INTER face

towards promoting accountability

April - June 2005
Volume-V, Issue-I

A Publication of FMSF
(for private circulation only)

Between Us...

"HOW GREAT THOU ART"...

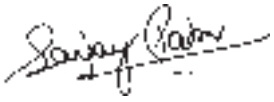
We invent nothing, truly. We borrow and re-create. We uncover and discover. All has been given, as the mystics say. We have only to open our eyes and hearts, to become one with that which is.
- Henry Miller

Visiting the country side in India can be very fascinating. Every time I have visited the villages, forests and fields, I have come back energized, revitalized and with a greater resolve to work for the poor, deprived and marginalized.

This particular incident is about one such visit that I undertook. I was traveling extensively in an area which had not received a decent rainfall for more than four years in a row. It was early summers and the day time temperature was shooting up to more than 40 degrees. I was able to see peoples' struggle to make a living out of the reality of the situation they were in. One thing was clear. They had not given up hope. I could see a number of check dams, water harvesting structures etc. Everything was ready and the stage was set for the rains to come down. Due to absence of rains, all around was brown. There was not a shade of green anywhere. Seeing all this, I thought, "the more we exploit nature, the more our options are reduced; until we have only one: fight for survival" coz 'Nature understands no jesting. She is always true, always serious, always severe. She is always right, and the errors are always those of man.' (Johann Wolfgang Von Goethe)

Excogitating, I came to a small village that evening to stay. This village was very beautifully located under the foot hills. It was already dark when I reached the village and I could see that there was fire in one of the mountains and was wondering about the cause of it. I reached the village where I was to stay over night. My host was waiting. We sat down to have dinner. He said "to-day again they put fire to the dry trees on the mountain. It will be very detrimental to the eco-system and the environment". Then he said some thing which was very thought provoking He said "the nature has a tremendous capacity to bounce back. How much it is abused, with a little care it rejuvenates". I thought to myself about the power the nature possesses. How much of love it has for the abuser called human beings.

It was late already. My host told me "Let me show you where you will sleep to-night". He took me to the terrace of a house. There was a bed prepared on the terrace. As I lay there on my back, I saw numerous stars and the moon providing the light. I felt lying in the lap of nature. I whispered in my hearts for the hand behind all these "HOW GREAT THOU ART"!!!



contents...

for private circulation only

April - June 2005

Editor : Sanjay Patra

Associate Editor : S. P. Selvi

Published by Sanjay Patra
on behalf of
Financial Management
Service Foundation
"ACCOUNTABILITY HOUSE"
A-5, Sector 26, NOIDA - 201 301

Tel: 00-91-120-2546732,
2546733, 2546744, 2546745
(For calling from Delhi -
95120 - 2546732/33/44/45)
Fax: 00-91-120-2546731

E-mail: fmsindia@vsnl.com;
fmsf@vsnl.com;
fmsf@fmsfindia.org
Web-sites: www.fmsfindia.org
www.fmsfindia.org.in
www.legalissuesforngos.org
www.fcraforngos.org

Financial Management Service Foundation
10
1994 Anniversary 2004
Celebrating Partnerships

The Finance Minister of India presented the first full year budget of the United Progressive Alliance (UPA) Government on February 28th, 2005. The stated ambitions of the UPA include the promotion of economic growth (especially job creating growth), the initiation of a rural employment guarantee scheme as well as a focus on agriculture and infrastructure and ensuring that there is greater and more efficient fiscal devolution. This article attempts to outline the performance of the budget in delivery against these objectives as well as placing the numbers of the budget in the larger context of the economic policy of the government. It suggests that though there

Union Budget 2005 - An Analysis

have been definite steps forward in health and education, areas including devolution, transparency and job creation have not got the attention that was promised by the UPA.

One of the positive sides of the budget has been the increase in allocations for both education and health under different programmes of the government. The allocation to the Sarva Shiksha Abhiyan is now to be routed through a non-lapsable fund called the Prarambhik Shiksha Kosh. The total allocation for SSA this year is at Rs. 7,156 crores (Rs. 71.6 billion). As the provision of a nutritious cooked meal could help to increase attendance, the allocation for the National Programme of Nutritional Support to Primary Education has almost been doubled to nearly Rs. 3,000 crores (Rs. 30 billion). Both these increases have been made possible through the cess levied on all taxes that will fund these programmes. Additionally, the allocation for the Integrated Child Development Scheme (ICDS) has been increased to Rs. 3,142 crores (Rs. 31.4 billion) which will no doubt help the anganwadi centres and the children in these centres. However, it will be interesting to see the PSK funds evolution over a period of time.

Students travelling abroad can now gain exemption from tax for all interest accrued for loans taken. However, this is limited to a few fields like science and management leaving out many others including the humanities, law and the social sciences. It is nonetheless beneficial for some students though it might start a selection of 'marketable' courses in preference to other courses that are also needed for the country. SC/ ST students undertaking higher education benefit through a grant of tuition fees and expenses if they gain admission to a specified list of institutions. This will help a few individuals who are unable to fund their studies even after gaining admission to these institutions.

A new programme of the government is the National Rural Health Mission to be launched and funded through a cess on tobacco and products including paan, gutkha and cigarettes. The Department of Health and Family welfare allocation up to Rs. 10,280 crores (Rs. 103 billion) and is likely to go up considerably as soon as the cess for the NRHM is collected and then disbursed in the year 2006-07. However, a simultaneous development that is likely to make healthcare more expensive is the passage of the Patents Bill. While it is not within the scope of this article to address those issues, the regime of patents that are proposed are likely to make pharmaceutical companies considerably richer while increasing the medical bills of ordinary people.

The Finance Minister outlined a whole programme of change called 'Bharat Nirman'. While the objectives of the programme are no doubt noble, there is practically no extra money going towards it. When compared with the Rs. 5,500 crore (Rs. 55 billion) allocated for the National Urban Renewal Mission, 'Bharat Nirman' remains at best an attempt to build castles in the air.

As stated in Bharat Nirman, one of the objectives of Bharat Nirman was to construct 60 lakh (600,000) houses for the poor. There is a total allocation of just over Rs. 2,500 crores (Rs. 25 billion) for both the Indira Awas Yojna and the Valmiki Ambedhkar Awas Yojna which are the two housing schemes of the government. This is only marginally above the previous years allocation. However, the allocation to HUDCO is increased by over Rs. 1,000 crores (Rs. 10 billion) to Rs. 6,746 crores (Rs. 67 billion). It is ironic this expenditure in the Urban Employment and Poverty Alleviation Ministry is not even given an explanatory note on the purpose of allocating so much money to HUDCO which cannot augur well for a more transparent and accountable system. How much of this allocation will then fund housing (especially low income housing) is a separate question.

One of the flagship programmes of the UPA was the Pradhan Mantri Grameen Jal Samvardhan Yojna which was allocated Rs. 200 crores (Rs. 2 billion) to repair, renovate and restore all the water bodies that are directly linked to agriculture in the budget for 2004-05. Since that promise was made, the actual allocation was just Rs. 5 crores (Rs. 50 million). This year's budget has subsequently reduced the allocation to zero. The onus for this programme has apparently been shifted to the state governments. Similarly, the promise to increase micro-irrigation gets a funding of just Rs. 400 crores (Rs. 4 billion) (at slightly over Rs. 1000 per acre). How the finance minister plans to create micro-irrigation schemes at that price is really anybody's guess.

When the dramatic increase of the last budget took place for the defence forces, it was stated that it was to fund long pending capital goods purchases. However, the expenditure this year has been increased by 7.8% this year and again; it is stated to be for capital good purchases. The need for money for the defence forces is not in doubt. However, the repeated omissions and errors pointed out by the Comptroller and Auditor General, especially in defence spending means that that there is a greater need for more transparency in defence expenditure without compromising the security of the country.

Another worrying feature of the budget has been the use of special purpose vehicles (SPVs) with or without the levy of a cess. The reason given often is that it will improve performance as budgets get linked with performance. However, one immediate negative outcome of these SPVs including the Rs. 10,000 crore (Rs. 100 billion) fund for infrastructure take away power from local (and sometimes state) governments and give this to para-statal bodies. In addition, such moves do not do anything to address systematic failures of the system through better governance practices. Even the levy of a cess (instead of an allocation from tax receipts) for education and health reflect an inability of the government and more broadly civil society to prioritise human development, necessitating the use of special instruments that will fund this sector. Similarly the Rs. 5,500 crores (Rs. 55 billion) for the National Urban Renewal mission is to be routed non-elected para-statals or SPVs like the Bangalore Metro and the Mumbai Trans Harbour link. The effects of the lack of transparency in decision making in these projects will only be felt later if they turn out to be financial white elephants.

Another example is the National Highways Development Programme, which is given an allocation for Rs. 9,230 crores (Rs. 92 billion). This programme like many others uses the SPV route, bypassing the state and the local government using a fairly heavy top down approach to the development of the road network. While the Highways Development Programme funded through a cess on petrol and diesel gets some money, the largest payer of this cess (the Indian Railways) gets just Rs. 400 crores for the construction of road and rail bridges. The wisdom currently seems to promote road based transport, which is generally used by the people of the higher income groups. Expanding the definition of highways to include high-speed railways would certainly help to improve both access and reach of travel to the lower strata of society.

The Finance Minister has made a promise to increase the financing of the National Rural Employment guarantee scheme. However, when one looks through the numbers, there is actually a fall in the allocation for Sampoorna Gramin Rozgar Yojna (SGRY) by nearly Rs. 1,000 crores (Rs. 10 billion). It is compensated by a provision of Rs. 5,400 crores (Rs. 54 billion) allocation for the National Food for Work scheme, but it remains a question whether this allocation is just a method to offload the surplus food stocks at the Food Corporation of India godowns. The experience of Maharastra, which increased employment through a food for work horticulture programme, has not been used with a small allocation of Rs. 630 crores (Rs. 6 billion) for the National Horticulture Mission.

The budget also makes a few assumptions regarding the readiness of different layers of government to accept and manage funds. Though local governments are gradually getting more funds through devolution and other schemes including the National Rural Employment Guarantee Act, very little is allocated for capacity building. The lack of funding for education and training will ensure that the non-elected programme officer will continue to wield considerable powers while the gram panchayat remains fairly toothless. In addition, in the case of poor application of funds, the strident calls for reduction of government is likely to get louder when such a situation could have been anticipated and dealt with earlier.

While the budget makes a lot of noise about the poor and the marginalized, apart from the education and health, there is very little cheer for the development sector. It seems that the finance minister has paid lip service to development while allocating money quite liberally to other areas including urban renewal and infrastructure which are no doubt needed but do not help to create as many jobs as a rural employment guarantee scheme or provide relief through a comprehensive irrigation scheme. It is essential as some say, to put the money where the mouth is…..

- Jacob John, FMSF

Charitable Institutions and Trusts exempted from the Fringe Benefit Tax.

The Finance Minister Mr.P.Chidambaram had proposed Fringe Benefit Tax in the Finance Bill 2005 which aimed to tax certain expenses incurred or payments made by the employer for or to the employees in the hands of the employer.

We had circulated a mail to many voluntary organisations about the adverse impact it can have on the functioning of the voluntary organisations if they will be subject to this tax. We had also shared a copy of the letter by FMSF written to the Finance Minister drawing his attention to the concern of the sector and requesting him to exempt voluntary organisations from the ambit of Fringe Benefit Tax. Many of you had also written to the Finance Minister in the above lines.

We are happy to inform that the Finance Minister has accepted this request of the Voluntary sector and has announced on May 2, 2005 that the **Charitable Institutions and Trusts will be exempt from the Fringe Benefit Tax.**

Salient Features of the Finance Act 2005

Relevant for Individuals and Non-Profit Organisations

A. INDIVIDUALS

1. Changes in Tax Rates

The Finance Bill, 2005 proposes to make changes in the tax rate that are applicable to individuals, Hindu Undivided Family (HUF), firms, companies etc as a part of a method to reduce the tax burden on individuals and increase the tax base. The new tax rates shall be as follows:

Income Slab	Rates Proposed
Upto Rs.1,00,000	Nil
Rs. 1,00,001 to 1,50,000	10%
Rs. 1,50,001 to 2,50,000	20%
Above Rs. 2,50,000	30%

For women, the maximum amount not chargeable to tax shall be Rs.135,000*. Similarly for senior citizens, the maximum limit for non-taxable income has been increased to Rs.185,000.00* Where the total income exceeds Rs.185,000 but does not exceeds Rs.250,000, tax at the rate of 20% of the amount by which the total income exceeds Rs.185,000 would be leviable. And if the total income exceeds Rs.250,000, tax at the rate of 30% shall be payable.

The surcharge is payable only when income exceeds Rs. 10 lakhs per annum as against presently payable when income exceeds Rs.8.5 lakhs per annum . The 2% Education Cess will continue to be payable by all on the amount of tax paid at the rates in force.

2. Removal of Standard Deduction and other Exemptions under Section 88.

Under section 16 of the Income Tax Act, 1961, an assessee whose income from salary does not exceed Rs. five lakhs is presently allowed a deduction of forty percent of salary or thirty thousand rupees, whichever is less. Where income is higher than Rs. 5 lakhs, the deduction is twenty thousand rupees. Section 16 is

*(*Initially at the time of presentation of budget, it was proposed that the maximum amount not chargeable to tax shall be Rs.125,000 in case of women and Rs.150,000 in case of senior citizens. On 2nd May, 2005, Finance Minister presented a Notice of amendments and increased the limit to Rs.135,000 and Rs.185,000 respectively.)*

proposed to be amended to eliminate these benefits. ***Therefore, no standard deduction will be available to any category of salary.***

3. Removal of Exemption under section 88 and introduction of new deduction under section 80C.

The existing deductions under Section 88 in respect of payment towards Life Insurance Premium, contribution towards Provident Fund, Public Provident Fund, National Savings Certificate, expenditure on education of children, repayment of housing loan and investment in eligible issue of capital is proposed to be withdrawn and substituted by a new scheme being reintroduced under Section 80C whereby a deduction upto Rs.1 lakh shall be allowed from Gross Total Income to an individual or Hindu Undivided Family, with respect to sums paid or deposited in the previous year out of income chargeable to tax towards life insurance premium, contribution to provident fund, purchase of infrastructure bonds, payment of tuition fees for children education, repayment of housing loans etc. However, there will be no sectoral limit i.e. the assessee shall be free to pay the entire amount towards life insurance premium or to claim benefit of the entire amount in one or more of the eligible investment

4. Elimination of tax rebate for senior citizens and women under Section 88B and 88C

Presently under section 88B, senior citizens are allowed an additional exemption of Rs.20,000 from tax payable and under section 88C, resident woman are allowed an additional exemption of Rs.5,000 from tax payable. In view of the proposed increase in exemption limit for both senior citizens and women , the benefit of rebate in tax under section 88B and 88C are withdrawn.

5. Deduction under Section 80L withdrawn

The present benefit of deduction under Section 80L of Rs.12,000 in respect of interest from bank, post office etc., and Rs.3,000 on account of interest from government securities is also being withdrawn.

6. Ceiling of Rs.1 lakh to include benefit available under Section 80CCC and 80CCD

Presently, under Section 80CCC a deduction of Rs.10,000 is allowed in respect of contribution to Retirement Pension Plan of an insurance company and under Section 80CCD a deduction is allowed to the employees of Central Government in respect of employer's and employee's contribution to the pension scheme of the Central Government. Under the new proposed provisions, the aggregate amount of deduction under Section 80C, Section 80CCC and Section 80CCD shall not exceed Rs.1 lakh.

7. Filing of Return in case the electricity bill exceeds Rupees Fifty Thousand

Under Section 139, a person is required to file his return under what is commonly referred to as the one- in-six scheme. In this list, another category has been included for persons incurring an expenditure of more than fifty thousand rupees on consumption of electricity. Such persons will be obliged to file their return irrespective of their level of income w.e.f. Assessment. Year 2006-2007.

8. Levy of Banking Cash Transaction Tax

The Finance Minister has proposed a very interesting new provision for levy of Banking Cash Transaction Tax. This proposal is being introduced as a measure to check tax evasion. Under this scheme, following transactions with bank will be subject to tax at the rate of 0.1% of the amount of banking transaction:

(i) Withdrawal of cash on any day from an account other than a savings bank account maintained with any scheduled bank or

(ii) Receipt of cash from any bank on any single day on encashment of one or more term deposits, whether on maturity or otherwise.

Provided that the amount of transaction shall be exceeding:

a) Rs. 25,000 in case such withdrawal is from the account, term deposit or deposits in the name of individual and Hindu undivided family.

b) Rs.1,00,000 in case such withdrawal is from the account, term deposit or deposits in the name of a person other than individual and Hindu undivided family

B. CHARITABLE INSTITUTIONS

1. Fringe Benefit Tax (Chapter XII-H)

A new chapter (XII-H) with sections 115W to 115WL is proposed to levy additional income-tax on fringe benefits. Fringe benefit has been defined in section 115B as any privilege, service, facility or amenity provided or any reimbursement made or any free or concession ticket provided for private journeys by employer to employees or any contribution by the employer to approved superannuation funds. The definition has been extended to include deemed fringe benefits such as entertainment, gifts, festival celebrations, use of health club, sports facilities, telephone and scholarship to children of employees among others. The proposed fringe benefit tax is at a rate of 30% and is to be paid by the employer before the due date as provided under section WD.

However in the Notice of Amendments presented by the Finance Minister on 02.5.2005, it has been provided that the charitable institutions and trusts will be exempt from Fringe Benefit Tax.

C. SERVICE TAX

All small service providers are exempt from service tax. If their annual turnover is less than Rs. 4 lakhs, then the service provider does not have to pay tax.

1. Some more services brought under the net of Service Tax Act:

It is proposed to bring the following services under the net of Service Tax:

1. Transport of goods other than water through pipeline or other conduit

2. Site formation and clearance, excavation and earth moving and demolition and such other similar services, other than those provided to agriculture, irrigation and watershed development

3. Dredging services

4. Survey and map making

5. Cleaning services except those in relation to agriculture, horticulture, animal husbandry or dairying

6. Services, facilities or advantages for a subscription or any other amount to its member by any club or association

7. Packaging Services

8. Mailing list compilation and mailing

9. Construction of residential complexes having more than twelve residential houses

D. VALUE ADDED TAX

1. **Introduce Value Added Tax from April 1st, 2005**

It is proposed to introduce Value Added Tax from April 1st, 2005 as scheduled.

- Purnima Jolly, FMSF

Taxation Amendment Bill 2005

On 12th May, 2005, Finance Minister introduced the Taxation Law Amendments Bill, 2005 in the Lok Sabha in order to amend the Income Tax Act, 1961. The important amendments as applicable to charitable and religious institutions are as follows:

1. Increase in limit for getting accounts audited by Charitable Trusts claiming exemption under section 11

Under the exiting provisions of section 12A of the Income Tax Act, if the total income of the trust or institution as computed under the Act without giving effect to the provisions of section 11 or 12 exceeds Rs.50,000 in any previous year, the accounts of the trust or institution for that year shall be audited and such audit report shall be furnished alongwith the return of income.

It is proposed to amend this section by providing that the accounts of the trust or institution for that year shall be audited and such audit report shall be furnished alongwith the return of income if the total income of trust or institution exceeds the maximum amount not chargeable to income tax i.e. Rs,1,00,000 as per the proposed tax rates.

2. Charitable and religious trusts and institutions registered under section 10 (23C) of the Income Tax Act to obtain one time approval

As per the present system, the Central Government can notify trusts and institutions established for charitable and religious purposes to be exempt from tax for a period not exceeding three years. The new amendment bill proposes to withdraw the above proviso of giving exemption for 3 years. As a result trusts and institutions established for charitable and religious purposes can get one-time approval from Central Government. Also, it has been provided that this approval shall be granted or rejected within a period of 12 months from the end of the month in which such application is received.

3. Audit of Charitable, Religious, Educational and Medical institutions registered under section 10 (23C)

In the amendment bill, it has been proposed that the following shall be required to get their accounts audited by a Chartered Accountant in case the total income exceeds the maximum amount which is not chargeable to tax (proposed amount as per the Finance Bill, 2005 is Rs. 1 lac). :

(i) All charitable and religious institutions claiming exemption under section 10(23C)

(ii) Only those educational and medical institutions having annual receipts more than Rs.1 crore and claiming exemption under Section 10(23C)

4.Filing of Income Tax Return by Educational and Medical Institution claiming exemption under section 10 (23C) and having annual receipt less then Rs. 1 Crore.

Presently only those Educational and Medical Institution claiming exemption under section 10(23C) and having annual receipts more than Rs. 1 Crore are required to file returns when the total income exceeds the prescribed amount. In the amendment bill, it has been proposed that those university or educational institutional or medical institutions claiming exemption under Section 10(23C) and having annual receipts less than Rs.1 crore shall be required to file the return of income in case its total income exceeds (before claiming exemption under Section 10(23C)) the maximum amount not chargeable to tax, i.e. Rs. 1 lac.

5. Approval under Section 35

As per the existing systems, amount paid by donor to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution for scientific, social science or statistical research can be exempt from tax provided the scientific research association, university, college or other institution for the time being are approved for the purposes by Central Government by notification in the Official Gazette. The notification issued by the Central Government shall at any one time, have effect for not exceeding three assessment years. The new amendment bill proposes to withdraw the above proviso of giving exemption for 3 years. As a result scientific research association, university, college or other institution can get one-time approval from Central Government. Also, it has been provided that this approval shall be granted or rejected within a period of 12 months from the end of the month in which such application is received by Central Government .

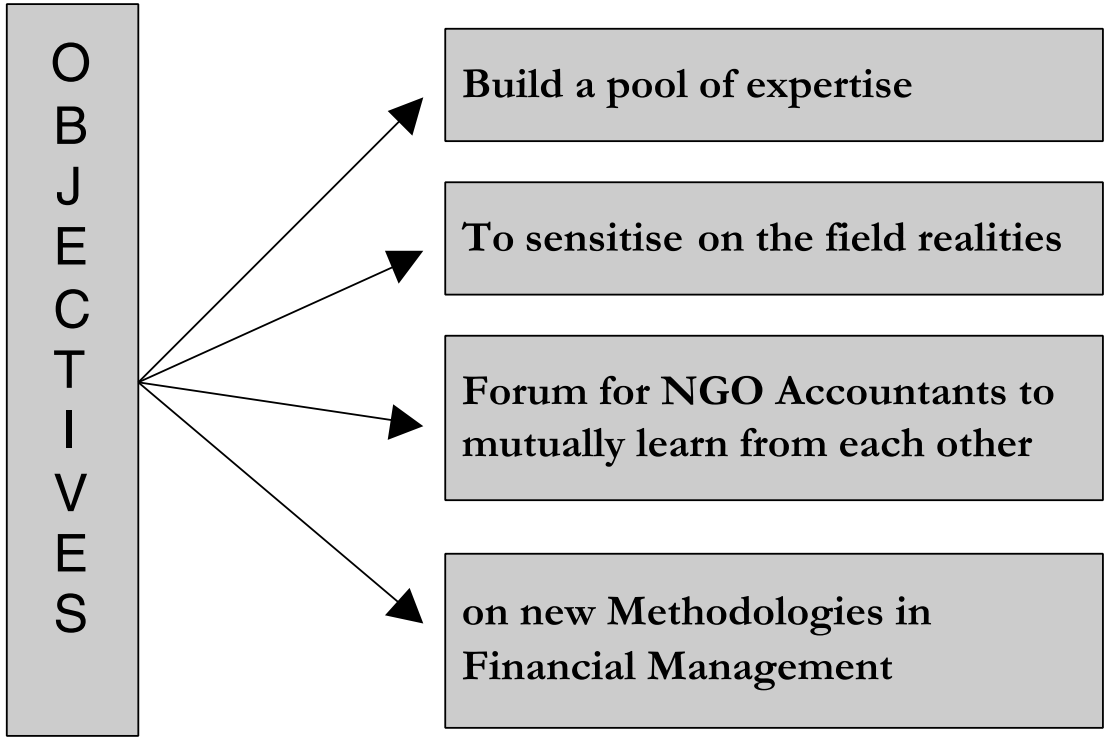
6. TDS provisions extended to royalty and rent for plant and machinery etc

The scope of Section 194-I in respect of tax to be deducted on payment of rent is being extended by including the payment of rent for machinery, plant, equipment, furniture or fittings. Accordingly, on payment of rent for hiring above things, payee has to deduct tax at source whether or not it is owned by the payee.

Provision of Section 194J in respect of deduction of tax at source on payment of professional or technical services is being extended to include payment of royalty and payment for not sharing any know-how, patent, copyright, trade-mark, licence, franchise etc. Now the tax will be required to be deducted at source in case where payment is of Rs.20,000 or more

-Purnima Jolly, FMSF

NGO Accountants Network (NAN)



Through regular interaction with the members of the forum, discussion groups, workshops and capacitation from finance consultants the expertise of the NGO accountants could be enhanced.

Eligibility to join the network :
If you are an NGO Accountant working full time with an organisation you can register with us.

Dear Readers,

The independence of auditors is an important issue in promoting accountability. Whether they need to be independent to perform their role effectively and to what extent they should be independent are very crucial issues. The Institute of Chartered Accountants of India (ICAI) has come out with 'Revised Guidance note on Independence of Auditors'. We are publishing the guidance note below with permission from ICAI.

With this we are starting a discussion process on this issue. Your views and inputs are welcome and they would be published in subsequent issues of INTER*face*.

-Editorial Team-

Revised Guidance Note on Independence of Auditors

The following is the text of the revised Guidance Note on Independence of Auditors issued by the Council of the Institute of Chartered Accountants of India.

1. INTRODUCTION

This Guidance Note aims to clarify the meaning of independence while performing their duties as Auditors. Professional integrity and independence is an essential characteristic of all the professions but is more so in the case of accountancy profession. Independence implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest. This document shall provide guidance to members about the specific circumstances and relationships that may create threats to independence. The Guidance Note also provides safeguards that should be employed by the auditors to mitigate the risk arising from such circumstances and relationship leading to the threats to independence.

1.2 It is not possible to define "independence" precisely. Rules of professional conduct dealing with independence are framed primarily with a certain objective. 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. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered.

1.3 There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. The Code of Ethics for Professional Accountants, issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

"Independence is:

(a) Independence of mind – the state of mind that permits the provision of an nopinion without being affected by influences that compromise professional

judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

(b) Independence in 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 safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised."

1.4 Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly, he is himself satisfied about his independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the auditors' independence.

1.5 In all phases of a Chartered Accountant's work, he is expected to be independent, but in particular in his work as auditor, independence has a special meaning and significance. Not only the client but also the stakeholders, prospective investors, bankers and government agencies rely upon the accounts of an enterprise when they are audited by a Chartered Accountant. As statutory auditor of a limited company, for example, the Chartered Accountant would cease to perform any useful function if the persons who rely upon the accounts of the company do not have any faith in the independence and integrity of the Chartered Accountant. In such cases he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do so.

1.6 The objective of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.

1.7 The idea of independence is instilled in the minds of Chartered Accountants from the commencement of their training under articles or audit service. It has to be applied in their day-today work and their success is dependent entirely upon their integrity, competence and independence of approach.

1.8 Dependent as it is on the state of mind and character of a person, independence, is a very

subjective matter. One person might be independent in a particular set of circumstances, while another person might feel he is not independent in similar circumstances. It is therefore the duty of every Chartered Accountant to determine for himself whether or not he can act independently in the given circumstances of a case and quite apart from legal rules, in no case to place himself in a position which would compromise his independence.

1.9 The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity. This is not self evident in the exercise of the reporting function but also applies to all other professional work. In determining whether a member in practice is or is not seen to be free of any interest which is incompatible with objectivity, the criterion should be whether a reasonable person, having knowledge of relevant facts and taking into account the conduct of the member and the member's behaviour under the circumstances, could conclude that the member has placed himself in a position where his objectivity would or could be impaired.

1.10 While performing audit functions, maintaining quality control is the objective of the quality control and policies to be adopted by an Auditor shall ordinarily incorporate the following:

(a) Professional Requirements: Personnel in the firm are to adhere to the principles of Independence, Integrity, Objectivity, Confidentiality and Professional Behaviours.

(b) Skills and Competence: The firm is to be staffed by personnel who have attained and maintained the Technical Standards and Professional Competence required to enable them to fulfill their responsibilities with Due Care.

(c) Assignment: Audit work is to be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.

(d) Delegation: There is to be sufficient direction, supervision and review of work at all levels to provide reasonable assurance that the work performed meets appropriate standards of quality.

(e) Consultation: Whenever necessary, consultation within or outside the firm is to occur with those who have appropriate expertise.

(f) Acceptance and Retention of Clients: An evaluation of prospective clients and a review, on an ongoing basis, of existing clients is to be conducted. In making a decision to accept or retain a client, the firm's independence and ability to serve the client properly are to be considered.

(g) Monitoring: The continued adequacy and operational effectiveness of quality control policies and procedures is to be monitored.

1.11 A member not in practice has a duty to be objective in carrying out his or her professional work whether or not the appearance of professional independence is attainable. Thus a member performing professional work must recognize the problems created by personal relationships or financial involvement, which by reason of their nature or degree might threaten his independence.

1.12 Standing alone, the word "Independence" may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

1.13 Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires chartered accountants to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules in the public interest.

2.THREATS TO INDEPENDENCE

2.1 The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

1. Self-interest threats, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include

(i) direct financial interest or materially significant indirect financial interest in a client,

(ii) loan or guarantee to or from the concerned client,

(iii) undue dependence on a client's fees and, hence, concerns about losing the engagement,

(iv) close business relationship with an audit client,

(v) potential employment with the client, and

(vi) contingent fees for the audit engagement.

2. Self-review threats, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement, or when a

member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are

(i) when an auditor having recently been a director or senior officer of the company, and

(ii) when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

4. Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways:

(i) close relative of the audit team working in a senior position in the client company,

(ii) former partner of the audit firm being a director or senior employee of the client,

(iii) long association between specific auditors and their specific client counterparts, and

(iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.

5. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

3.SAFEGUARDS TO INDEPENDENCE

3.1 The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

3.2 To address the issue, Members are advised to apply the following guiding principles: -

- For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.

- In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.

- Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.

- When such threats exist, the auditor should either desist from the task or, at the very least, put in place safeguards that eliminate them. All such safeguards measure needs to be recorded in a form that can serve as evidence of compliance with due process.

- If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

3.3 Provisions contained under the Companies Act, 1956

3.3.1 In order to ensure independence, the law has made certain provisions which either prohibit the appointment of a person as auditor in certain circumstances or place certain restrictions on his appointment as auditor or put third parties on guard against the possibility of an abridgement of independence by requiring certain disclosures to be made. These provisions are briefly outlined below:

3.3.2 Section 226 of the Companies Act, 1956 prohibits the appointment of a Chartered Accountant as auditor of a Company if he is:

(i) an officer or employee of the Company;

(ii) a partner of a person in the employment of an officer or of an employee of the Company;

(iii) a person who is indebted to the company for an amount exceeding Rs. 1000;

(iv) a person who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs. 1000;

(v) a person holding any security of that company.

3.3.3 A person who is disqualified from becoming auditor of any body corporate under the above rules is also disqualified from appointment as auditor of such body's subsidiary, co-subsidiary or holding company.

3.3.4 Section 314 of the Companies Act, 1956 makes separate provision for the case where an auditor of a Company (whether public or private) is a relative of a director, or manager of a private company of which the director of the company is a director or member.

In the case of such a person he may be appointed as auditor of a company only if such appointment is approved with the consent of the company in general meeting obtained by a special resolution. 3.3.5 It will be observed from the above that the Act has specifically provided for cases where the independence of an auditor may be affected by his connection with the company and prohibited or restricted him from acting as auditor under those circumstances.

3.3.6 A question often arises as to whether an indebtedness (as referred in para (iii) above) arises in

cases where in accordance with the terms of his engagement by a client (e.g. resolution passed at the

general meeting) the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job. In these circumstances, where in accordance with such terms the auditor recovers his fees on a progressive basis he cannot be said to be indebted to the company at any stage.

3.3.7 A question of indebtedness may also be raised where an auditor of a company purchases goods or services from a company audited by him. In such a case, if the amount outstanding exceeds Rs. 1000/- irrespective of the nature of the purchase or period of credit allowed to other customers the provisions concerning disqualification of auditor as contained in Section 226 (3)(d) of the Companies Act, 1956 will be attracted.

3.3.8 Another question which arises for consideration is whether a partner is disqualified from appointment as auditor when the firm of which he is a partner is indebted to the company in excess of the limit prescribed and whether the firm is disqualified from appointment as auditor when a partner of the firm is indebted in excess of the prescribed limit. In both cases, the disqualification will apply, because when a firm is appointed as auditor, each partner is deemed to be so appointed and when a firm is indebted, each partner is deemed to be indebted.

3.3.9 There may also be situations in which, though the appointment is in the individual name of a partner, the work, is, in fact, carried out by the firm and the fees are credited to the account of the firm. In such situations, the firm will be deemed to be acting as auditor and the disqualification will be attracted.

3.4 Provisions contained under the Chartered Accountants Act, 1949, Chartered Accountants Regulations, 1988 and under Code of Ethics to ensure

Independence of Auditors **3.4.1** Clause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits acceptance of, what have been described as contingent fees, i.e., fees, which are either based on percentage of profits or otherwise dependent on the finding or the results of employment.

3.4.2 What distinguishes a profession from a business is that professional service is not rendered with the sole purpose of a profit motive. Personal gain is one but not the main or the only objective. Professional opinion, therefore, frowns upon methods where payment is made to depend on the basis of results. It is obvious that a person who is to receive payment in direct proportion to the benefit received by his client, may be tempted to exaggerate the advantage of his service or may adopt means which are not ethical. It will have the effect of undermining his integrity and impairing his independence. Therefore, the members are prohibited from charging or accepting any remuneration based on a percentage of the profits or on the happening of a particular contingency such as, the successful outcome of an appeal in revenue proceedings.

3.4.3 Professional services should not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is obtained or where the fee is otherwise contingent upon the findings or results of such services. However, fee should not be regarded as being contingent if fixed by a Court or other public authority.

3.4.4 The Council of the Institute has framed Regulation 192 which exempts members from the operation of this Clause in certain professional services. The said Regulation 192 is reproduced below: -

192. Restriction on fees No chartered accountant in practice shall charge or offer to charge, accept or offer to accept, in respect of any professional work, fees which are based on a percentage of profits, or which are contingent upon the findings, or results of such work: Provided that:

(a) in the case of a receiver or a liquidator, the fees may be based on a percentage of the realisation or disbursement of the assets;

(b) in the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid up capital or the working capital or the gross or net income or profits; and

(c) in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued.

3.4.5 Attention of the members is invited to the provisions of Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 which provides that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or any enterprise in which he, his firm or a partner in his firm has a substantial interest, unless he discloses his interest also in his report.

3.4.6 If the opinion of auditors are to command respect and the confidence of the public, it is essential that they must disclose every factor which is likely to affect their independence. Since financial interest in the business can be one of the important factors, which may disturb independence, the clause provides that the existence of such an interest direct or indirect should be disclosed. This is intended to assure the public as regards the faith and confidences that could be reposed on the independent opinion expressed by the auditors.

3.4.7 The words "financial statements" used in this clause would cover both reports and certificates usually given after an examination of the accounts or the financial statement or any attest function under any statutory enactment or for purposes of income-tax assessments. This would not however, apply to cases where such statements are prepared by members in

employment purely for the information of their respective employers in the normal course of their duties and not meant to be submitted to any outside authority.

3.4.8 Public conscience is expected to be ahead of the law. Members, therefore, are expected to interpret the requirement as regards independence much more strictly than what the law requires and should not place themselves in positions which would either compromise or jeopardise their independence.

3.4.9 A Member must take care to see that he does not get into situations where there could be a conflict of interest and duty. For example, where a Chartered Accountant is appointed the liquidator of a company, he should not himself audit the Statement of Account to be filed under Section 551 (1) of the Companies Act, 1956. The audit in such circumstances should be done by a Chartered Accountant other than the one who is the liquidator of the company. Attention of the

members is drawn to the audit assignments where appointment is done by the Comptroller & Auditor General of India (C&AG), Reserve Bank of India (RBI) and such other authorities. In addition to ensuring independence during the assignment, it is also essential to avoid any situation in near future which may be interpreted as a threat to independence, as for example, he or any other partner of his firm should not accept any other assignment such as internal audit, system audit and management consultancy services within one year from the completion of audit assignment.

3.4.10 A Chartered Accountant in employment should not certify the financial statements of the concern in which he is employed, or of a concern under the same management as the concern in which he is employed, even though he holds certificate of practice and that such certification can be done by any chartered accountant in practice. This restriction would not however apply where the certification is permitted by any law, e.g. Section 228 (iv) of the Companies Act, 1956 and the Companies (Branch Audit Exemption) Rules made thereunder. The Council has decided that a chartered accountant should not by himself or in his firm name:-

(i) accept the auditorship of a college, if he is working as a part-time lecturer in the college.

(ii) accept the auditorship of a trust where his partner is either an employee or a trustee of the trust.

3.4.11 Many new areas of professional work have been added, e.g., Special Audit under the Statutes, Tax Audit, Concurrent Audit of Banks, Concurrent Audit of Borrowers of Financial institutions, Audit of non-corporate borrowers of banks and financial institutions, audit of stock exchange, brokers etc.The Council wishes to emphasise that the requirement of Clause (4) of Part I of the Second Schedule to the Chartered

Accountants Act, 1949 is equally applicable while performing all types of attest functions by the members.

3.4.12 Some of the situations which may arise in the applicability of Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 are discussed below for the guidance of members:-

1.Where the member, his firm or his partner or his relative has substantial interest in the business or enterprise. The independence of mind is a fundamental concept of audit and/or expression of opinion on the financial statements in any form and, therefore, must always be maintained. Nothing can substitute for the essential and fundamental requirements of independence. Therefore, the Council's views are clarified in the following circumstances.

(i) An enterprise/concern of which a member is either an owner or a partner The holding of interest in the business or enterprise by a member himself whether as sole-proprietor or partner in a firm, in the opinion of the Council, would affect his independence of mind in the performance of professional duties in conducting the audit and/or expressing an opinion on financial statements of such enterprise. Therefore, a member should not audit financial statements of such business or enterprise.

(ii) Where the partner or relative of a member has substantial interest The holding of substantial interest by the partner or relative of the member in the business or enterprise of which the audit is to be carried out and opinion is to be expressed on the financial statement, may also affect the independence of mind of the member, in the opinion of Council, in the performance of professional duties. Therefore, the member may, for the same reasons as not to compromise his independence, desist from undertaking the audit of financial statements of such business or enterprise. However, where a member undertakes the audit of such business or enterprise, he should disclose such interest in his report while expressing his opinion on the financial statements of such business or enterprise.

(2) Where the member or his partner or relative is a director or in the employment of an officer or an employee of the company Section 226 of the Companies Act, 1956 specifically prohibits a member from auditing the accounts of a company in which he is a director or in the employment of an officer or an employee of the company. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

(i) Where a member is a director In cases where the member is a director of a company the financial statements of which are to be audited and/or opinion is to be expressed, he should not undertake such job and/or express opinion on the financial statements of that company.

(ii) Where a partner or relative of the member is a director in the company who has a substantial interest.

In such cases for the reason as not to compromise with the independence of mind, the member may desist from undertaking the audit of financial statements and/or expression of opinion thereon. However, if a member feels that his independence is not affected and undertakes the audit of such company, he should disclose such interest in his report while expressing his opinion on the financial statements of such company. The meaning of the words "relative" and "substantial interest" shall be the same as are contained in the Resolution passed by the Council in pursuance to Regulation 190A of Chartered Accountants

Regulations, 1988 (Appendix 9 of 2002 edition). 3.4.13An accountant is expected to be no less independent in the discharge of his duties as a tax consultant or as a financial adviser than as auditor. In fact, it is necessary that he should bear the same degree of integrity and independence of mind in all spheres of his work. Unless this is done, the accounts of companies audited by Chartered Accountants or statements made by them during the course of assessment proceedings would not be relied upon as correct by the authorities.

3.4.14 The Members are not permitted to write the books of accounts of their auditee clients.

3.4.15 A statutory auditor of a company cannot also be its internal auditor, as it will not be possible for him to give independent and objective report issued under sub-Section 4A of Section 227 of the Companies Act, 1956 read with the Companies (Auditors' Report) Order, 2003.

3.4.16 The Council has issued a Notification No.1-CA(37) /70 dated 23rd May, 1970 whereby a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if-

I. he accepts appointment as Cost auditor of Company under Section 233B of the Companies Act, 1956 while he -

(a) is an auditor of the company appointed under Section 224 of the Companies Act; or (b) is an officer or employee of the company; or (c) is a partner, or is in the employment of an officer or employee of the company; or (d) is a partner or is in the employment of the Company's auditor appointed under Section 224 of the Companies Act, 1956; or (e) is indebted to the company for an amount exceeding one thousand rupees, or has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;

OR

II. after his appointment as Cost Auditor, he becomes subject to any of the disabilities stated in items I (a) to (e) above and continues to function as a cost auditor thereafter.

3.4.17 The Council has issued a Notification No.1-CA(39)/70 dated 16th October, 1970 whereby a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he accepts the appointment as auditor of a company under Section 224 of the Companies Act, 1956, while he is an employee of the cost auditor of the Company appointed under Section 233B of the Companies Act, 1956.

3.4.18 The Council has issued a Notification No.1-CA(7)/60/2002 dated 8th March, 2002 whereby a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he accepts the appointment as statutory auditor of Public Sector Undertaking(s)/ Government Company (ies)/Listed Company(ies) and other Public Company(ies) having turnover of Rs. 50 crores or more in a year and accepts any other work(s) or assignment(s) or service(s) in regard to the same Undertaking(s)/ Company(ies) on

a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same Undertaking/company.

3.4.19 The Council has issued a Notification No.1-CA(7)/63/2002 dated 2nd August, 2002 whereby a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he accepts appointment as auditor of a concern while he is indebted to the concern or has given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding Rs. 10,000/-.

3.4.20 To ensure that the professional independence of a member doing attest function does not appear to be jeopardized he should, as far as possible, take care to see that the professional fees for audit and other services received by the firm in which he is a partner, by him and his partners individually and by firm or firms in which he or his partner are partners from one or more clients or companies under the same management does not exceed 40% of the gross annual fees of the firm, firms and partners referred to above. 'Companies under the same management' here would refer to the definition of this expression as provided in section 370(1-B) of the Companies Act, 1956. Provided that no such ceiling on the gross annual professional fees of a member would be applicable where such fees do not exceed two lakhs of rupees in respect of a member or firm including fees received by the member or firm for other services rendered through the medium of a different firm or firms in which such member or firm may be a partner or proprietor. Provided further that no such ceiling on the gross annual professional fees of a member would be applicable in the case of audit of government companies, public undertakings, nationalized banks, public financial institutions or where appointments of auditors are made by the Government.

3.4.21 Members' attention is also drawn to Clauses (8) & (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949: - "A Member shall be deemed to be guilty of professional misconduct, if he: X XX XXX XXXX

(8) accepts a position as auditor previously held by another chartered accountant or a restricted state auditor without first communicating with him in writing;

(9) accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 in respect of such appointment have been duly complied with."

3.4.22 Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949 emphasized the requirement of mandatory communication with the previous auditor in all types of audit viz., statutory audit, tax audit, internal audit, concurrent audit or any kind of audit and it is equally applicable to audits of both government and non-government entities.

3.4.23 Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949 provided that an auditor of the company before accepting the appointment, should ascertain from the auditor whether

the requirements of Section 225 of the Companies Act, 1956 in respect of such appointment have been duly complied with. Section 224 of the Companies Act, 1956 contains several provisions in the matter of appointment of auditors in different circumstances and situations whereas Section 225 laid down the procedure which must be followed whenever a company desires to change its auditor. Also that the validity of the appointment of an auditor is not challenged or objected to by shareholders or the retiring auditors at a later date, it has been made obligatory to ascertain from the company that the appropriate procedure in the matter of appointment has been faithfully followed. Independence of auditor is a concept to be addressed through its all the possible aspects and the message of Clause (8) & (9) is to ensure that an auditor should be conscious about this aspect from the very point of accepting the position of an auditor.

4. CONCLUSION

4.1 The Council feels that there are adequate safeguards provided in the Companies Act, 1956 as well as in the Chartered Accountants Act, 1949. The Council is of the view that independence, being a state of the mind, is not necessarily affected by the fact of mere relationship any more than it should be existence if the relationship did not exist. In any case, lest there may be any feeling in the public mind that relationship would affect the independence of auditors, the Council suggests that where, due to near relationship of an auditor, with a Managing or a Whole-Time Director the independence of an auditor is likely to be jeopardized, he should use his good sense, and acting in the best traditions of he profession, refrain from accepting the appointment.

4.2 If the opinion of chartered accountant is to command respect and the confidence of the public, it is essential that they must ensure their independence to assure the public as regards the faith and confidence that could be reposed on them. The Chartered Accountant should ensure his independence in all assurance services including concurrent audit, tax audit and internal audit. The chartered accountant should make it certain that his independence is not jeopardized. Where he feels that his independence is jeopardized, he should refrain from accepting the assignment.

Published in the "Chartered Accountant"
February Issue 2005

Tax Deduction at Source

The Income Tax Rules have been amended by the Central Board of Direct taxes wherein U/s 206 & 206 C (5A) prescribes the new forms for:

- Annual return of TDS from Salary (Form No. 24)
- Annual return for TDS from payments other than salary(Form No. 26)
- Annual return for TDS from payments made to Non-residents. (Form No. 27)

W.e.f 1.04.2005 all TDS returns have to be submitted in the new forms. Old forms are not acceptable by the Income Tax authorities. In fact all the TDS returns for earlier financial years will also have to be filed in the new forms.

Under Section 200(3) and proviso to Section 206 C(3) have also been inserted w.e.f 1.04.2005,wherein new rules and forms for filing of quarterly statements of TDS have been prescribed.

New forms for furnishing Annual TDS returns and quarterly TDS Statements

Accordingly every assessee has to file quarterly statements for TDS u/s 200(3) and Section 206 C (3).The due dates for filing quarterly statements for both TDS are:

Quarter ending	**Due date**
30th June	15th July
30th September	15th October
31st December	15th January
31st March	30th April

The forms prescribed for Quarterly statements are:

TDS from Salary	Form 24Q
TDS from payments other than salary	Form 26Q

Verification for TDS returns in computer media.

Form No. 27A for furnishing information with the returns of deduction of tax at source filed on computer media has been substituted. The new form will have to be used for filing all electronic TDS returns after 1/04/2005.

Source: http://incometaxindia.gov.in/archive/FormsForTCSReturns.pdf

The Constitution of India under "Directive Principles of State Policy" provides that the State shall within the limits of its economic capacity make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness & disablement.

Accordingly,The EPF & MP Act, 1952 was enacted by Parliament and came into force with effect from 14th March, 1952. Presently, the following three schemes are in operation under the Act:

1. Employees' Provident Fund Scheme, 1952
2. Employees' Deposit Linked Insurance Scheme, 1976

*Voluntary Coverage***:** If any of the establishment is not satisfying the above conditions of employing 20 or more persons, still it can voluntarily get covered under the Act, if the employer and majority of the employees are willing.

But the Act does not apply to those co-operative societies which satisfy both the following conditions:

a)Employ less than 50 persons and
b)Work without the aid of power

Meaning of the word "Employee" under the *Employees' Provident Fund Scheme, 1952*

Applicability of Provident Fund to NPOs

3. Employees' Pension Scheme, 1995 (replacing the Employees' Family Pension Scheme, 1971)

Through this article on Provident fund we would like to address few key issues:

The Applicability of Employees' Provident Fund and Miscellaneous Provisions Act 1952 to an organisation:

The Employees' Provident Fund and Miscellaneous Provisions Act 1952 is applicable to every organisation which *is employing 20 or more persons* **.** Also the organization to which this Act once applies shall continue to be governed by this Act, even if the number of employees *falls below 20 at a later date.*

"Employee" means any person who is employed for wages in any kind of work, manual or otherwise, or in connection with the work of an organization and who gets his wages directly or indirectly from the employer, and includes any person who is employed by or through a contractor in or in connection with the work of the organization.

Therefore keeping in view of the above, all the employees who fall under the above definition, irrespective of the salary amount they are getting are to be considered for arriving at *above mentioned number of 20.*

It is important to note that the dominant factor in the definition of 'employee' is that a person should be employed in the work of the establishment on a regular basis. It means the employees should have been employed regularly in or in connection with the work of an establishment. A person who is employed for a day or two or for certain period but not in connection with the regular work of the organization will not get the benefit of the provident fund scheme.

Therefore the duration of employment is not material but it is the nature of employment which is material in order to attract the provisions of the Act. Even *part time employees (Short period)* will fall within the ambit of EPF Act provided it is in connection with the regular work of the organisation.

However the *temporary workers* are not to be counted in the number of persons according to the Supreme Court Judgment in the case of *RPFC,AP vs T.S.Hariharan*. The employment of a few persons on account of some emergency or for a very short period necessitated by some abnormal contingency which is not a regular feature of the programme activities of the organisation would not be covered by the definition of "employees".

The definition of "employee" in the Act is wide enough to include not only persons employed directly by the employer but also *through a contractor.*

An employee is eligible for membership of the funds under the schemes from the day he joins the covered organisation. But in case, the employee's emoluments exceed Rs. 6,500/- per month, he has the *option* to join the Scheme(s) with the consent of employer. *Here, the emoluments mean* basic wages, dearness allowance, cash value of food concession and retaining allowances if any.

The Registration of the organisation under the Act *:If an organisation finds that the Employees' Provident Fund and Miscellaneous Provisions Act 1952 is applicable to it,then it can* fill-in the attached proforma for registration.The duly filled-in proforma alongwith one or more of the documents mentioned in the proforma can be submitted to the respective provident fund offices for getting the registration.

(.....to be continued)

- Rahul Khanna: FMSF

4th NATIONAL CONFERENCE ON SWARAJ
28th January -1st February 2005

'SWARAJ', a secular National Forum for Gandhian Societal perspective and action attempts at making a difference. It brings together brings together like minded activists, action groups, voluntary organizations and peoples' organizations, striving for building a just and equitable society. Its area of operation covers 8 states namely, Bihar, Jharkhand, Orissa, Maharashtra, Goa, Kerala, Tamil Nadu and Gujarat.

The 4th National Conference on **'SWARAJ'** was organized by Peaceful Society, a Gandhian Voluntary Organisation. The conference was for a period of 4 days, starting from the 29th of January till the 1st of February 2005. The objective of the develop concrete plans and policies for a possible way of self-reliance at the grass roots. The basic principles of Gandhian economics and its implications and relevance in the present day context formed a part of the discussion at the conference. Various eminent Gandhians were there to present their views on various issues. The discussions were very thought provoking. Two members from FMSF also attented in the conference as well.

Financial Management Service Foundation

announces

Dates: *18th & 19th October, 2005*

For further details, please contact :

***The Programme Co-ordinator*, Financial Management Service Foundation**
"ACCOUNTABILITY HOUSE", A-5, Sector 26, NOIDA -201 301.
Ph: 0120-2546732, 33, 44, 45, Fax : 0120 – 2546731
(For calling from Delhi : Ph: 95120-2546732, 33, 44, 45,)
E-Mail : fmsindia@vsnl.com Also visit us at: www.fmsfindia.org

The Technical Guide on Accounting and Auditing in Not-for-Profit Organisations (NPOs) brought out by The Institute of Chartered Accountants of India (ICAI) deals with suggesting the accounting and financial reporting framework for NPO sector for presentation of true and fair view of the state of affairs and the results of the financial statements. The Guide also discusses the salient feature and principal requirements of various Accounting Standards (AS).

In the previous issue we focused on AS-4 – Contingencies and Events Occurring After the Balance Sheet Date. Through this issue we deal with AS-5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies and highlight some of the relevant aspects relating to NPOs.

Accounting Standards for NGOs

Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies (AS -5)

One of the significant statements prepared along with the preparation of Balance Sheet is the Profit and Loss Account. The objective of the preparation of this account is to compute if an organization has earned a profit or has incurred loss at the end of the respective year for which it is prepared.

As the name itself indicates, this account relates to profit oriented organizations and is primarily prepared by for - profit organizations.

As we are focusing on the Not-for-Profit Organizations (NPOs), the parallel statement to the Profit and Loss Account prepared by these organisations is the Income and Expenditure Account. This account enables an NPO to ascertain whether the organisation has ended up with excess of income over expenditure or the expenditure has been more than the income for the respective period. Let us now look into the requirements of AS-5. Basically, AS-5 deals with disclosure that needs to be made in the Profit and Loss Account / Income and Expenditure Account. They are :

a. significant items arising in the course of ordinary activities of the organisation;
b. extraordinary items;
c. prior period items;
d. changes in accounting estimates; and
e. changes in accounting policies.

Let us look into each of the above in brief.

a. Significant items arising in the course of ordinary activities of the organizations :

As per this requirement, all items of income and expenditure relating to the period that arise in the regular implementation of its stated activities should be included in determining the surplus or deficit in an Income and Expenditure Account for the respective period.

It may also happen that regular / ordinary activities may have a specific impact on that respective year's surplus or deficit due to the nature and size of such incidence.

In such instances, AS-5 requires that a disclosure of the same is made either in the Income and Expenditure Account itself or in the notes to the financial statements.

Example of such instance can be sale of fixed assets or settlement of a legal dispute by the NGO. These need to be disclosed clearly.

b. Extraordinary items

In case, there is a significant impact in the Income and Expenditure Account of an organization due to an extraordinary activity that has been carried out, then the details of the same needs to be disclosed separately in the Income and Expenditure Account. It needs to be ensured that the activity is such that, it is not expected to happen frequently or regularly.

The disclosure should be made in such a manner that the impact of the same on the current Income and Expenditure can be easily understood.

For example, an NGO is working in the area of health of women and children in its target village. A natural calamity (a cyclone, for example) strikes the area resulting in major loss of life and properties. Following which there is an epidemic that breaks out in the area.

On the one hand the NGO is not in a position to carry on with its planned development activities as the target village is badly affected and on the other hand, the NGO has to immediately respond to this sudden situation in helping the community to overcome the epidemic by providing required medicines and relief.

This activity is likely to impact its Income and Expenditure Account of that organization for that particular year in a significant manner. The expenditure under the item "Health" will reflect an increased expenditure than usual.

This instance is referred to as "Extraordinary" and a disclosure to this effect is to be made in the Income and Expenditure Account in a distinct manner so that the user of the financial report is able to understand the impact of the same in the respective year's Income and Expenditure account and how it has influenced the surplus or deficit of that year.

c. Prior Period Items

It may so happen that the Income and Expenditure Account of an NGO for a specific year is affected due to items that actually do not relate to that year.

This can happen either due to rectifications of errors committed in the previous financial statements.

For example, in the Income & Expenditure Account of an NGO for the period ending 31st March, 2004, the provision for the payment of salaries for 5 part – time employees for the month of March 2004 was made erroneously @ Rs. 6,000 per month instead of Rs. 4,000 per month.

This has affected the Income & Expenditure Account of that year whereby the Salaries Account has shown an excess expenditure of Rs. 10,000 (5 employees @ Rs. 2,000 per month taken more) for the month of March 2004. This was noticed in the next month April 2004 while making the actual payment of the salaries.

This error of excess provision was subsequently corrected while finalizing the financial reports in the following year i.e., for the period ending 31st March, 2005.

As per the requirements of AS-5, the rectification of error that has taken place in the previous year's statement, is required to be separately disclosed as a Prior Period Item error in the Income & Expenditure Account for the period from April 2004 to March 2005.

In such instances, the nature and amount of such prior period items should be separately disclosed in the Income and Expenditure Account in such a manner that the impact of the same on the current year's surplus or deficit can be easily understood by the user of that financial statement.

However, it needs to be noted that payment of arrears of salary from the previous year due to salary revision is not a Prior Period Item as the decision regarding the payment of the same is taken during the current year.

d. Changes in Accounting Estimates

Normally, accounting estimates are made while determining the useful lives of depreciable assets or while making a provision for doubtful debts that are unlikely to be recovered.

Such accounting estimates made in a year may sometimes require revision in the subsequent year. This could be due to changes in the circumstances on which such estimates were based or due to a new information received or developments that have presently taken place.

For example, an asset has been depreciated @ 5% in the previous year and accordingly reflected in that year's financial reports.

However, it is understood later that the asset has been excessively used leading to reduction in the useful life of that asset. Due to this aspect, it is realized that it should have been depreciated at the rate of 8 % instead of at 5%.

This new information has a definite impact on the Income and Expenditure Account of the year in which this change has to be made.

As per AS-5, the effect of this change in the accounting estimate needs to be disclosed if it results in a material effect in the current year as well as the subsequent periods.

e. Changes in Accounting Policies

A change to adopt a different accounting policy is to be made only if it is required as per law or for complying with an accounting standard.

Sometimes a change in an accounting policy is made if the organization considers that it would enable presentation of financial statements in a more appropriate manner.

Examples of changes in accounting policies are :

- *accounting on accrual basis instead of on cash basis.*
- *reflection of income / grant received on gross basis from the net basis.*

If such a change in the accounting policy has a material effect on the current year's financial statements, then it needs to be specifically disclosed.

In case, the effect of such change is not ascertainable, then the fact should be disclosed.

It may also happen that such a change has no material effect on the current year's financial statements but is expected to have a material effect in the subsequent periods. The fact of such change should be disclosed appropriately in the period in which the change has been adopted.

Having gone through the requirements of this Standard, it is evident that the objective is to enable the users of the financial statements to make meaningful comparisons of performance of an organization over a period of time.

Adhering to the requirements of this standard AS-5 by an NGO, will contribute in presenting its Income and Expenditure Account in a more meaningful manner.

- S. P. Selvi, FMSF
- Rahul Khanna, FMSF

Dissolution of a Registered Society

Under the Societies Registration Act 1860, Section 13 gives the provisions for the dissolution of the society and lays down the procedure for dissolving the society.

According to Section 13 (corresponding to Section 29 of the Literary and Scientific Institutions Act 1854) of the Societies Registration Act 1860:

"***Provision for dissolution of societies and adjustment of their affairs*** *: Any number not less than three-fifths of the members of any society may determine that it shall be dissolved and thereupon it shall be dissolved* ***forthwith****, or at the time then agreed upon, and all necessary steps shall be taken for the disposal and settlement of the property of the society, its claims and liabilities, according to the rules of the said society applicable thereto ,if any ,and ,if not, then as the governing body shall find expedient, provided that, in the event of any dispute arising among the said governing body or the members of the society, the adjustment of its affairs shall be referred to the* ***principal court of original civil jurisdiction*** *of the district in which the chief building of the society is situated and the Court shall make such order in the matter as it shall deem requisites..'*

A society, which is generally formed for a specific purpose, may live to dissolve as soon as the purpose for which it was formed is fulfilled. Similarly a society may be dissolved by its members, registrar of societies or the court where the purpose of the formation of the society is not being fulfilled or for any other reason leading to the dissolution.

In cases like *Shanti Swarup vs Radhaswami Satsang Sabha, Dayal Bagh AIR 1969,*where the bye laws of the society state the terms for dissolution like 'the society shall stand dissolved in case no Satsang Guru reappeared within two years of the death of the last Satsang Guru', it was decided that such byelaws militates against the said provisions of Section 13 of the Societies Registration Act 1860 and therefore be deemed to be invalid and inoperative.

Certain specific terms like 'Forthwith' and 'Principal Court of Original Civil Jurisdiction' mentioned in Section 13 can be explained as:

'Forthwith' according to the dictionary means, 'immediately, at once, without delay or interval'. In *Bidya Deb Burma Vs District Magistrate Tripura, Agartala AIR 1969,* the court interpreted from the case of *Keshav Nilakanth Joglekar Vs Commissioner of Police Greater Bombay, (the Constitution Bench of Supreme Court)* that "When a Statute requires that something shall be done 'forthwith' or 'immediately' or even 'instantly', it should probably be understood as allowing a reasonable time for doing it".

Therefore 'Forthwith' does not mean a precise time but should be within a reasonable time without avoidable and unreasonable delay.

'**Principal Court of Original Civil Jurisdiction'** under Section 13 of the Act means the Principal Court of Civil Jurisdiction of the District where the Registered Office of the society is situated. In case of any dispute relating to adjustment of affairs of a society in case of dissolution, the matter has to be referred to the Principal Court of Civil Jurisdiction of the District where the Registered Office of the society is situated.

A Society can be dissolved by:

- its members,
- the Registrar,
- the Court or
- by the Government.

Dissolution by Members:

To dissolve a society Section 13 says that '*Provided that no society shall be dissolved unless three- fifths of the members shall have expressed a wish for such dissolution by their votes delivered in person, or by proxy, at a general meeting convened for the purpose.'* Therefore the Dissolution of a society can take place at the time as agreed upon by the members of the society.

In a society, if Government is a member or contributes in the society funds or is otherwise interested in the society Section 13 further says the following regarding the consent from the Government

'*Provided that whenever any Government is a member of or a contributor to, otherwise interested in, any society registered under this Act, such society shall not be dissolved without the consent of the Government of the State of registration.'*

Section 13A & 13 B have been inserted by the UP Societies registration Act where Section 13A deals with the 'Power of registrar to apply for dissolution' and Section 13 B deals with the 'Dissolution of Society by Court' and also the cancellation of registration of a society.

For the dissolution of a society the members should decide the time when the society may stand dissolved. To dissolve a society the members should pass a special resolution at a special general meeting and follow the following procedure for the dissolution:

- The resolution for the dissolution should be passed with $3/5^{th}$ majority.($3/4^{th}$ under Karnataka Act, Travancore Cochin Act and $2/3^{rd}$ under Rajasthan Act)

- Decide whether the society should be dissolved 'forthwith' or at a later time agreed upon by them.

- The steps for the disposal of the property and settlement of all the claims and liabilities of the society

Adequate steps for the disposal and settlement of the Society property and adjustment of claims, liabilities of the society according to the rules of the society.

Section 24 of West Bengal Act and section 41 of the Tamil Nadu Act gives the specific provisions for dissolution by resolution which states that a society

may be dissolved by resolution by 3/4 members of the society in the special general meeting wherein the governing body shall take adequate steps for disposal and settlement of the property.

Thereafter a report has to be sent to the Registrar if any surplus is left over. The registrar will then issue a notice in the official gazette to seek no objection from any claimant, creditor, and members within three months of the notice. In case no objection is raised during the 3 month period, the registrar shall record the order of dissolution in the register maintained in his office.

Dissolution by Registrar of Societies:

Under various circumstances, the registrar of societies (as per the respective state acts) can dissolve a society. These circumstances may be:

The society has done unlawful activities

According to the memorandum of association governing the society:

- Society's object clause has not been fulfilled
- Office of the society has ceased to be in state of registration
- Members of the society are below the required number of seven
- Society has ceased to function for a particular period of time
- Society has been declared insolvent(not able to pay its liabilities)
- Society's activities are against the Governmental or the state policy
- Society has become insolvent
- Society has contravened any law or the provisions of the Societies Registration Act 1860

To dissolve the society, the registrar inquires into the activities of the society and calls for show cause for no dissolution from the society. Thereafter the registrar may move the court for making an order for dissolution in case the registrar is not satisfied with the show cause of the society.

Specifically certain State Acts have certain specific provisions regarding dissolution by the registrar like:

Section 25 of West Bengal Act gives the provisions for dissolution by Registrar wherein if the registrar is of the opinion and has reasonable grounds to believe that a society is not managing its affairs properly or is not functioning, he shall send to the society at its registered office, a notice by registered post calling upon it to show cause within such time as may be specified in the notice why the society shall not be dissolved.

If no cause is shown or if the cause shown be considered by the registrar as unsatisfactory, the registrar may move the court under Section 25 for making an order for the dissolution of the society.

Similarly under **Section 27 of Karnataka Societies Act** the registrar may dissolve a society if the registrar is satisfied that a society is carrying on any unlawful activities and the dissolution is done in accordance to provisions of Section 22 of the Act.

Section 37 of the Tamil Nadu Act states that the registration of a society can be cancelled by the Registrar of the society when he is satisfied that the society has contravened any of the provisions of the act or is insolvent or the business of the society is being carried out fraudulently and not in accordance to the bye laws or objects as per the memorandum. Section 38 of the Act deals with the cancellation of registration where the society is carrying on unlawful activities.

Dissolution by Court:

In the principal Societies Registration Act, 1860 there are no specific mention for the dissolution of a society by the order of the court. However there are a few states who have inserted certain sections related to dissolution of society by court.

Section 25 of West Bengal Act gives the provisions for dissolution by Court where the court may on an application of the registrar or on the application of not less than one tenth of the members, make an order for the dissolution of a society in the following cases:

- If there is a contravention of the provisions of the Societies Act by the society.
- If the number of members are below seven.
- If the society has ceased to function for more than three years.
- Society is unable to pay its debts or meet its liabilities.
- If it is proper that the society should be dissolved.

Section 25 of Travancore Cochin Act gives the provisions for Application to court for dissolution, framing a scheme etc. Wherein it says that an application can be made by the state government or one tenth of the members of the society to the district court in which the society is registered with a fees of Rs.100 as security for costs. Thereafter the court may after enquiry may pass the following orders:

- Removing the existing governing body and appointing a fresh governing body;
- Framing a scheme for the better and efficient management of the society;
- Dissolving the society.

Section 13 B of the UP (Amendment) Act says that a court may dissolve a society on application made by the District magistrate that the activities of society are opposed to the public policy.

Dissolution by Government

The Central or the State Government may also dissolve a society if it finds adequate reasons for doing so.

Members not to receive profits- On Dissolution of a society, the activities of the society cease to exist. Thereafter the property and settlement of all the claims and liabilities of the society have to be done.

However, it is specifically stated under Section 14 of the Societies Registration Act (corresponding to the Section 30 of the Literary and Scientific Institutions Act 1854 (English)) that members are not to receive profit .In case of surplus remaining after satisfaction of all the debts and liabilities Section 14 states that '*If upon the dissolution of any society registered under this Act there shall remain, after the satisfaction of*

all its debts and liabilities, any property whatsoever, the same shall not be paid to or distributed among the members of the said society or any of them, but shall be given to some other society, to be determined by the votes of not less than three-fifths of the members present personally or by proxy at the time of the dissolution, or, in default thereof, by such court as aforesaid.

Provided, however, that this clause shall not apply to any society which shall have been funded or established by the contributions of shareholders in the nature of a joint stock company. '

The decision making votes of the members under Section 14 may vary accordingly as per the respective state acts.

Section 14 shows that the properties of the society whether movable or immoveable belongs to the society registered under the Act. Therefore the provisions under Section 14 of the Societies Registration Act are mandatory. Any surplus with the society after the debts and liabilities are paid of should be transferred to any society with kindred object even if the rules and regulations of the society contains provisions for division of property of the society upon dissolution among its members.(*Re* Bristol Athenaeum(1889))

The Bihar and Uttar Pradesh Societies Registration Act have inserted Section 14A which says that it shall be lawful for the members of the society to determine by a majority present personally or by proxy at the time of dissolution of such society that any property remaining after the debts and liabilities are paid off, shall be given to Government for utilization of any purpose referred under Section 1 of the Act.

To be contd……

Pooja Bagga, FMSF

Financial Management Service Foundation

announces series of workshops to be held in :

Mumbai – ***28th & 29th September, 2005***
Bangalore – ***7th & 8th November, 2005***

Brief Contents :

- Importance of Monitoring & Reporting in a Development Project
- Setting up of a Good Monitoring Systen
- Different Stages of Monitoring
- Levels of Monitoring
- Objective of Reports
- Analysis of Stakeholders and their expectation of information
- Different types of Reports
  - Financial Reports
  - Progress Reports
- Setting up of a Good Reporting System
- How to report the observations and analysis
- Key Elements of a Good Financial and Progress Reports
- Linkage between Financial and Activities Reports
- Presentation of Reports
- Linkage between Effective Monitoring and Reporting

Resource Team :

Resource Team comes from the Panel of consultants of FMSF which includes qualified and experienced persons having long association in the development sector. The Resource Team also includes the members of FMSF.

Who can participate ?

Persons who are involved in Monitoring and Reporting functions of a Voluntary Organisation.

Participation :

Registration is limited to a maximum of 30 participants on First Come First Serve Basis for each workshops.

For further details, please contact :

***The Programme Co-ordinator*, Financial Management Service Foundation**
"ACCOUNTABILITY HOUSE", A-5, Sector 26, NOIDA -201 301.
Ph: 0120-2546732, 33, 44, 45, Fax : 0120 – 2546731
(For calling from Delhi : Ph: 95120-2546732, 33, 44, 45,)
E-Mail : fmsindia@vsnl.com Also visit us at: www.fmsfindia.org

Financial Management Service Foundation
"ACCOUNTABILITY HOUSE"
A-5, Sector 26, NOIDA - 201 301
Tel: 00-91-120-2546732, 2546733, 2546744, 2546745
(**For calling from Delhi:** 95120-2546732, 2546733, 2546744, 2546745
Fax: 00-91-120-2546731
E-mail: fmsindia@vsnl.com, fmsf@vsnl.com, fmsf@fmsfindia.org
Websites: www.fmsfindia.org
www.legalissuesforngos.org
www.fcraforngos.org
www.incometaxforngos.org

ISSN 0972-7248
9 770972 724006