INTER *face*

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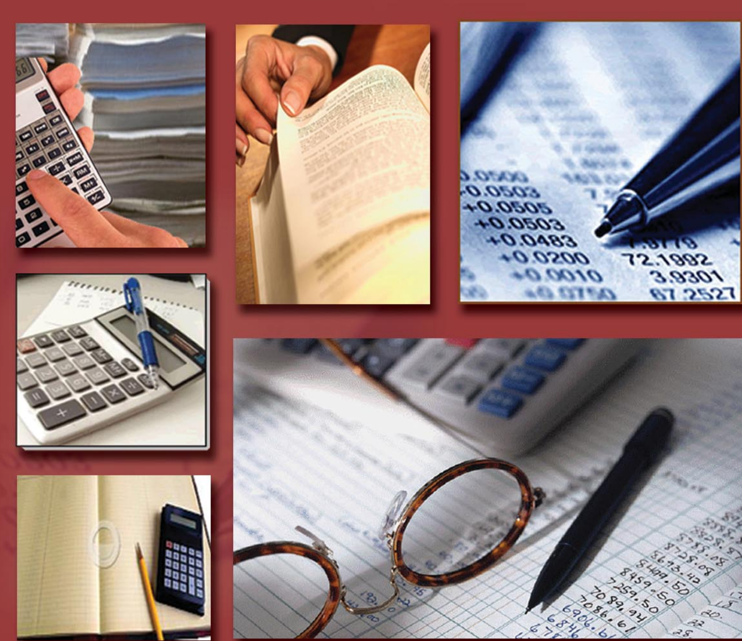

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Between Us ....

Urgent vs. Important

One day, an old professor was called as an expert to speak on the more efficient way of planning.

Standing up, he took from under the table a large empty glass. At the same time he also took a dozen large stones like tennis balls that he deposited delicately one by one in the glass until it was full. When no more stones could be added, he asked his pupils: 'Do you think the glass is full?' and they all answered 'Yes!'

"He bent down again and took out from under the table a box full of crushed stones which he poured over the large stones, moving the glass so that the crushed stones could infiltrate between the large stones to the bottom. 'Is the glass full this time?' he asked. Becoming more prudent, the pupils began to understand and answered: 'Perhaps not yet.'" And thus the professor continued with sand, and finally water, each time able to put more into the glass.

At this point he asked: 'What great truth does this experiment show us?' One student replied: 'This demonstrates that even when our agenda is completely full, with a bit of good will, we can always add some new endeavor, something else to do.'

No, answered the professor. ***'What the experiment demonstrates is that if one does not put the large stones first in the glass, one will never succeed in making them go in afterward.'***

What are the big stones that we should be handling first? Take some time and decide! Let not the urgency take away your handling of "Important" . So look for the big stones first and handle them! Other things can be tackled eventually!

Charities to be in Tax Net???
Implications of the Direct Tax Code Bill

Sanjay Patra, *FCA*

1. Introduction

Since last more than 6 decades, the voluntary sector has been working for the welfare of the general public and marginalized sections of the society. The charitable purpose and nature of the sector has also been appreciated by the Government of India in the past. The Government distinguishes it from the other sectors of the economy by giving certain exemptions to the organisations working for a charitable purpose.

Since the introduction of the Income Tax Act in 1961, certain exemptions have been provided to charities from payment of Income Tax. However, these may not be there any longer if the proposals of the Government are passed in the Parliament. The current Income Tax Act was enacted almost 48 years ago. In order to replace the present Act, the Government has announced its intention to introduce a revised and simplified Income Tax Bill while presenting the Union Budget for 2005-06. The Finance Minister Shri Pranab Mukherjee has released the draft of the Direct Tax Code Bill on 12th August 2009 to replace the present Income Tax Act, 1961 and Wealth Tax Act, 1957.

In this Bill, special provisions relating to taxation of Income of Non Profit organisations have been made. Section 86 to 96 of Chapter IV of the said Code relates to the Special provisions for the taxation of Non Profit organizations and the method of computation of the total taxable Income.

In this Bill, special provisions relating to taxation of Income of Non Profit organisations have been made. Section 86 to 96 of Chapter IV of the said Code relates to the Special provisions for the taxation of Non Profit organizations and the method of computation of the total taxable Income. The key issues of the said bill have been detailed below.

2. **Key Issues**

- The proposed Code has replaced the term 'Charitable Purpose' with 'Permitted Welfare Activities'. Though the definition remains the same, there is a radical shift in approach. The Government will now emphasise not on the purpose but on the activities performed by the organisation.

- Till now, the voluntary sector was given certain privileges due to the charitable nature. The existing Act provides for computing the exemption available to NGOs, but the proposed code provides that the taxable income of an NGO shall be computed on the basis of the method provided in the code. Again there is a radical shift in treatment of NGOs from exempt entities to tax paying entities.

- The organisations involved in this sector were required to register with the Income Tax Act under various sections depending upon the type of activities performed. They could register themselves under section 12A or 10 (23)(c) of the Act., However, the concept of different registration for NGOs under section 10(23C) and section 12A have been deleted through the proposed Code and there will be only one form of registration for all NGOs.

- Under the Income Tax Act, 1961, the NGOs could give the benefit from tax for the donations made to them to their donors. However, with the proposal, incentive u/s. 35AC which provides 100% deduction to the donors has been deleted. Under the proposed code, the donors can get only 50% deduction on the donations.

- Religious trust or NGO have been kept out of the purview of the Act. However, they may have to get themselves registered under appropriate statutes.

- At present, the NGOs have the option to spend 85% of the funds received during the year and carry forward the remaining funds to the coming years. With the proposed amendment, the benefits of 85% of application and 15% indefinite application has been deleted. The NGOs have to spend 100% of the funds during the year itself.

- The benefit of utilizing unspent funds in the succeeding year under explanation to section 11(1) has been deleted. This means that, if an NGO is unable to spend its funds during the year for reasons such as late receipt of fund, then the entire unspent amount will become taxable.

- The benefit of utilizing unspent funds in the next five years u/s. 11(2) has been deleted. In other words if an NGO is unable to spend its funds during the year and it wants to apply the same in the next five years, it is not possible and the entire unspent amount will become taxable.

- The new Code has proposed various new terms for assets, such as ‘financial assets', ‘investment assets' etc., which have not been defined from a NGOs perspective.

- The new Code prohibits investments in ‘financial assets'. This provision may imply that even creating Fixed deposits may become difficult.

- The existing Act allows exemption on all types of capital gain, provided the entire amount is reinvested in another asset. However the proposed code partially allows this benefit. The capital gain from financial assets will be subject to tax. It may be noted that it is not clear what a financial asset is.

- The existing Act provides that all kind of capital expenditure are permissible if applied for the purposes of the NGO. The proposed Code does not allow capital expenditures towards financial assets.

- The existing Cct allows depreciation as a valid expenditure. The proposed Code has completely ruled out the possibility of claiming depreciation.

- The existing Act allows accrual as well as cash basis of accounting. The proposed Code prescribes only cash basis of accounting as well as admissibility.

- Under the existing Act, by virtue of Supreme Court ruling in THANTI Trust case, even unrelated business activity is permissible. However the proposed Code clearly provides that business can only be carried as a part of welfare activities.

- Under the existing Act, the business activities of the 6th category NGOs are not permissible, i.e. NGOs engaged in advancement of any other general public utility. The same has been retained in the proposed Code.

- The existing Act is silent but the proposed Code provides that if an NGO convert itself into a commercial organisation then its entire net worth will be taxed at the rate of 30%.

- The existing Act is silent but the proposed Code provides that if an NGO fails to transfer, on its dissolution, assets to another NGO, then its entire net worth will be taxed at the rate of 30%.

- The existing Act is silent but the proposed Code provides that if an NGO ceases to be an NGO in the financial year and any two financial year out of the preceding four years, then its entire net worth will be taxed at the rate of 30%.

- Under the existing Act expenditure outside India are permitted for specific purposes. The same has been retained in the proposed Code. However under the existing act NGOs registered under section 10(23C) can have activities outside India, this provision is deleted.

- Under the existing Act there is no compulsion of having some activity during the year. The proposed Code requires that NGO has to have welfare activity. If an organisation does not have welfare activity in three out of five years then the entire net worth will become taxable.

- Under the existing Act businesses can be held as corpus assets. The proposed Code does not allow any such benefits.

3. Critical areas for our attention

There are certain matters in the said proposal which should be considered again by the Ministry.

- Considering Gross receipts as income for the year is totally unfair as there are certain receipts by the NGOs which are not actual receipts but reimbursement for activities done during the year. Further, legal obligations and contract bound receipts should be kept out of the purview of Income.

- 100% application of funds during the year of receipt should not be mandatory. There may be certain receipts which are received on the last day of the year and the same cannot be applied for the designated purposes during the same year.

- Depriving NGOs from performing international activities would be highly detrimental to them and also to the nation.

Tax reforms are welcome if they simplify the processes and make life easy for the organisations/ individuals covered by it. The Tax Code Bill, if passed in the present form would have far reaching impact and cause hardship to NGOs.

- This provision of taxing the entire net worth at the rate of 30%, if the NGO does not have activities, needs to be reconsidered. Because NGOs, generally, depend on external grants and assistance and it is likely that there might not be any activity in some year.

4. Conclusion

Tax reforms are welcome if they simplify the processes and make life easy for the organisations/ individuals covered by it. The tax code bill if passed in the present form would have far reaching impact and cause hardship to NGOs.

Therefore, there is a need to reconsider some of the issues highlighted above. This will help in improving the effective compliance to the law and help in implementing the activities of NGOs without legal hurdles. It is sincerely hoped that the makers of law would listen to the voice of reason.

Governance and Board Processes of NGOs

Manoj Fogla, *FCA*

1. Introduction

The main object of this standard is to provide clarity about the induction, role and function of Trustees / Board Members. It should also help in assessing and enhancing the quality and accountability of trusteeship and governance.

2. Key Questions on Governance and Board Processes

- What kind of governance structure does the organisation have ?

  (A governance structure can be single tier or dual tier. For instance, a Trust is a single tier structure where the Trustees are the final reference point of decision making, on the other hand a company or a society have two tier governance structure where the board is constituted by another larger body called the general body.)

- Whether the structure is closely held or broad based ?

  (When an organisation has a board of less than 7 members and general body of less than 12 members for long periods, (say 7 years) it can be considered as a closely held organisation.)

- Does the organisation have trustees or board members who are permanent in nature ?

- The name and percentage of trustees or board members who have served for more than 15 years on the board either continuously or through intermittent tenures.

- Whether the board of the society is having two or more close relatives ?

- Is there a clear distinction between executive leadership and legislative leadership ?

  (For instance, the Chairman should not be the Executive Director or CEO)

- Is the board independent enough to recruit, control and govern the CEO ?

- What is the gender balance in general body and board members ?

  (Less than 25% of either women or men in the general body or board should be considered as inequitable gender balance).

- What is the percentage of persons drawing salaries or other benefits on the board ?

  (More than 40% of the board members shall not draw salaries or benefits as it will start blurring the distinction between the Governance and the Administrative Management).

- What is the mandate of the Board ? Can it be said that there is an ideal and clear distinction between the role and function of the board and managerial staff?

NGO should exemplify openness and transparency by having desirable criteria for selection and rotation of trustees

3. Prelude to NGO Governance and Board

NGOs deal in public money for public utility purposes, however for legal and practical purposes the ownership of all funds lie with a group of people.

A good NGO should exemplify openness and transparency by having desirable criteria for selection and rotation of trustees.

The NGO law normally varies from country to country and normally within the country also there are various kinds of registration which permit different board and trustee structure. For instance a public charitable trust can be formed with one or two trustee who are permanent in nature. Such law belong to an era when charities were entirely based on the funds / assets bequeathed by a particular donor/ author. But when such trust are registered for fund raising and donor based projects, it raises a serious question mark on the public ownership of the NGO. Similarly various other forms & registration also provide the possibility of the ownership being in the hands of a private group of persons.

NGOs also struggle in defining the role and responsibilities of the trustees which results in a governance imbalance where the board may hinge from being dormant to overactive and interfering.

The different forms of registration also create different ownership structures, for instance in a trust there is no provision for general body, but in case of a society there can be a general body which appoints the board.

The board should not have members who are permanent in nature except the case of institutional nomination.

The diversity of skills and the ability of the board member to assume and exercise authority also require careful support from the policies and norms. This standard endeavours to address some of such issues.

4. Composition of the Board

The board should be ideally between five to ten members unless the legal requirements are different.

The board should not have members who are permanent in nature except the case of institutional nomination. In case of a trust normally a clause regarding permanent trustees is found, in such instances it is desirable that the total voting right of the founder trustees is less than 50%.

The composition of the board should be clearly defined in terms of the diversity of the skills required for discharge of the board functions. The balance of the board should be maintained in terms of gender, finance & other specialised skills, stakeholders and distance & availability.

Not more than 2-3 employees should be board members with voting rights or at any point the employees participation should not exceed 40% of the board members. If two or more employees are on the board then they should not be relatives.

5. Election/Selection of the Board Members

There should be a clearly defined policy for recruitment, election, selection of trustees or board members. The induction of new trustees should be through an open process providing the opportunity of being elected/selected to a wider group of stakeholders. The process should include use of methodologies such as advertising for new trustees through various medium.

The board members should retire and be re-elected on the basis of rotation. For instance every two years a third of the board can retire. Though the board members usually get re-elected but the technical possibility of replacing the entire board in an election process should be avoided.

6. Board Processes

There should be a process for orientation and sensitising of the trustees regarding their responsibilities in particular as well as in general.

There should be a process through which clear distinction between strategic matters and operational matters should be made and a position paper should be drafted and revisited annually.

The board should set key performance indicators for themselves.

The board should meet once at least in every quarter.

An annual report on the financial or other contributions of the board members should be prepared to assess the stakes and ownership of the board members.

7. Roles and Responsibilities

- The board should formulate the mission statement of the organisation and should revisit it every three years in order to ensure that the programmes and resources are in consonance with it.
- The board should formulate the structure of authority and responsibility to be delegated to the CEO and other staff.
- The board should determine the procedure of electing/selecting the CEO and the compensation thereof.
- The board should formulate important policy documents and guidelines on gender, human resource, finance etc.

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- The board should appoint the statutory auditor and the internal auditor if required. Both the auditors should directly report to the board.
- The board should determine and approve the annual budget and allocations.
- The board should determine and approve the bank accounts to be operated and the signatories thereof.
- The board should develop proper policy and systems regarding the title, safeguard, location and verification of fixed assets.
- The board should ensure strict adherence with all statutory compliances. It should also ensure that requirements/ obligations towards other stakeholders is diligently done.
- The board should constitute advisory committees for special functions or for specific purposes.
- The board should review the performance of the CEO and other senior management staff on annual basis.
- The board should prepare a position paper every three years on issues such as

(i) Financial Sustainability, (ii) Institutional Sustainability, (iii) Programmatic Sustainability, (iv) State, need and relevance of corpus, endowment and general funds, (v) Risk and contingencies.

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

- approval of projects and activities to be undertaken;
- periodical perusal of the reports from the Secretary and other key functionaries;
- approval of purchase of assets for large financial transactions;
- approval of project budgets and investments;
- finalising annual financial state-ments;
- staff capacity building measures;
- appointment of staff;
- internal control measures;
- resource mobilisation, etc.;
- Having commercial interest in any decision or resolution.

The Board of Directors of the trustees should declare such interests. The interested trustees and directors should not participate in the decision making and voting process for that particular resolution. An annual declaration of such interests should be placed in the annual general meeting.

8. Conflict of Interest

There should be a clearly defined policy to ensure that any conflict of interest is properly dealt with. The issues which may be regarded as material interest are as under :

- Appointment of relatives in board or senior management;
- Ownership or partial ownership in organisations which are engaged or may seek business or consultancies;
- Payment of fees and remuneration;
- Directorship or management position in other NGOs;
- Providing consultancies in personal capacities.

9. Ex-officio Board Members

The memorandum of association of the society can be suitably drafted so as to have provision regarding Ex-officio board members. An Ex-officio board member denotes the right of a particular formal position holder to participate and vote in the board proceedings. For instance, an NGO may provide that the District Magistrate will be one of the board members, then who ever is the District Magistrate will automatically have the right of a normal board member.

An Ex-officio board member denotes the right of a particular formal position holder to participate and vote in the board proceedings.

10. General Members

The NGOs registered under the Societies Registration Act or under the Companies Act or any other law which require both the general body and the board, should ensure that there is a transparent and appropriate policy regarding general members and general meetings.

The general body should be the body of general members with equal voting rights. The membership should be open to all section of stakeholders. The size of the general body is determined by the nature of NGOs work, generally movement based NGOs have larger general body. However normally the size of general body should vary between ten to thirty members. The general body should always be larger than the board.

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Vouchers and their Preparation

1. Introduction

Every transaction whether receipts or payment should be supported by vouchers. Vouchers are normally prepared to record cash & bank transactions . For cash and bank transactions separate vouchers for receipts and payments are made. Payment vouchers which are the most important and the most frequently used vouchers are known as **Debit Vouchers.** The receipts vouchers are known as **Credit Vouchers.**

Vouchers are also required for transactions other than cash & bank. These vouchers are required while passing adjustment entries and are known as **Journal Vouchers.**

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2. Objective Of Vouchers

Vouchers are prepared to have proper evidence/ supporting of financial transactions. The presence of proper vouchers makes a financial transaction independent and verifiable. The vouchers also are necessary to establish safe administrative procedures and enable proper recording of transactions.

3. Notes in Preparation of Vouchers

All vouchers should contain the following information:

- Voucher Number
- Date of transaction
- Nature of transaction
- Amount in words and figures
- Account head to be debited/ credited
- Person who has prepared the voucher
- Authority who has passed it
- Supporting documents

Each voucher should be supported by third party documents such as bills, cash memos, letters, etc. Where secondary support documents are not available then self attested documents may be given in their place. In such cases all the details must be narrated so as to make it convincing to the auditors, funding agency and statutory authorities. The self-generated vouchers should be approved specifically by the requisite authority.

All vouchers, whether cash or bank or journal, should be approved by an authorised person, other than the accountant who prepares the vouchers.

For payment above Rs.5000/-, a revenue stamp of appropriate value must be affixed and the payee or the person authorised by the payee should sign and write his/her name and address.

If the voucher is supported by a third party bill cash memo then no receipt on the voucher with a revenue stamp is required.

It is suggested that a rubber stamp in the name of the respective funding agency should be stamped on the voucher and its support. This would ensure its correct accounting to the respective funding agency .

It is also suggested that a 'Paid' stamp be put on the supportings and voucher in order to avoid double payments being made for the same support.

Various vouchers should be distinguished by using paper of different colour , which, for example, could be coded as follows :

1. Cash Vouchers (White in colour)

2. Bank Voucher (Yellow in colour)

3. Journal Voucher (Pink in colour)

The vouchers or the support documents should not be overwritten and white correction fluid should not be used unless it becomes absolutely necessary and is approved by the chief functionary.

4. Receipt Vouchers

All income or receipts should be recorded through a receipt or credit voucher. As far as grant/donations are concerned these are generally of two types, corpus grant and other grants for the NGOs concerned. Whenever corpus grants are received they should be supported by a letter from the donor concerned wherein it should be specifically mentioned that it is a corpus grant. If the institution concerned has 80G exemption for the donations from the Income tax authorities, the NGO concerned should print the reference number and validity period of the same on the official receipt or use a seal which can be affixed on the receipt giving number of the certificate, date and the period for which the exemption is valid.

Receipt vouchers/book should generally contain the following :

- It should be serially numbered.

- A duplicate copy of the receipt should be retained for record.

- The address of the donor should be given on the receipt, it may be noted that with effect from 1st April 2006 anonymous donations are subject to tax.

- Every receipt should be signed by a responsible/ authorised person.

- Separate receipt books must be kept for the foreign contributions, local contributions, for other income and receipts.

- The receipt books should be continued year to year .

- There should be a record of how many receipt books and of what serial numbers have been printed, which ones are in use and where the balance are.

- Proper follow up of receipt books given to the staff for outdoor collection should be made so as to avoid misuse.

- Receipts should be properly acknowledged with revenue stamp.

The vouchers or the support documents should not be overwritten and white correction fluid should not be used unless it becomes absolutely necessary and is approved by the chief functionary.

5. Statement of Expenses

The purpose of preparation of Statement of Expenses is to consolidate the expenses of an activity or the particular period by a particular person, in a single format with relevant information about the various expenditures incurred.

After completion of an activity or a programme tour the concerned Programme staff should collate all the vouchers & information & consolidate with the statement of expenses.

This statement must be accompanied by a) Name and address of the participants, b) Vouchers for all Expenses, c) Brief Report of the programme by the concerned staff, d) Statement of date-wise distribution of expenses such as conveyance, lunch, dinner etc.

The Finance department should scrutinize the details before the expenditure are approved for payment or adjustment against earlier advances.

7. Travel Form

Organisations are advised to use two type of travel form. One for the payment to resource person and participants from outside for attending programme/ meetings and other for the programme staff. Both the form should provide relevant information about the activity or the purpose for which the travel was made or reimbursed. Such form should be supported by the original secondary documents such as tickets, petrol bills, etc.

7. Summing Up Notes :

- Vouchers should be properly supported.
- The contents of the voucher should be adequate and separate colour vouchers should be used for cash, bank and journal.
- Statement of expenses and travel should be properly documented and supported by relevant third party documents

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

Filing and Documentation of Records

1. Filing Systems

All organisations including NGOs should build proper filing systems. It is very important that all the useful and important documents and records are properly filed and kept in a secured way in order to ensure easy and systematic accessibility. Usually tracing the papers and documents becomes a time taking and tedious job if proper filing system is not in place. A good filing system enhances the efficiency and institutional memory of the organisation.

Files should be numbered and they should have an identifiable place from where they can be easily retrieved. Files may be classified as :

- Cash payment voucher file
- Cash Receipt Voucher file
- Bank payment voucher file
- Bank receipt voucher file
- Journal voucher file
- Fixed assets file
- Fixed deposits file
- FCRA record file
- Foreign contribution projects file
- Local contribution file
- Income tax files
- Registrar of Society file
- Telephone bill file
- Electricity bills file
- Water bill file
- Municipal taxes bill file
- Management reports file
- Audited accounts file
- Budget file
- Contract files for each of the contracts
- Files for each of the staff
- Files containing important papers like that of the property documents, F.D. receipts, investments documents etc.
- Files related to Insurance papers
- Files related to Leave Records.
- Purchase order file
- Quotation file, etc.
- Requisition file for programme expenses
- Workshop/Meeting File

Most of these files should be continued from year to year except the cash, bank and journal files which should be changed every year.

2. Documentation of Fixed Immovable Assets

Immovable properties such as land & buildings should be supported by the following documents :

i) Original sale deed

ii) Parent documents (if any)

iii) Sketch of the property

iv) Encumbrance certificates

v) Legal opinion regarding the title of the property

vi) Land tax receipts

vii) Patta

viii) If leasehold, then lease agreements

ix) Donor details and documents related to donated assets.

x) In case of constructed building plan approved by the respective authority and valuation report from an approved valuer as to the value of the building

3. Documentation of Movable Assets

In case of vehicles the following documents should be kept :

i) Original Invoice

ii) Registration Certificate Book

iii) Road tax receipts

iv) Insurance policy bond

v) In case of hypothecation, the documents pertaining to loan and hypothecation.

In case of other movable assets, the following documents should be kept :

i) Original Invoice or Cash Memo

ii) Proof of payment or cash receipts

iii) Donor consent in case of a contribution in kind, such consent should create a valid legal title.

iv) Documents pertaining to annual maintenance contract

v) Insurance policy, if any

vi) Details in Form FC-6 in case of foreign contribution receipt in kind.

4. Conclusion

It is the foremost responsibility of an organization to segregate and maintain records that are statutory and operational in nature. Ideally, access to the correct sources of records / documents is made much easier if the organization outlines its structure, objectives, functions and services in a compact document or manual. This should include descriptions of the record series in which the organization's documents are arranged.

This calls for a proper planning in establishing and maintaining the filing and documentation system of maintaining records.

A system thus established and maintained not only helps in saving time but also speaks for itself. In other words, the documentation system should be such that it can justify itself without you being there to give explanations.

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

Performance Measurement in Non-profit Organisations:

An Evaluation Of Financial & Nonfinancial Measures

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1. Introduction

Non-Profit Organisations (NPOs) provide important services throughout the world. They range in size from small, local organisations to large national and international ones. Their scope covers inter alia health and welfare, research, education, social organisations, and professional associations. The fundamental features of NPOs are: (1) they exist to fulfill a charitable purpose, (2) they function without the use of coercion, (3) they operate without distributing profits to shareholders; and (4) they exist without simple and clear lines of ownership and accountability (Keating and Frumkin, 2001).

In pursuit of their charitable purpose(s), NPOs mobilize a large amount of funds. According to the figures from the Ministry of Home Affairs, NPOs in India received Rs. 45352 million by way of contributions from abroad during 2000-01, an increase of 220% since 1991. The largest chunk of the money received was earmarked for rural development (Rs. 5370 million), followed by health and family welfare (Rs. 4330 million). The US heads the list of donor countries with Rs.14926 million, followed by the UK and Germany contributing Rs.6776 million and Rs.6554 million respectively (Yesodharan, 2003).

The fundamental reason for nonprofit performance assessment is to determine how well an organisation is fulfilling its mission.

The fundamental reason for non-profit performance assessment is to determine how well an organisation is fulfilling its mission. However, the degree to which such organisations are effective remains a much-debated topic (Herman and Renz, 1999; Jackson and Holland, 1998). Several major financial scandals have rocked the nonprofit world in the past. Some of the documented ones include embezzlement by the president of the United Way of America, theft by the leaders of the Episcopal and Baptist churches, and excessive generous compensation of the president of Adelphi University (Keating and Frumkin, 2001). Given these issues, one can argue that the NPOs' future economic success depends not only on the quality of its social and economic activities, but also on improvements in measurement of their work and communicating their results to the multiple and diverse stakeholders.

2. Chracteristics Of NPOs

Measuring and managing performance is a difficult task in any kind of organisation and more so in case of NPOs. The difficulty arises mainly due to the characteristics of NPOs distinct from those of POs(Profit Organisation). Anthony and Young (1999, Chapter 2) have identified the following distinct characteristics of NPOs:

2.1. *Ownership and Owners' Interests:* The complexity of performance management is related to the existence of one clearly defined ownership group in a firm. For firms having such an ownership group, various policies are guided by the primary interest of this group. Further, the common interest also provides a common base for assessment of performance and delegation of responsibilities inside these firms.

Based on the above premise, it is found that the complexity of performance management is relatively less for Profit Organisations (POs) (Speckbacher, 2003). Such organisations have a clearly defined single ownership group irrespective of nature of business and constitution (proprietorship or partnership or limited companies) whose primary interest is maximization of wealth. This is relatively homogenous and easy to measure. Even for widely held public limited companies, the share prices reflect a measure of success acceptable to all the owners. In such organisations financial measures allow managers to assess impact of their different courses of action on owners' interest.

In NPOs, this is not the situation. There is no single clearly defined interest group. The external stakeholders include donors, beneficiaries using non-profit services, and the community at large that benefits indirectly from the services. The internal stakeholders include either trustees or the Board, and the staff. Obviously, their interests are not homogeneous and can not be easily expressed through a common performance measure and transferred into the organisation for assessment of alternative courses of action.

2.2 *Absence of Profit Measure:* In case of POs, profit provides a single broad measure of many separate aspects of performance. It provides managers with a current, frequent, easily understood signal as to how well they are doing, and it provides others an objective basis for judging a given manager's performance. The management decisions in such organisations are intended to increase/maintain profits and success is generally measured by the profits earned.

NPOs can be compared with one another only if they have similar functions. There is no way of comparing effectiveness of a fire department of a local municipality with the effectiveness of a hospital run by the same municipality.

By contrast, in NPOs, management decisions are intended to result in providing the best possible services with the available resources and the success is generally measured by how much service is provided and by how well the service is provided, that is contribution to the public well-being. Thus, performance with respect to amount and quality of services is difficult to measure in absence of a single criterion like profit.

The profit measure has certain advantages:

2.2.1 Single Criterion: In POs, profit provides a single criterion for evaluating alternative courses of an action based on the impact on the profit. In NPOs, there often is no clear-cut objective criterion for such evaluation. Different stakeholders may not agree on the relative importance of alternatives. For example, how would a local municipality decide whether to spend money on buying a fire fighter to increase the effectiveness of the fire department, or, to spend on parks, roads or welfare?

2.2.2 Quantitative Analysis: The profit measure permits quantitative analysis of costs and benefits of various proposals. For many important decisions in NPOs, managers may find difficulty in judging the effect of expenditure of X amount on achieving the goals of the organisation. Would the addition of one more professor in an academic institution increase value of education by an amount exceeding the cost of that professor?

2.2.3 Decentralisation: POs have a well-understood goal and the performance of individual managers can be measured in terms of their contribution to that goal. This facilitates decentralization thereby delegating many decisions to lower levels in the organisation. If an organisation has multiple goals without a definite process of measuring performance in attaining them, it cannot delegate many important decisions to lower level managers.

2.2.3 Comparison of unlike Units: The profit measure facilitates comparison of performance of various units within an organisation or among organisations performing dissimilar functions.

NPOs can be compared with one another only if they have similar functions. There is no way of comparing effectiveness of a fire department of a local municipality with the effectiveness of a hospital run by the same municipality.

2.3 *Tendency to be Service Organisations:* In general, NPOs tend to be service organisations. Since, services cannot be stored, failure to provide service with the available manpower and facilities today results in the permanent loss of potential benefits from that capability.

They tend to be labour-intensive. Controlling the output requires managing the people who deliver the services, which generally is more difficult than managing an operation dominated by machines.

The quantity of tangible goods can be tracked at every stage but not the quantity of services. For example, the number of patients treated by a physician in a day is not equivalent to measuring the amount of service the physician provides to each patient.

The quality of tangible goods can be inspected before delivery to end-users but that of a service cannot be inspected in advance and objective measurement instruments and unambiguous quality standards for such services do not exist.

2.4 *Constraints on Goals and Strategies :* POs have wide choice of industries in which they can do business. They can formulate a number of strategies to survive and grow and can change these strategies fairly easily to suit their needs. Many NPOs have less freedom of choice and change strategies like discontinuing a service/program slowly, if at all, tend to be a slow process. Further, at times they provide services as directed by outside agencies. The donors also may restrict management's options on the uses of their contributions.

2.5 *Source of Financial Support :* POs get financial resources from sale of goods and services and subjected to forces of marketplace. Some NPOs like cooperatives, hospitals, schools etc. also fall in this category and are referred to as client-supported organisations (CSO). Other NPOs get resources from the sources other than the above and are referred to as public-supported organisations (PSO). The former prefers more number of customers to increase the revenue whereas the latter has problems in serving the numbers as per the resources as the new client is a burden for them. In case of CSO, market mechanism plays an important role in allocation of resources whereas managers of PSOs compete with one another for resources. For example, in a university, various departments try to get as large funds as possible. The success of CSO depends upon its ability to satisfy their customers, whereas the success of PSO depends upon its ability to satisfy those who provide resources.

2.6 *Professionals :* In many NPOs, success in achieving goals depends upon the behaviour of professionals. Professionals face the dilemma of organisational objectives versus professional objectives. Sometimes, rewards for achieving organisational objectives may be less potent than those for achieving professional objectives. The reluctance of a faculty in an academic institution to serve on administrative committees is a result of this reward structure. Many professionals like academicians, researchers, and such others prefer to work independently. Such professionals may possess professional skills but not management skills to lead their organisations. Still, custom often requires that the manager be a professional.

Financial incentives tend to be less effective with professional people as their primary satisfaction comes from their work. They also tend to give inadequate weight to the financial implication of their decisions.

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2.7 *Governance:* In POs, shareholders may exercise their authority in crisis and such authority is always there. In NPOs, corresponding line of responsibility is not clear. There are no shareholders, members of the governing bodies are seldom paid for their services, and they may be chosen for political or financial reasons rather than for their management abilities.

In absence of a measure like profit, NPOs face a problem of getting signals in time to take corrective action if they are in trouble. In such situations, the personal appraisal of the health of an organisation by board members is much more important. They need to spend considerable time in learning what is going on in the organisation, and they need to have enough expertise to understand the significance of what they learn.

Thus, NPOs are likely to face governance problems. For reasons indicated in the first paragraph, many governing boards do an inadequate job in fulfilling the responsibilities mentioned in the second.

3. Performance Measurement

In view of the above characteristics of NPOs distinct from those of POs, the concepts and tools used for performance measurement of POs may not be easily transferable to NPOs. At the same time, NPOs need to provide information on their performance to help various stakeholders to assess whether the organisation fulfills its mission properly. If such an assessment is not possible, public trust in NPOs is bound to be lost (Herzlinger, 1996).
Various studies have attempted to bridge the above gap by identifying appropriate financial and non-financial measures of performance of NPOs.

Table 1: Performance Categories and Relevant Financial Ratios

Fund raising Efficiency	Public Support*	Fiscal Performance
Direct Public Support divided by fund-raising expenses [1]	Total contributions received divided by total revenue [3]	Total revenue divided by total expenses [4]
Total Revenue divided by fun-raising expenses [2]	Direct public support divided by total assets [2]	Total contributions received divided by total expenses [2]

* Contributions received directly from individuals and foundations
1 Greenlee and Bukovinsky, 1998; 2 Ritchie & Kolodinsky, 2003; 3 Siciliano, 1996 and, Greenlee and Bukovinsky, 1998; 4 Siciliano, 1996, 1997.

Table 2: Indicators of Financial Vulnerability

Sr.No.	Indicator	Formula
1.	Equity ratio	Total equity/total revenue
2.	Revenue concentration ratio	$\Sigma \left(\frac{\text{Revenue source}_j}{\text{Total revenues}} \right)^2$
3.	Administrative Cost ratio	Administrative expenses/total revenues
4.	Operating margin	$\frac{\text{Total revenues - total expenses}}{\text{Total revenues}}$

* Contributions received directly from individuals and foundations
1 Greenlee and Bukovinsky, 1998; 2 Ritchie & Kolodinsky, 2003; 3 Siciliano, 1996 and, Greenlee and Bukovinsky, 1998; 4 Siciliano, 1996, 1997.

3.1. *Financial Performance Measures:* A review of the NPO and strategic management literature indicates absence of common, distinct financial measures that can be useful for determining firm-level outcomes. Various studies report contextually specific measures like goal attainment (Green and Griessinger, 1996) and system resources (Siciliano, 1997). The focus on such contextual measures runs the risk of "even greater fractionating of knowledge and incommensurability of theories and findings" (Herman and Renz, 1999). A study on synthesis of the strategic management and non-profit literature for the period 1977 to 1997 concluded that "despite the wealth of research, performance has received scant attention" (Stone, Bigelow, and Crittenden, 1999).

3.1.1 Financial Ratios: Few studies on financial measures for NPOs have been made which are context-free. They have identified three distinct categories of performance, and specific financial ratios as performance measures under each performance category. They have been conducted at different points of time and in different types of NPOs. Putting them together offers "multidimensional" approach to the performance measurement as summarized in Table 1:

The four financial ratios used by Greenlee and Trussel (2000) for predicting financial vulnerability are given in Table 2:

3.1.2 Other Financial Measures: While addressing the issue of information on programme accomplishment to stakeholders of NPOs, Keating and Frumkin (2001) specified nine sets of financial measures as follows:

i. Peer Benchmarking: Benchmarking an organisation on several attributes like compensation, changes in programme services, etc., against a peer can lend perspective to the analysis.
ii. Common-sizing financial statements: By converting financial statements to percentages, one can determine as to how the resources are distributed. Specifically, the following insights can be developed: (a) Asset concentrations to identify the resources available to deliver future services,

(b) revenue concentrations to assess reliance on different forms of revenue, periodic shifts, and similarity with peers, and (c) expense concentrations to assess whether resources are consumed in delivering program services or in support services (fund-raising and administrative).

iii. Trend analysis: The annual growth rates in important accounts like programme expenses, support services, total revenues, etc., can be used to analyse an organisation. Generally, stakeholders look for positive and sustained growth rates in such accounts.
iv. Comparisons in relation to the budget: This is another method to assess achievement against annual budgets.
v. Profitability measures: Such measures help to assess whether revenues are consumed as expenses in the period received and how the surplus, if any, is deployed.
vi. Liquidity ratios: The ratios like current ratio, days cash on hand, accounts payable as % of monthly expenses etc. help to assess the organisation's liquidity i.e. ability to pay the obligations in time.
vii. Measures of vulnerability: The four indicators listed earlier help in predicting long term viability.
viii. Activity and efficiency measures: The programme efficiency ratio (programme expenses divided by total expenses) depicts the input costs of services provided. The fund-raising efficiency ratio (fund-raising expenses divided by sum of contributions and special event revenue) assesses the cost of generating a rupee of contributions.
ix. Compensation issues: The issues like excessive compensation of top executives and adequate compensation to ther employees regularly emerge in NPO setting.

3.1.3 Advantages of Financial Measures

i. They are generally context-free, more objective and more convenient to use.
ii. They permit comparability of performance across similar NPOs.
iii. One can choose different measures and can also assign different weights to the same measures depending upon the purpose. For example, stakeholders of a new NPO may assign more importance to "Public Support" and may also give more weight to "fund raising efficiency" than "fiscal performance".
iv. They can facilitate further studies on the factors that influence convergence or divergence between financial measures and non-financial measures.

3.1.4 Limitations of Financial Measures

i. Different accounting practices for similar transactions across NPOs reduce comparability among peers and make benchmarking difficult. However, if a given NPO continues to follow the same practices then trend analysis of financial measures can still provide useful information.
ii. A focus on a particular performance category in short run can affect the performance in other categories in the long run. For example, a focus on fiscal performance measures may lead to cut back on expenses in the short run that may affect public support in the long run.
iii. Majority of studies covered above have used empirical data from IRS Form 990, the tax returns filed by NPOs in the US. The Form 990 provides the basic data for computation of financial measures and this database can be easily accessed. In India, one would be required to collect data from individual NPOs in the desired format.
iv. The performance categories mentioned earlier need not be exhaustive.
v. Many NPOs may not be capitalizing all donated assets or may be holding valuable collections that are not reflected at their fair market value on the financial statements.
vi. There may be several joint costs (employee costs, rent, travel, communication expenses, etc.) between programs, fund-raising, and administration. Through the allocation process, NPOs may misreport such costs under any or all of the three.
vii. NPOs can understate some expenses like employee costs by creating multiple reporting entities.

3.2 *Non-financial Measures :* Researchers in 1980s (Cameron, 1981, 1982; Connolly, Conlon and Deutsch, 1980) advocated use of multidimensional approaches like the organisation's ability to acquire resources (fund-raising), and ability to achieve desirable outcomes.

While studying philanthropic organisations, Sheehan (1996) found absence of performance measures that could help the organisations to know whether their strategy had an impact on its mission and whether their strategy was succeeding or failing.

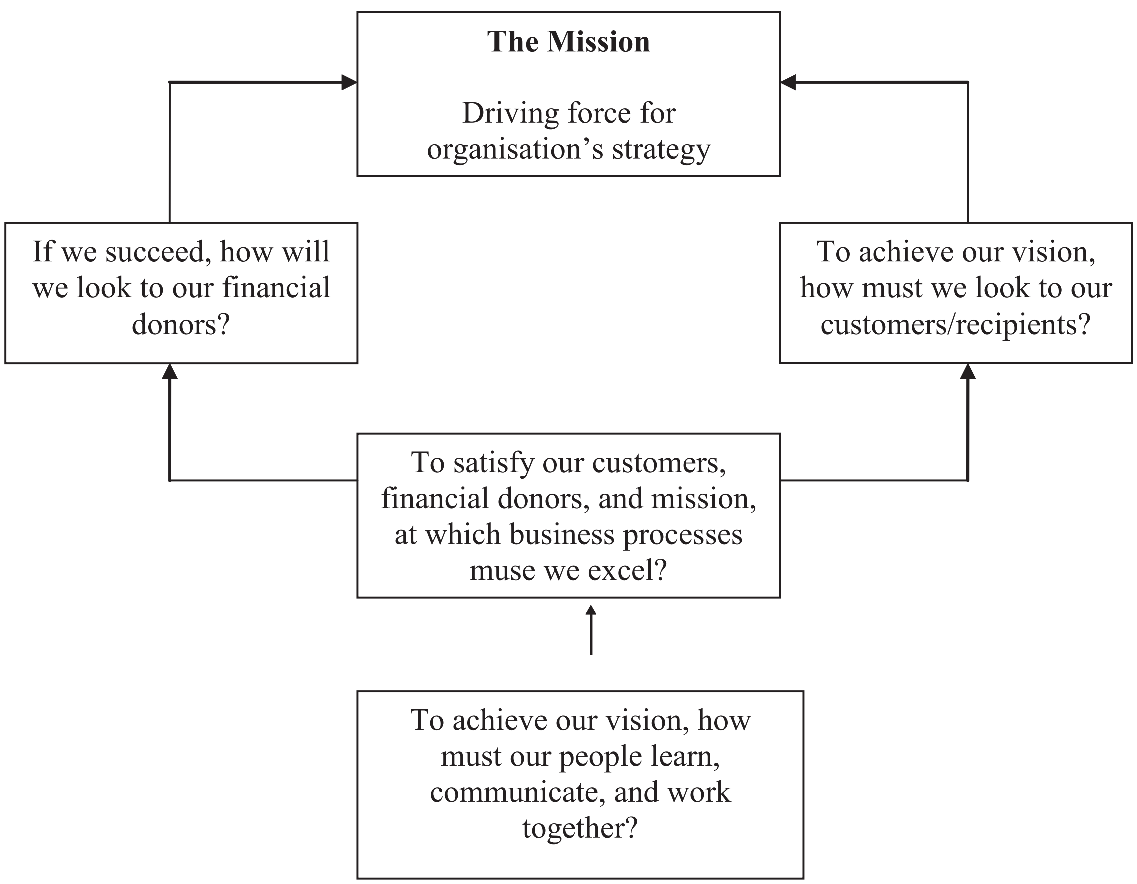
Anthony and Young (1999, Chapter 12) have suggested three categories of measures: (a) social indicators, (b) results measures, and (c) process measures.

A social indicator is a broad measure of output that reflects the impact of an organisation's work on society at large. Unfortunately, in almost all cases such measures are affected by external forces other than those of the organisation. For example, mortality is partly influenced by the quality of healthcare (impact of an organisation's work) but it is also affected by other external forces like nutrition, environment, heredity, and others. Thus, social indicators are nebulous, difficult to obtain on a current basis, little affected by an organisation's current program efforts, and much affected by external forces. They are useful in strategic planning to guide management's decisions about the overall directions the organisation should take. Because of this, they are often stated in broad terms (e.g. "the expectations of healthy life free from any serious disease").

A results measure is a measure related to an organisation's objectives. It relates to an organisation's success in attaining its goals. For example, organisations rendering services to a class of clients, such as alcoholics, may measure output in terms of results for the whole class or a target group.

A process measure (or a *productivity* measure) relates to an activity carried on by the organisation. Process measures like number of livestock inspected in a week, the member of vaccinations done in a week, etc., are useful in the measurement of current, short-run performance. They measure efficiency but not effectiveness.

Figure 1: Adapting Balanced Scorecard Framework to NPOs



While a result measure is “ends oriented”, a process measure is “means oriented”.

Moss Kanter and Summers (1987) concluded in their article on performance measurement in NPOs:

“*The ideal performance assessment system in a NPO would acknowledge the existence of multiple stakeholders and build measures around them. It would acknowledge the gap between grand mission and operative goals and develop objectives for both the short term and the long term……by developing an explicit but complex arrays of tests of performance that balance clients and donors, board and professionals, groups of managers, and any other stakeholder”.*

The performance management tool they had in mind was what we today would call a balanced scorecard for NPOs.

The balanced scorecard was developed in the 1990s for the POs by Kaplan and Norton (1992,1996) as an answer to several deficiencies of the traditional financial measures. It is a concept that complements financial measures with nonfinancial measures that measure and monitor the organisation’s ability to build up both tangible assets and intangible assets like the skills and capabilities of its employees, customer acquisition and retention, innovative services, products, and information technology. These are grouped into four perspectives: financial, customer, internal, and learning and growth. These are connected by cause-and-effect relationships that reflect the organisation’s strategy.

Strategy and performance measurement should focus on what output and outcomes the organisation intends to achieve, not what programs and initiatives are being implemented

The balanced scorecard is believed to be easily transferable to NPOs (Chow, 1998; Forgione, 1997; Haine, 1999). The pioneering efforts in deriving performance measures from strategy and mission of NPOs have been made by Kaplan (2001). He carried out an explicit action research program in 1998 at United Way of America and United Way of Southeastern New England and subsequently in several other organisations for applying the Balanced Scorecard. He explicitly defined the role for strategy in a nonprofit balanced scorecard and stated the following:

a) Strategy and performance measurement should focus on what output and outcomes the organisation intends to achieve, not what programs and initiatives are being implemented
b) The organisation should focus its limited resources on a limited set of objectives and constituents. Attempting to be everything for everyone virtually guarantees organisational ineffectiveness.
c) The start of any performance measurement system has to be a clear strategy statement. By quantifying and measuring the strategy, organisations reduce and even eliminate ambiguity and confusion about objectives and methods.

Further, Kaplan adapted the original balanced scorecard framework to NPOs as shown in Figure-1.

He modified the original architecture of the balanced scorecard in two respects while adapting it for NPOs as shown above: (i) instead of the financial perspective at the top, “the mission” features and measures at the highest level as the organisation’s mission represents the accountability between it and the society – the rationale for its existence, and (ii) expansion of the definition of the customer to include both the donors (payers for the service) and the constituents (receivers of the service), and placing both the donor perspective and the recipient perspective in parallel.

The studies done by Kaplan and Elias (1999), Kaplan (2001), Meliones and others (1999), and Meliones (2000) have shown the ways to successfully evolve the balanced scorecard. Their studies have demonstrated the effective linkages between the performance perspectives (focus), outcomes (measures) related to each perspective, and the strategic objectives to achieve those outcomes. The linkages between performance perspectives and outcomes (measures) that emerge from these studies are given in Table 3:

Table 3: Linkages between the Perspectives and Outcomes

Perspective	Outcomes
Financial	External growth
	Internal stability
	Improvement in net asset and liquidity
	Effectively link staff compensation, performance, and service delivery
	Sufficient funding support for all programmes/services
Customer	Customer satisfaction – beneficiaries and funders
	Market growth
	Customer retention
	Recognition as a leader in the given sphere of activities
Internal	Key internal business processes based on quality
	Innovative products
	Viable product line
	Safeguard rights, responsibilities, and ethics via corporate compliance office
	Effective collaboration and partnering with other agencies/providers
Learning & Growth	Adherence to performance improvement
	Access to career development and mentoring for all staff
	Diverse staff working productively – guided by the balanced scorecard

4. Summary

The characteristics of NPOs restrict the choice of a single measure of performance. The financial measures emerging from various studies are found to be having more limitations than the advantages. Non-financial measures related to output measurement ignore the linkages with the resources and internal processes. The balanced scorecard can provide a combination of both non-financial and financial measures that are derived from the mission of the organisation. It can enable to bridge the gap between mission and strategy statements and day-to-day operational actions. It can be used as a communication tool between the organisation and its stakeholders, and hence, as a substitute for the financial statements to inform the stakeholders about the value of their implicit claims. It may be easier to attract new donors or volunteers that support the mission if the organisation makes explicit its strategy for achieving the mission's goals.

*(**Prof. Shailesh Gandhi** is the Associate Professor in Finance & Accounting Area at **IIM, Ahmedabad. This article was a working paper authored by prof. Gandhi during his tenure at IRMA as a Professor.)***

CSO Partners' Outstanding Annual Report Award 2010

The CSO Partners' outstanding annual report award is an endeavor in creating benchmarks in the realm of NGO reporting and is the first and only annual report awards in the voluntary sector. It is an effort to build a movement for transparency to bring in accountability. The award was instituted by the **CSO partners** jointly with the **Financial Management Service Foundation, Spatial Advertising Consultancy (SAAC)**, & the **Credibility Alliance**. Not-for-profit organizations across India are invited to participate in the process. The annual reports will be judged in three different categories;

- **'Small'** (Organizations with an annual income of less than Rs.50 lakhs)
- '**Medium**' (Organizations with an annual income range of between Rs.50 Lakh to Rs. 5 Crore) &
- '**Large**' (Organizati*ons with an annual income of more than Rs. 5 Crore)*.

Presently, FMSF invites participation from the voluntary sector organizations to submit their entries and participate in the CSO Partners' outstanding annual report award 2010. The annual reports and audited financial statements of the organization will be evaluated on three main aspects of 'financial reporting', 'transparency' 'reader friendliness & effective communication'. The short listed annual reports will then be presented to a Panel of Jury who would judge the reports and select the winners.

For more details, please visit, www.annualreportawards.org

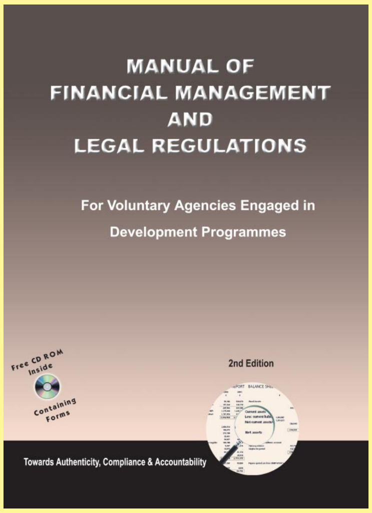
Workshop on Budget, Budget Monitoring and Reporting in Southern Region

FMSF had organized a workshop on Budget, Budget Monitoring and Reporting for select EED partners in Southern region during 17th & 18th Sep 2009 at Accion Fraterna, Anantapur. The objective of the workshop was to bring in focus the role of budgets in the implementation of development projects. FMSF believes that preparation of budgets forms the basis of proper implementation of programmes, evolution of action plans, effective financial management and monitoring. This also forms the basis of the financial reporting as well. Thus, the workshop aimed to capacitate the Finance and Accounts staff working with EED partners in the areas of Budgeting related aspects. The first workshop was conducted in September 2009 for Southern Region.

About 27 participants from 6 EED partner organizations had participated in the workshop. The Resource Team included Mr. Sanjay Patra, Ms. S.P.Selvi and Mr. P. Hari Krishna from FMSF.

During the workshop, sessions on the Planning, Budgeting, Budget Implementation and Reporting to EED were taken up. Detailed discussions and case study exercises on the essentials of budgeting and cashflow planning invoked active participation from the participants. Practical tools for preparation of budget flow chart, budget monitoring, cash flow planning and EED reporting requirements were also shared during this workshop.

Publications of FMSF



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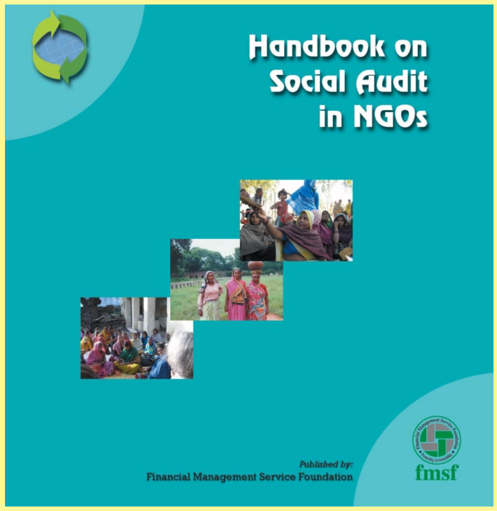

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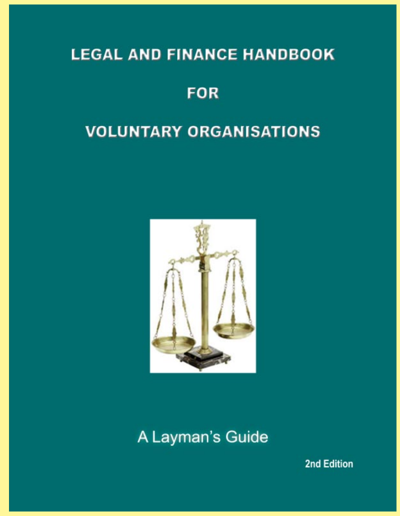

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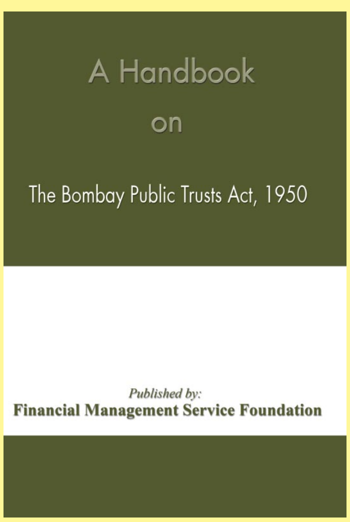

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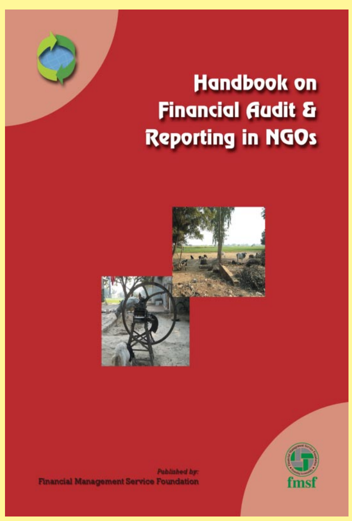

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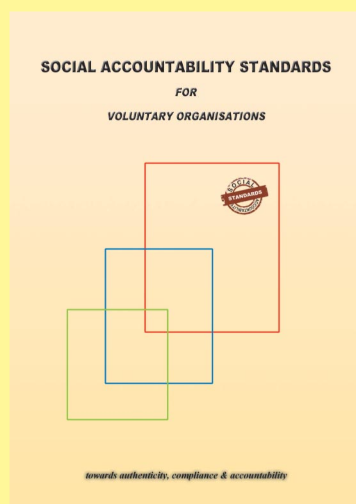

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