INTER *face*

towards promoting accountability

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Development Dilemma

Development is a complex process. Sometimes, even though we may have good intentions, it may not work to the benefit of the disadvantaged sections of the society. Here are two interesting incidents to substantiate the issue.

Who needs the road?

One NGO was facilitating a series of village meetings. The villagers unanimously decided that a road was the most important priority for their village. An action plan was finalized with the village is supplying labour & locally available material. The NGO would provide the technical expertise and would provide resources beyond the reach of the villagers. When the time came to start the work, the villagers who had eagerly voted for a road were no where to be found. The NGO workers went out looking for these people. They were working in their fields, collecting water, cooking at home or doing other household work. When asked, all of them gave the same answer, "What is a road to us? What are trucks or tractors to us? Road or no road, we travel by foot or by donkey. A road will only make our donkey`s feet sore. If a road is built, who is going to maintain it? Will a tractor owner or a landlord ever come forward to maintain it? They will say- "This is your road, the people`s road. And our children will go hungry while we repair 'our road, a road we never wanted`. You may ask why we did not speak in the village meetings. It is because we work for truck owners, land lords - people who want the road. In their presence, we kept silent." The road was never built.

How to sell the wheat?

Abdul came back from the grain market in the evening. Today also he could not sell the wheat he had grown. Abdul lived in a country which had faced civil war for last 5 years. The economy of the country was in shambles. Some international humanitarian aid agencies got together and decided that they need to mobilize wheat from other countries. Many organizations and people from around the world came forward and shipped large quantities of wheat. As a result of this mass dumping of wheat, the price crashed in the local market. Local producers therefore could not sell their wheat in the market. Abdul was one of them. The concern of the international community was genuine. But it was not helping the local farmers at all.

We live in a complex society and a complex economy. Therefore, our interventions have to be carefully planned so that it brings positive change.

Sanjay Patra

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DEBATE

Independence of Auditors

An auditor is the executor of the sacred role of confirming the human efficacy in sticking to financial propriety and integrity . This is in the backdrop of the common human weakness and ever present temptation to manipulate for misappropriation of value. To the extent that this violates the laws of human co-existence and communal living in the form of clever misappropriation of value without obvious physical force or coercion, or simple non-adherence to any acceptable financial procedure, the auditor has to bring it to light as a crime or for the sake of corrective action respectively. The auditor is therefore the grassroots guardian of economic value for humanity.

Thus independence is liberating as well as burdening – Liberating by freedom, and burdening with responsibility – both traits of humanness for the sake of guarding humanity.

The independence of auditors is, therefore, a supreme requirement to be seen as equivalent in stature to integrity . Independence means that all auditors should be free to make correct judgement regarding the propriety of financial management. Independence further means that auditors are given space, time and all required support for making their study.

Independence also means responsible freedom – the responsibility to serve humanity in the best way possible, the responsibility to arrive at correct judgements, to arrive at just corrective action, to provide constant guidance and feedback to the juridical person being audited, to stay above all invitations to join hands with manipulators or to do so oneself.

The perception of auditors as people who come once or twice in a year ,do random checking of vouchers, books of accounts and certify the financial statements are no more relevant. The main objective of any NPO is to maximize its value to its stakeholders which in turn is a reflection of its efforts in scientific management of both programme as well as finance. The auditor, as external expert without prejudice, has a lot to contribute in the realization of this objective.

The role of auditors in one NPO may differ from another . Their duties and responsibilities may also change accordingly. For example, it has been observed that auditors take full responsibility of finance of some NPOs including preparation of books of accounts, final accounts, filing of returns etc. In such cases normally what happens is besides diluting the overall responsibility and accountability of finance managers, auditors may have to act as per the dictations of the management. This of course has the risk of compromising with independent opinions of auditors. On the other hand, there is a chance of auditors dominating the NPO with a lot of ‘Dos’ and ‘Don’ts.

While auditors can be approached for expert advice on financial management, it is always better both for the organization and auditors that they be excluded from the routine functions. If an organization feels that it requires outside expertise for managing finance, it is advisable to take help of another Chartered Accountant who is not the auditor of the organization.

To keep their independence intact, auditors should concentrate more on application of analytical tools to give a true and fair view of the financial management which will help the NPO to make sound decisions. With the fast emerging scenario of technology, we have better methods to comment on the finances of an organization and auditors should take maximum advantage of it.

Nowadays many people feel that auditors have no choice but to act as per the wishes of an NPO. This perhaps is correct in some cases where auditors are keen to retain their clients by ignoring the prescribed audit principles and procedures. This is very dangerous and can create uncertainty and the very relevance of an audit report may also be challenged.

Auditors are entitled to check the books of accounts and other relevant documents and obtain specific information regarding a particular transaction. However, this access is limited sometimes when an organization feels that auditors should be satisfied with whatever information they give and should not ask for details. Here again the independence of auditors is at stake. Needless to say, it is advisable that auditors having professional ethics should insist on being given whatever documents they want to verify even at the cost of loosing the client.

While dealing with the subject 'Independence', we should also keep in mind that auditors who are associated with NPOs should have basic information about the programmes undertaken by such NPOs. This will help them identify any gross violation of project objectives for the sake of fund misappropriation. On the other hand, it will also help them appreciate the difficulty levels and perform the audit with social sensitivity. Nevertheless, auditors should not deviate from a conservative approach when it comes to financial dealings.

Despite difficulties caused by several factors, many NPOs are trying their level best to preserve their identity in serving the society. Financial distress can be one such factor and auditors can play a vital role in finding out remedies available and suggest the same to the management. This in no way should be treated as getting involved in the affairs of the organization but should be considered as a kind gesture on the part of an independent auditor.

The Auditors' Report which is attached with other final accounts is normally as per the standard format. This may suffice the requirements of donors and other statutory bodies. However, it is very important for auditors to give an independent management report with major observations and suggestions which will help the NPO to take corrective measures. Auditors should also insist on a report from NPO to make sure that their suggestions have been complied with. The ultimate purpose is to have a good financial management system in place.

To conclude, it is important for auditors to strictly follow AASs' issued by the ICAI. which will automatically manifest the independence of auditors.

- Cyriac Mathew
Chief Finance Officer, AFPRO

DEBATE

Independence of Auditors

- An Auditor 's Perspective

Poet and Nobel Laurete Shri Rabindranath Tagore brought out the essence of Independence in his memorable poem "Gitanjali". His words denoting freedom were - "where the head is held high and the mind is without fear". That I think sums up the basic concept of Independence of Auditors.

The word Auditor as we all know has been derived from the Latin word "Audire" which means to Listen/ Hear . The basic skill of listening requires that one hears the other party without fear or favour i.e. any negative or positive bias.

The entire understanding of the independence of the auditors can be derived from these two concepts.

The Institute of Chartered Accountants of India has brought out a revised Guidance Note on Independence of Auditors. The guidance note has brought out this concept in a well defined manner

If one has to analyse the independence of the auditors from the point of view of auditors, then I feel one has to look at the constraints to such independence i. e the factors that would hinder the independence of the auditor . Some such major constrains are listed below.

1. **Appointment of Auditors**

Whether it is the audit of commercial organization or the NGO/NPO sector, the law regarding appointment of auditors is quite different from the actual practice of appointment.

In most of the cases, the law provides that auditors should be appointed by the owners of the organization i.e. the shareholders/ partners/ proprietors etc. In case of NGO / NPO sector , it will be the members of the organization which are the appointing authorities.

However, given the fact that most of the members are spread out geographically, their association with the organization in terms of commitment – financial, mental or emotional is minimal at most of the times. It is only few individuals / groups which have deeper commitment – financial, mental or emotional-who then exercise the control of the organization. In many cases, these are the very same people who form the management of the organization. The actual appointment, renewal or for that matter removal therefore rests in the hands of these people as distinguished from the general public which are the owners or members of the organization.

In effect, therefore, you have the appointing authority (in practice as distinguished from law) on one side and the stakeholders i.e. the other owners, Government or employees and the rest on the other side. There could be areas where the interests of all these parties merge or unite and here there is no problem for the auditors.

It is, however, on the issues where the interests clash that the auditor has to display great level of independence, for in those cases his own appointment is at stake.

The late Prime Minister Indira Gandhi was once asked as to which side she was leaning – to the Left (USSR Group) or to the right (USA group). Madame Gandhi replied that she was not leaning and was standing straight. The auditors too have that duty to stand straight rather than leaning on any side.

It is here that the Institute's Guidance Note helps in terms of limiting the dependence on a single audit entity in terms of fees from the entity vis –a-vis total fees or even intra the same entity in terms of audit fees vs non-audit fees. This will greatly help the auditors.

2. **Clash of Interests**

The second constraint to the independence of auditors is the clash of interest between the stakeholders. Briefly the interest of the stakeholders can be summarized below :

	STAKEHOLDERS	INTEREST
1. a. b.	Owners (Commercial organization) Members (NPO / NGO)	Higher profits / growth Higher availability / disbursal of funds for activities.
2.	Employees	Higher salary / bonus (Apart from good working environment)
3.	Government / Local authorities	Higher share of taxes/ fees
4.	Beneficiaries	Higher / Faster Disbursements
5.	Management / CEO	Higher salary / Bonus Faster / Higher growth
6.	Donor	Proper utilization of funds Proper follow up of formalities

While in the few cases the interests of the stakeholders would converge, in rest of the cases, all the stakeholders are interested in greater share of the funds. The availability of funds is normally a constraint in most of the organizations and the financial results could therefore be tailored to suit the interests of some of the stakeholders as against the others.

3. Familarity with Auditors

The traditional saying goes that familiarity breeds contempt. In the case of auditors, one could say that familiarity breeds sympathy.

In most of the cases the auditor auditee relationship goes for a number of years and sometimes for decades. When the auditor and his staff are associated with the auditee and his staff there is always a fear that too much trust could be developed as well as a lethargy to question the auditee.

Social and other interaction with the auditee could develop bonds. This could be at the cost of retaining the independence of the auditor.

I have discussed above the three major constraints to the independence. Inspite of these and other constraints I am happy that most of the auditors have really managed to be independent to a substantial extent and that is a matter of great pride to me as a member of auditor community.

To conclude I would like to point out a similarity between auditor and an iceberg.

An iceberg is composed of the same water which surrounds it. A major portion ($7/8^{th}$) of the Iceberg always remains submerged in the water and yet the Iceberg always keeps its head higher than the rest of the water (the $1/8^{th}$ part).

An auditor too, being a part of the society, has the same characteristics – good or bad, of the community in which she/he is born or bought up. The trick is to keep the head above the water – to be the part of the community and yet be above it in terms of maintaining independence.

- Sandip Bhandare
Chartered Accountant

Dependence, Independence & Interdependence?

- A Reflection on Independence of Auditors

In the month of February 2005, the **Institute of Chartered Accountants of India** published a *"Revised Guidance Note on Independence of Auditors"* in the Chartered Accountant journal. A debate was initiated by FMSF on "Independence of Auditors" to assimilate the understanding at various levels. We approached both NGO leaders and NGO Auditors to reflect upon this very important issue. In all we received four articles from NGO leaders and an equal number from Auditors. The debate continued for months and covered four issues of **INTER***face*.

It is difficult to sum up the rich inputs that have been received from both development practitioners as well as auditors of development organisations.

In order to bring this debate to a close, I would like to divide this article into four areas :

1) Revised Guidance Note on Independence of Auditors

2) Views of Auditor's Community

3) Development practitioners speak

4) Open questions

5) Conclusion

6) Post Script

Let us examine the above issues one by one –

1. Revised Guidance Note on Independence of Auditors:

1.1 Professional integrity and independence is an essential characteristic of all the professions but no more so in the case of accountancy profession.

1.2 Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged her/him or to his/her self interest.

1.3 It is not possible to define "independence" precisely. The rules themselves cannot create or ensure the existence of independence. Independence is a condition of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law.

1.4 There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance.

1.4.1 Independence of Mind- The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity and exercise objectivity and professional skepticism.

1.4.2 Independence of Appearance-
The avoidance of facts and circumstances that are so significant, a reasonable and informed third party having knowledge of all relevant information, including any safe guards applied, would reasonably conclude a firm's, or a member of the assurance team's integrity, objectivity or professional skepticism had been compromised.

1.5 Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

1.6 Independence is a very subjective matter. It is therefore the duty of every Chartered Accountant to determine for herself/ himself whether or not s/he can act independently in the given circumstances.

1.7 The Code of Ethics for Professional Accountants prepared by the International Federation of Accountants (IFAC) identified five types of threats. They are –

- Self Interest threat
- Self Review threat
- Advocacy Threat
- Familiarity Threat
- Intimidation Threat

1.8 The Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safe guards available to eliminate them.

1.9 The Chartered Accountants Act, 1949 and Chartered Accountants Regulation, 1988 and the code of conduct have certain regulations for independence of Auditors. They are-

1.9.1 The fees should not be based as a percentage of profits or on findings or results.

1.9.2 Personal gain of the auditors is one but not the main or only objective.

1.9.3 The auditor must disclose any substantial interest that he/she may have in the auditee organisation.

1.9.4 The auditor has to ensure that there is no conflict of interest or conflict of duty. For example, a Chartered Accountant should not certify the financial statements of the organisation where she/he is employed full time. Another example is that he/ she cannot accept the auditorship of a trust where one of the partners of the audit firm is either an employee or a trustee.

2. Views of the Auditors:

2.1 There are no specific reporting requirements prescribed in the Act, i.e. Societies Registration Act or Trust Laws. Only Companies Act specifies certain framework for reporting for organisations registered u/s 25 of Companies Act, 1956.

2.2 Therefore we see very general statements in the audit report like *"statements are in agreement with the books of account."*

2.3 However, the general perceived expectations from various stakeholders from these reports are quite different to what is being provided to them. Therefore, there is a clear disconnect between the two.

2.4 An auditor may have to make a report independently which may be against the wishes of his/her client. Therefore, it is very important to determine the appointment and removal authority and the necessary safeguards for the same.

2.5 The key issue should be that the auditors need to be appointed by a body of persons who are not directly involved in the management.

2.6 There has to be clear separation between the appointing authority and the authority involved in the management of the organisation.

2.7 Indian Trust Act and Societies Registration Act should be suitably amended to ensure independence of auditors.

2.8 Properly qualified and experienced Accountants need to be employed by organisations

2.9 Auditors should refrain themselves from doing accounting services.

2.10 There should be a disclosure of remuneration paid to auditors for non-audit services in the audit report

2.11 The audit fees are sometimes so low that it is not practicable to engage quality time for conducting the audit.

2.12 Auditors feel that voluntarism is the basis of this sector and hence the fees are low.

2.13 Independence connotes that the auditor and the clients are unrelated parties.

2.14 The *"Principle of Arms Length"* must be practiced. This means the auditor should avoid over-familiarity with the organisation so as to ensure independence.

3. Development Practitioners Speak:

3.1 In the social sector, the auditor should be like the conscience of the organisation.

3.2 Is it possible for auditors to witness and consider social change as an impact of NGOs work which is not visible?

3.3 If counting is not possible, how does one verify invisible effects? What are the mechanisms and tools to be used in such social settings?

3.4 Many would not have liked to have auditing if it was not a statutory requirement.

3.5 There is a need for more interface between auditors and rest of the Trustees. Action taken report prepared by the Chief functionary needs to be taken seriously.

3.6 Auditors should be independent but not indifferent to values and culture of an organisation

3.7 Independence is ultimately in the minds of the auditors and the auditee.

4. Open Questions:

4.1 Whether there should be rotation of auditors in an organisation?

4.2 An audit committee to monitor the audit function of the organisation may be necessary.

4.3 Should the auditors conduct surprise checks and visits?

4.4 A panel of auditors who understand the field realities and well versed with the legal regulations of the voluntary sector.

5. Conclusion:

5.1 There is a common saying *"Familiarity breeds contempt."* In case of audit one can say that "familiarity breeds sympathy."

5.2 Auditors are like icebergs, even though they are in the water, they rise above the water.

5.3 Auditor/ Auditee is a delicate relationship.

5.4 Auditors are like doctors, therefore one need to be open and honest before them.

5.5 Mere presence of auditors ensures that frauds and mis-appropriation are minimized.

5.6 The auditor should be straight-forward, honest and sincere in his/her approach to his/her professional work.

5.7 Auditors are amphibians. The amphibians have to survive both in land and in water. Similarly auditors even though appointed by the organisation, need to be independent to judge, guide and even regulate.

5.8 Auditing is a necessary evil and auditors are the perpetrators of that evil.

5.9 It is said that auditors are those who fly like a butterfly and sting like a bee.

6. Post Script

Finally, as famous poet **Rabindranath Tagore** wrote, "*Let me pray to be sheltered from dangers, but to be fearless in facing them. Let me not beg for the stilling of my pain, but the heart to conquer it.*"

Further, E.F. Schumacher in his famous work 'Small is Beautiful' has written, "*Any organisation has to strive continuously for orderliness of order and disorderliness of creative freedom.*"

Aesop's Fable talks of the blind men feeling an elephant from different sides and thinking it to be s rope, tree trunk or hose. **Edward De Bono** in "*Lateral thinking*" talks about co-operative exploration rather than argumentative understanding.

Mr. Kamlesh S.Vikamsey "*the past president of Institute of Chartered Accountants of India has said " The moral and ethical dilemmas are integral part of every professional's day-to-day life and pose a considerable challenge while resolving the same.*"

Rabindranath Tagore has written in his famous book **Gitanjali** "*where the mind is without fear and the head is held high*……." That is true independence.

Even though we formally close this debate……. the debate would continue …..

Sanjay Patra,
Executive Director, FMSF

Legal and Financial Challenges for the Voluntary Sector

1.0 Overview of the Voluntary Sector

India, is a welfare state. Therefore education, health and social welfare are the responsibility of the state. In late 60's and early 70's, a new breed of organisations emerged, called "Voluntary Organisation". Now they are known in many names. They are:

- Non-Governmental Organisations (NGOs)
- Non-Profit Organisations (NPOs)
- Not-for-profit Organisations (NPOs)
- Voluntary Organisations (VOs)
- Non -Governmental Development Organisations (NGDO's)
- Government Promoted NGOs (GONGOs)

There are many differences between "Non-Profit Organisation" and "Profit Organisation". We need to understand that non-profit organisations are not debarred from earning profit. The key difference between a 'Non-Profit Organisation' and 'Profit Organisation' is in its purpose of existence. Whereas 'Profit Organisations' exist to earn profit, for "Non-Profit Organisations", profit comes as incidental to its operations. Secondly , in profit organisation, the surplus/ profit is distributed among the owners/ shareholders of the organisation. In a non-profit organisation, the surplus is used to further the objective of the organisation.

The main sources of receipts for voluntary organisations are:

- Self Generated Funds
- Grants
- Donations
- Membership Fees (subscription)
- Surplus from Business Activity

As per a study conducted by John Hopkins University on the voluntary organisations, there are 1.2 million voluntary organisations in India. There are 20 million people associated with voluntary organisations as paid or voluntary staff. Approximately, 20,000 crore rupees are mobilized from within and outside the country in a year About 5,000 crore rupees are received as foreign contribution every year. There are about 30,000 FC(R)A registered organisations in India.

2.0 Key Issues

The voluntary sector plays a key role in the social and economic development of the country. Voluntary organizations have been able to reach the remote corner of the country braving adverse situations. Voluntary organizations have also been known for exemplary selfless service to the less privileged and marginalized sections of the society.

Inspite of all these the voluntary sector suffers from lack of clarity and operational difficulties in its accounting, reporting, management and legal framework. For the sake of discussion, I have divided the areas into four.

2.1 Legal framework and Governance

2.2 Accounting and Reporting

2.3 Income Tax

2.4 FCRA

We will discuss each of these areas and bring up certain key issues.

2.1 Legal Framework & Governance -

Voluntary organizations can be registered broadly in three ways. They are:

2.1.1 Registered Public Charitable Trust

2.1.2 As a Charitable Society

2.1.3 As a Not-for-Profit Company (Sec.25 of Companies Act 1956).

Each of them have their own issues to deal with.

2.1.1 Registered Public Charitable Trust

Indian Trust Act, 1882 is not applicable to Public Charitable Trusts. Therefore, Public Charitable Trusts are registered as a Trust under General Law with guidance from:

- Charitable & Religious Trust Act 1920.
- Religious Endowment Act 1863.
- Bombay Public Trust Act 1950.

The trust deed is only registered. As a result, once these organizations are formed, there is no mechanism within the frame work of the law to regulate them. The only exception being the states of Maharashtra, Gujarat and Goa where there is charity commission. But a very little facilitation for trusts is observed. They have to be registered under Income Tax Act, 1961 when they seek Income Tax exemption and under FCRA, 1976, if they apply for foreign contribution. But the basic regulatory mechanism for public charitable trusts is not there. Therefore, it is entirely left to the organisations to make necessary practices and procedures for good governance.

2.1.2 Charitable Societies

Charitable Societies are registered under Societies Registration Act, 1860.On one hand, the Act is very old and in some sense has outlived its utility. On the other hand, there is every poor administration of the Act. Then there are different requirements for different States as there are State Acts as well. For example, in the state of Karnataka, the Act requires that 1% of the total receipts for the year is paid as filing fees along with the annual return of the society for the year. In the State of Uttar Pradesh and in some other States, the registration is available for only five years and then it has to be renewed. Since many of these offices of Registrar of Societies are not computerised, it is very difficult to know the status of the returns of any society. Therefore, the Registrar of Societies plays a very little regulatory role for Societies. In this scenario, it is difficult even to get data about the actual member of active NGOs registered under the Act. Since there is no real compulsion to dissolve the organisation once the members are not actively pursuing its objective, therefore there are plenty of dormant NGOs.

2.1.3 As a Not-for-Profit Company (u/s 25 of Companies Act, 1956)

This form of registration is by far the best regulated. The Registrar of Companies is quite active in regulating entities registered under the Act. However, since the reporting requirements are more, small and medium sized organisations find it difficult to cope with it.

2.2 Accounting & Reporting

The accounting legislation applicable to NPOs do not lay down the form of balance sheet and the requirements as to income & expenditure account. Even there are no requirements for additional disclosure. As a result of which these issues are left to the judgement of the accountants and auditors. Therefore, we can see today that there are many annual accounts of NPOs which do not even have previous years figures, leave alone disclosure practices.

There are no specific accounting standards for NPOs in India. The Institute of Chartered Accountants of India has come out with “Technical Guide on Accounting and Auditing in Not-for-Profit Organisations“. The guide strongly recommends:

- Maintenance of books as per accrual basis;
- NPOs should follow the accounting standards irrespective of whether any commercial, industrial or business activity has taken place.

However, we must note that there are certain areas very much NPO specific which have been left un-explained. For example, NPOs raise a lot of non-cash local contribution. The accounting and reporting of it is a major challenge before the sector. The Income Tax Act does not recognize non-cash contributions and therefore they have to be kept outside of the return for income tax. The FCRA requires a Receipt & Payment Account and Balance Sheet. This again implies that the non-cash contributions need not be reported to FCRA authorities as well.

The second example is treatment of restricted fund. The restricted funds are not the income of the organisation as they are for a pre-determined purpose and the NGOs do not have any control over it. Therefore, a clear direction from ICAI on this issue will be helpful.

Thirdly, ICAI strongly suggests accrual basis of accounting for NPOs. It also needs to come out with a practical guide on ways to implement it in an organisation. There would be issues like grants due but not received, corresponding expenses etc.

Fourthly, ICAI also needs to suggest certain disclosure norms for NPOs as well as standardized form of Balance Sheet and fund based accounting statements (instead of Income & Expenditure Account).

2.3 Income Tax

Under the Income Tax Act, 1961, the NPOs are not required to pay tax if they follow certain reporting requirements. However, NPOs are facing certain operational difficulties under this Act as well.

- Until the year 2001, the NPOs were able to accumulate income up to 10 years and spend it within that period. However, in the Finance Act, 2001 the 10 years period was reduced to 5 years.
- In the year 2002, accumulation of income which was earlier allowed up to 25% of the total income was reduced to 15%.Further Inter-Charity donations out of accumulated funds were also not allowed.
- Now in 2006, Section 115 BBC was inserted according to which any charitable organisation receiving anonymous donations would be charged to tax at the maximum marginal rate.

We can see that systematically certain privileges which were earlier available are being withdrawn. This is a cause for concern. Whereas as an NPO there is no doubt that it would be committed to highest level of accountability, certain amount of space need to be provided for it to perform better. Another issue that comes up is that India becoming the hub for development in South Asia, there is a need for mobility of funds within South Asian countries. As per the Income Tax Act, at present, the funds can be utilized only within India to be eligible for exemption from Income Tax.

2.4 FCRA

FCRA was enacted in the year 1976. Therefore it is now 30th year of the implementation of the Act. Being an internal security legislation, this is under the Ministry of Home Affairs. There are few issues/concerns which need to be addressed for smooth functioning of the sector.

2.4.1 Bank Accounts:

There needs to be a clarification from the FCRA department authorities about multiple bank accounts. As per the Act, only one designated bank account can be opened for receipt of foreign contribution. However, it is not explicitly stated that for utilization, there can be more than one bank account even through practically, it is implied that an organisation cannot operate with a single bank account for implementation of its programme given the fact that the actual operational area may be far away from the place where FCRA designated bank account is situated. The draft Foreign Contribution (Management & Control) Bill, 2005 makes it explicitly clear that multiple bank accounts are allowed for utilization of foreign contribution. Therefore, it may be deduced that the intent of the law makers is to allow multiple bank accounts for utilization.

The second issue under bank account is the change of designated bank account. It may be helpful to stipulate a time-limit for disposal of the application for change of designated bank account. This will help many NGOs who struggle with certain inefficient banks to operate their designated bank account and are apprehensive to approach the FCRA department to change lest they have problem with their FCRA registration.

2.4.2 Change of Office Bearers:

On 27.12.1996, the Form FC-8 was changed which includes a declaration by the Chief Functionary to give an undertaking which among other conditions, ,specifies that foreign contributions should not be accepted if more than 50% of office bearers as mentioned in the application at the time of registration are replaced or changed. This is not valid for organisations registered before 27.12.1996.

This declaration in certain ways limits good governance. One of the ways of promoting good governance is rotation/ term of board members. Therefore, this declaration needs to be removed to enable organisations to be better governed.

2.4.3 Time Limit for regular registration

Presently, there is no time limit prescribed under the Act to approve or reject the application in Form FC 8 for regular registration. It is important that a time limit is prescribed for disposal of application for regular registration.

2.4.4 Foreign Contribution (Management & Control) Bill, 2005- Few Concerns :

The draft Foreign Contribution (Management & Control) Bill, 2005 which was put in the public domain for discussion has thrown up some very serious concerns for functioning of NGOs. Some of them are:

- Renewal of registration every five years;
- Fixing of Administrative Cost;
- Disposal of Assets,

We do hope that the government would take note and act on a series of representations from the voluntary sector to this effect.

Conclusion:

In conclusion, one must say that accountability issues are non-negotiable for the voluntary sector. Whereas the accountability issues should not be compromised at any cost, at the same time, enabling environment must be created for voluntarism. At the moment, the laws are such that it is quite a challenge to setup a voluntary organisation. Right from legislation to other laws like Income Tax, FCRA etc. need to be easily accessible to encourage and sustain voluntary efforts. The laws need to be compliance oriented rather than control oriented. Further, there should be uniformity in compliance requirements from various legal bodies. For example, if ICAI recommends accrual basis of accounting, then that should be acceptable to FCRA as well. Similar is the case with accounting for non-cash local contribution. Common understanding on these issues will save the voluntary organisations from compliance hardships and they can target their efforts to the social objectives.

- Sanjay Patra,
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Taxability of Voluntary Contributions and Computation Of Expenditure On Non-Taxable Income

The exempted Institutions falling within the meaning of 10(23C), such as :

- University or other Educational Institutions existing solely for educational purposes and not for purpose of profits,
- hospital or other Institution for the hospitality and treatment of persons suffering from illness or mental defectiveness or
- hospital or other Institution for the hospitality and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit are coming under taxation, based on their income from voluntary contributions. At present these institutions and trusts are availing tax benefits because of the specific exemption available under the Income-T ax Act. There are certain debatable issues and different interpretations are arising out of the donations or voluntary contributions received by these Institutions, religious trusts and charitable trusts.

In order to regulate all these institutions, the Finance Minister has proposed certain changes in the Finance Bill, 2006. The definition of the term "income" in clause 2(24)(iia) is extended to cover all the voluntary contributions or donations received by the University or other Educational Institutions or by Hospitals or other Institutions referred to in sub clause (vi) or sub clause (via) of section 10 [23C] as income retrospectively with effect from 1st day of April, 1999 i.e. for the assessment year 1999-2000 onwards. Hitherto the voluntary contributions received by a trust registered under section 12A only was covered under this definition.Further it is proposed to include in this definition of income, the voluntary contributions received by a University or other educational institution referred in sub clause (iii ad) or by any hospital or any Institution referred in sub clause (iii ae) of section 10(23C) of the Income tax Act with effect from 1st April 2007. In section 10(23C), there are different classifications among the public institutions based on the quantum of gross receipts and financial assistancetance from the Government. The institutions covered under sub-clause (iiiab) and (iiiac) are wholly run by substantial finance by Government and their income is fully exempted from the tax. The institutions specified in sub clause (iii ad) and (iii ae) such as university or any educational institution or hospital or other institution whose gross income or receipt does not exceed Rs. 1 crore in any financial year are not required to file returns of income with the department.

Whereas, in the case of institutions specified in clause (vi) and (via) whose gross income or gross receipts exceed Rs.

1 crore must be approved by the prescribed authority for claiming exemption from taxation. These institutions are required to file the return of income within the time limit specified under section 139(1).

There was a proposal in the year 1973 on the recommendation of Wanchoo Committee to tax the unidentified donations received by the charitable or religious trusts. But subsequently, based on the recommendations of the Select Committee of the Parliament, it was withdrawn. The growth in the number of institutions under this exempted category was closely monitored by the Government and it was found that the donations received by these institutions from unidentified persons were out of tax net. In the case of *Director of Income-tax (Exemption) Vs. Keshav Social & Charitable Foundation (2005) 146 Taxman 569 (Del.)*, the High Court has held that even when the donations were received by the trust from donors who were fictitious persons and the trust was unable to explain it properly, such donations were not taxable.

In the present case, the assessee had not only disclosed its donations, but had also submitted a list of donors. The fact is that even if complete list of donors was not filed and that the donors were not produced, it does not necessarily lead to the inference that the assessee was trying to introduce unaccounted money by way of donation receipts. The Court further held that the Assessing Officer cannot apply section 68 because the assessee had in fact disclosed the donations as its income and it cannot be disputed at all that receipts other than corpus donations would be income in the hands of the assessee.

Applying this principle, the donations or voluntary contributions from any unidentified persons or any anonymous donations cannot be taxed under any provisions of the Income tax Act. A similar logic can be applied for the institutions specified under section 10(23C).

The Finance Bill, 2006 proposes that all the voluntary contributions received by a university or other educational institution or Hospital or any other institution irrespective of the fact whether their gross receipts exceed Rs.1 crore or not should be treated as income.

In view of this, two new sections are proposed to be inserted viz section 13(7) and section 115BBC. As per new section 13(7), the operation of sections 11 and 12 in relation to the exempted trust relating to anonymous donations referred in section 115BBC is to be excluded and such anonymous donations will be treated as part of the total income. The proposal is focusing on these institutions specified in section 10 [23C] and trusts or institutions referred to in section 11 and includes any income by way of anonymous donations. As per the new section 115BBC any income by way of anonymous donations of the entities referred to in section 10(23C) shall be subject to income-tax. These entities are required to pay the tax aggregate of tax calculated on the income by way of any anonymous donations at the rate of 30% and the amount of tax with which the Assessee would have been chargeable as per the regular provisions.

The explanation for anonymous donations as per sub section 3 of section 115BBC provides that anonymous donations means any voluntary contribution referred to in sub clause (ii a) of clause 24 of section 2, where a person receiving such contribution does not maintain the record of identity by indicating the names and addresses of the persons making the donation and such other particulars as may be prescribed.

There is a specific exemption available for the trusts or institutions created or established wholly for the religious purposes. Only those Institutions created or established wholly for the religious purposes are exempted from the taxability of anonymous donations. Similarly, anonymous donations received by any trust or institution created or established wholly for both religious as well as charitable purposes come within the scope of section 115BBC, only if such anonymous donations are made with a specific direction that such donation is for any university or other education institutions or any hospital or other medical institution run by such trust or institution.

Whether any sum is found credited in the books of an assessee maintained for any previous year, if the assessee had not offered proper explanation about the nature or source thereof or the explanation offered is not to the satisfaction of the Assessing Officer, that amount should be treated as income of the assessee of that previous year. At present, there are a number of cases where these institutions offered this unexplained credit as income and have claimed that they have applied the income to the extent specified under section 11, i.e. 85% for charitable or other objects for which they have been established. Hence, they claim that they are not subject to taxation.

Now the definition of anonymous donation will widen the powers of the Assessing Officer to enquire specifically with reference to section 68 and other donations received by these institutions. These institutions would be required to maintain proper details to prove beyond the doubt, the names and addresses and means of the persons who donate the money. Otherwise, the Department will take a different view with reference to section 115BBC and subject the donations for taxation. Even though, where all the details are given under section 115BBC regarding the Donors, the Assessing Officer still has the power to enquire into them.

The voluntary contributions received by these institutions or charitable trusts are to be utilized only for the purpose for which they have been established. There is no specific definition relating to what is a voluntary contribution under the Income-tax Act, 1961. Broadly, there are two types of voluntary contributions – one is voluntary contribution in the form of donation for general purpose and the other is donation for specific purpose or corpus donation. In the Income Tax Act, 1961, there is no definition for “corpus donation”, however, the distinction between the two can be established with reference to section 11(1)(d) and section 12 both read together with section 2 (24) (iia) that the voluntary contributions received with a specific direction that they should form part of the corpus of the trust are not includible in the total income. However, the applicability of section 115BBC cannot be ignored. The definition of anonymous donation will cover both regular donation and corpus donation. The donation received in kind but if it is not properly explained, can also be treated as anonymous donations. This proposed amendment will set right certain anomalies and disputes with reference to income of the exempted trusts and institutions.

As per the Memorandum explaining the provision in the Finance Bill, 2006, the proposed section 115BBC will cover the following institutions:

(i) Any trust or institution referred to in section 11;

(ii) Any university or other educational institution referred to in section 10(23C) (iiiad) and (vi);

(iii) Any hospital or other institution referred to in section 10(23C) (iiiae) and (via);

(iv) Any fund or institution referred to in section 10(23C) (iv);

(v) Any trust or institution referred to in section 10(23C) (v)

Whether the Assessing Officer empowered under section 142A for the purpose of assessment can refer the case to the valuation cell to find out the cost of construction of the property belonging to the trust or institutions and thereafter add the difference between the cost disclosed in the books of account and the value determined by the valuation cell treating the same as anonymous donation?

Will acceptance of anonymous donations lead to the withdrawal of exemption granted by the prescribed authority or cancellation of a registration granted under section 12A is another debatable issue.

Computation of Expenditure on Non-Taxable Income

The existing section 14A of the Income-tax Act was introduced through the Finance Act, 2001 retrospectively with effect from 1.4.1962 to nullify the decision of the Apex Court in Rajasthan State Warehousing Corpn. Vs. CIT (2000) 242 ITR 450 (SC). The Apex Court in its decision held that where an assessee is carrying on an indivisible business yielding taxable and non-tax-able income the entire expenditure can be deducted without any apportionment of expenditure relating to non-taxable income. In view of the retrospective amendment by inserting section 14A, the Finance Act, 2001 set rest all the controversies relating to the claiming of expenditure, commonly with taxable and non-taxable income.

The solid and deliberate intention of retrospective legislation was, warranted to tax the correct income. The total income as per section 2(45) computed in the manner laid down in this Act referred to in sec- tion 5 has to be computed with reference to the permissible deductions specified in section 15 to 59 for all the sources under the five heads as mentioned in section 14. There are a number of disputes among the taxpayers relating to allocation of expenditure against the non-tax-able income and the method adopted in each case. There is considerable debate on this issue. The assessees having non-taxable income such as dividend, tax free interests etc. are apportioning expenditure, proportionately. However, there was always difference of opinion in computation. The Bill proposes to insert two new clauses under section 14A so as to provide a method of apportionment of expenditure against taxable and non-tax-able income.

As per the proposed new subsection 2 in section 14A, it is mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to such income which does not form part of the total income. The Government will prescribe the method of computation and it has to be applied only when the Assessing Officer is not satisfied with reference to the accounts maintained by the assessee and as to the correctness of the claim of expenditure relating to the income not includible in the total income of the assessee. Further, the new sub section 3 to section section 3 to section 14A empowers the Assessing Officer to apply the method of computation where the assessee has claimed that he has not incurred any expenditure in relation to income which does not form part of the total income. This amendment will be applicable with effect from 1st April 2007 and accordingly apply in relation to assessment year 2007-08 and subsequent years.

- G. Ramaswamy
(The author is Central Council Member, ICAI.)
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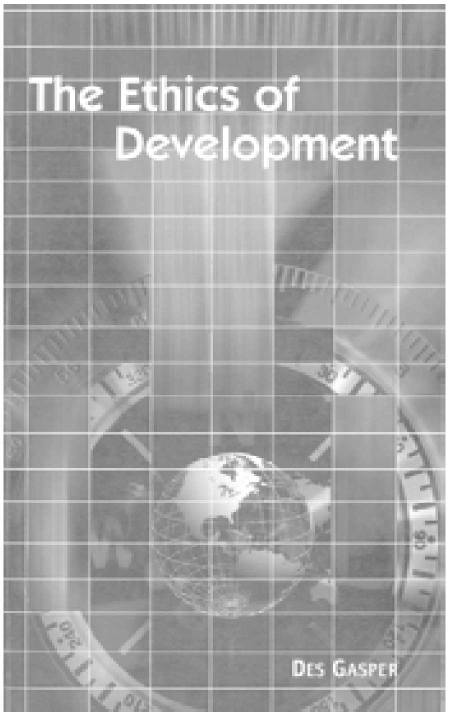
The Ethics of Development



Author: Des Gasper
Vistaar Publications, New Delhi
Rs. 295/-

"Development is a term ubiquitous in daily language" .The book, 'Ethics of development' explores the various meanings given to development in the broad sense of progress or desirable change. At the very beginning, the author Des Gasper clarifies the rationale and meanings of 'development ethics'. He examines the concept of development in some detail. He describes the various connotations of the term ranging from its synonymity with change/modernization to improvement or an agent that facilitates improvement. The book throws light on the inadequacy of equating development with the sense of social improvement, with economic growth and its social concomitants. An entire chapter is devoted to the basic needs approach where the contributions of Amartya Sen, Jean Dreze and Martha Nussbaum are discussed.

The issue of universality versus relativism is explored in the book. The question of how far do concepts of good development contain universally shared and valid elements and how far are they culturally relative is dealt with in this book.

The book focuses on concepts along with ongoing reference to cases, contexts and individuals. The emphasis throughout is on probing and clarifying the meanings, uses and areas of relevance of some key concepts like development, efficiency and effectiveness, equity , culture etc. examination of concepts is partnered with examination of cases and contexts. The book goes on to explore an alternative concept – "that of human development". It brings together ideas from philosophy , economics and social theory and elucidates complex issues with the help of historical and contemporary examples.

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