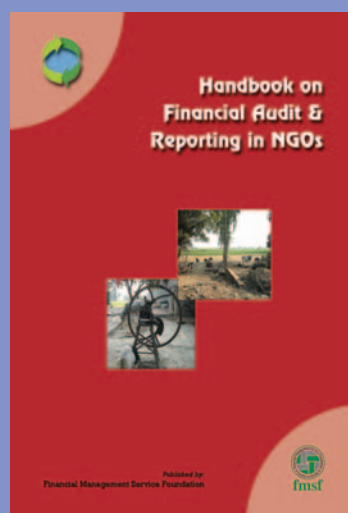
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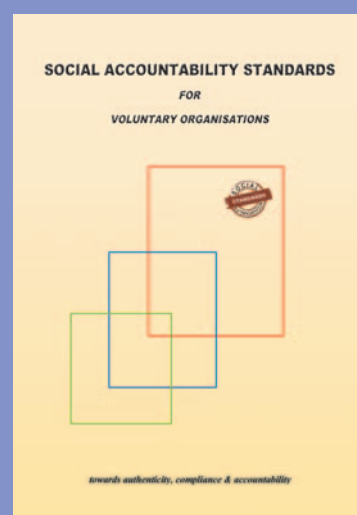
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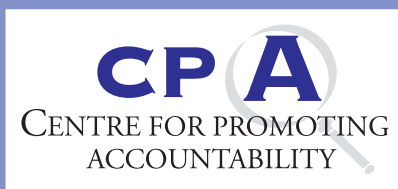
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