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Between Us...

Staying in Focus

This is the story about two outstanding people.

Bijay came from Nepal at a very young age in search of work. Being very young and not having formal education proved to be a major limitation for him in a large city. Many times, he went through identity crisis. He started asking the question 'who am I' to himself. He seemed lost in the multitude of people. Finally he landed in the office of a Charitable Health Care Centre. He had no training to get any job in the centre in the healthcare area. The Director told him to work as a gardener and take care of the plants. Bijay got the opportunity to prove himself. But how? In a hospital, will his work ever get noticed? He took up the challenge. He worked hard and slowly the centre became known for beautiful plants and flowers. Many years passed. The centre participated in flower and plant show competitions. At last, the day came when the centre was honoured for the best flower arrangements and plants. Bijay's day for reckoning had come. A man of few words, he just gave a smile and went back to his favorite place…..watering the plants and see them grow.

Rajinder came to earn a living and again lack of formal training was a handicap for him. He was one of the ten children of his parents and his parents being poor could not afford to send him to school. He realised that he has to work not only to take care of his needs but also look after his aging parents and young brothers and sisters. He joined an organisation as an office attendant. His job description was preparing coffee, doing work in the post office, bank, photocopying etc. Soon his objective was "people should get the best coffee in this office". When visitors came, they always asked who has prepared the coffee. His office earned the name for best coffee being available. Rajinder was recognised as an outstanding employee by the Board for his sincerity and commitment. When asked, he preferred to say "I have only performed my job".

Bijay and Rajinder, ordinary faces, extra-ordinary achievements. They have brought excellence to their work and contributed significantly to the organisation. It prompts us to think "It does not matter what we do, but how we do it".

- Sanjay Patra

S. P. Selvi

Programme
Co-ordinator, FMSF

ACCOUNTING

Accounting is another important component of Financial Management System. Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. In the context of development organisations, the purpose of accounting is to communicate or report the results of the activities implemented and its various related aspects. Though accounting has been variously defined, according to one commonly accepted definition,

" Accounting is the art of recording, classifying and summarising in a significant manner and in terms of funds, transactions and events which are, in part at least, of financial character and interpreting the results thereof."

Another definition which is less restrictive interprets accounting as,

"The process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of information."

Whatever may be the agreed definition, an accounting system consists of personnel, procedures, devices and records used by an organisation which help in development and structure of accounting information and communicating this information to decision makers. Design and capabilities of these systems vary greatly from organisation to organisation. In very small organisations, the accounting systems may consist of little more than a cash book and a cheque book and may be an annual interaction with the chartered accountant for filing tax returns. In large organisations, accounting systems would include computers, expensive software, highly trained staff and periodic accounting reports that provides the backbone for controlling the daily functions of each department of the organisation. Still the basic purpose of the accounting system remains the same -

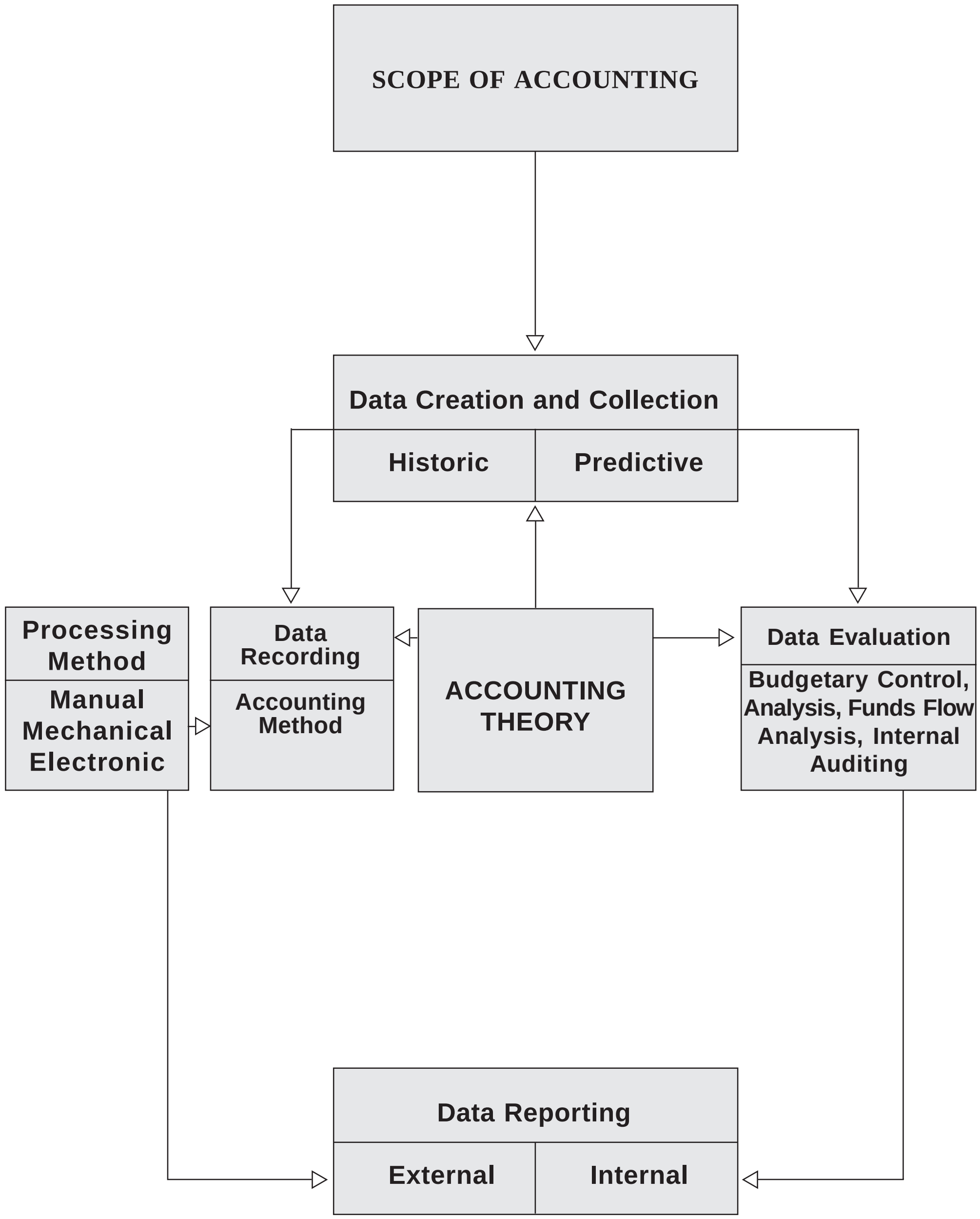
" To meet the organisation's need for accounting information as efficiently as possible."

SCOPE OF ACCOUNTING

The scope of accounting can be presented in a diagrammatic form***** as shown in the next page :

Data Creation and Collection is the area which provides raw material for accounting. The data collection is ***"historic"*** in the sense that it refers to events which have already taken place. Earlier accounting was largely concerned with what had happened, rather than making any attempt to predict and prepare for the same.

After the historic data has been collected, it is ***recorded*** in accordance with generally accepted accounting practice. All transactions or events have to be entered in the books of account Journals, Cash Book and Ledgers in accordance with the classification scheme already decided upon. The recording and processing of information usually accounts for a substantial part of



* Source : Adapted from R. J. Bull, Accounting in Business, Butterworths, London, 1969, p.2

the total accounting work. This type of activity of accounting may be called ***recordative***. The processing method employed for recording may be either manual, mechanical or electronic.

Data Evaluation is regarded as the most important activity of accounting. Evaluation of data includes controlling the activities of the organisation with the help of the budgets and budgetary controls, evaluating the performance of business, analysing the flow of funds and also analysing the accounting information for decision-making purposes by choosing among alternative courses of action.

The ***analytical and interpretative*** work of accounting may be for internal or external uses and may range from snap answers to elaborate reports produced by extensive research. Capital project analysis, financial forecasts, budgetary projections will help in generating research-based reports.

Data evaluation has another dimension and this can be known as ***auditing*** work which focuses on verification of transactions as entered in the books of account and authentication of financial statements. This work is done by public professional accountants. However, it has become common nowadays for even a medium-sized organisations to engage internal auditors to keep a continuous watch over financial flows and review the operation of the financial system.

Data reporting consists of two parts - external and internal. External reports refer to the communication of financial information (financial and funds position) about the activities undertaken to external parties like the Government agencies, Funding partners, etc., Internal reporting is concerned with the communication of results of financial analysis and evaluation to management for decision-making purposes.

In the diagram, the accounting theory has been shown in the center of the diagram. The central purpose of accounting is to make possible the periodic matching of costs (efforts) and the revenues (accomplishments). This concept is the nucleus of accounting theory. However, accounting is moving away from its traditional procedure-based record-keeping function to the adoption of a role which emphasises its social importance.

EVOLUTION OF ACCOUNTING

The history of accounting indicates the evolutionary pattern which reflects changing socio-economic conditions and the enlarged purposes to which accounting is applied. In the present context, four phases in the evolution of accounting can be distinguished.

- Stewardship Accounting
- Financial Accounting
- Cost Accounting
- Management Accounting
- Social Responsibility Accounting

STEWARDSHIP ACCOUNTING

Earlier times in history, wealthy people employed "stewards" to manage their property. These stewards rendered an account of their stewardship to their owners periodically. This notion lies at the root of financial reporting even today which essentially involves the orderly recording of business transactions, commonly known as "book-keeping". In fact, the accounting concepts and procedures we use today have their origin in the practices employed by merchants in Italy during the 15th century. The Italian method which specifically began to be known as "Double Entry Book-keeping" was adopted by other European countries during the 19th century. Stewardship Accounting, in a sense, is associated with the needs of the business owners to keep records of their transactions, the property they owned, debts they owed and the debts others owed them.

FINANCIAL ACCOUNTING & COST ACCOUNTING

Financial Accounting primarily dates from the development of the large-scale business organisations which permits a limit to the liability of its members. The importance of financial accounting statements can be traced to the need of the society to mobilise funds and channel them to profitable investments. This also enabled the investors to make efficient financial decisions.

Cost Accounting techniques were developed as guides to management decisions. Cost accounting is concerned with the application of cost accounting, cost techniques for ascertaining the costs with a view to controlling them and assessing the profitability and efficiency of the business organisation.

As the above two accounting primarily concerns with the business entities, we will not focus much on the same.

MANAGEMENT ACCOUNTING

The advent of management accounting was the next logical step in the developmental process. The practice of using accounting information as a direct aid to management is a phenomenon of the 20th century particularly in the last 30-40 years. The genesis of modern management with its emphasis on detailed information for decision-making provided a tremendous impetus to the development of management accounting.

Management accounting is concerned with the preparation and presentation of accounting and control information in a form which assists management in the formulation of policies and decision-making on various matters connected with routine or non-routine operations of the organisation. It is through the techniques of management accounting that the required information is supplied to the management which they need for achieving objectives for which they are accountable.

Management Accounting has thus shifted the focus of accounting from recording and analysing financial transactions to using information for decisions affecting the future. While the reports emanating from financial accounting are subject to the conceptual framework of accounting, internal reports - routine or non-routine are free from such constraints.

SOCIAL RESPONSIBILITY ACCOUNTING

Social Responsibility Accounting is a new phase in the development of accounting and owes its birth to increasing social awareness which has been particularly noticeable over the last two decades or so. Social responsibility accounting widens the scope of accounting by considering the social effects of business decisions, in addition to the economic effects. Several social scientists, social workers have been drawing the attention of their governments and the people in their countries to the dangers posed to the environment and ecology by the unbridled industrial growth. The role of business in society is thus increasingly coming under greater scrutiny. The management is being held responsible not only for efficient conduct of business as expressed in profitability, but also for what it contributes to social well being and progress. There is a growing feeling that the concepts of growth and profits as measured in traditional balance sheets and income statements are too narrow to reflect the social responsibility of a business.

Among some of the emerging new developments, ***Human Resource Accounting*** is a significant one. It is a branch of accounting which seeks to report and emphasise the importance of human resources (knowledgeable, trained, loyal and committed employees) in an organisation's functional process towards achieving its objectives and total assets. In simple words, it is accounting for people as organisational resources (i.e., measurement of the cost and value of people for the organisation).

METHOD OF ACCOUNTING

Accounting is a valuable management tool for an organisation. This will facilitate to ascertain the correct financial status of the organisation. The books of account shall be maintained under the double entry system which means that for every debit there should be a corresponding credit. The debit and credit of each transaction completes the principles of double entry.

SYSTEM OF ACCOUNTING

The system of accounting needs to be simple enough to understand, adopt and implement. The accounting system needs to be informative and have an inbuilt system to ensure compliance with the requirements of legal and Government laws as well as the requirements of the donor agencies.

There are basically two types of accounting :

- Cash Basis
- Accrual Basis

In the Cash basis of accounting, entries are recorded in the books of account when cash is received or paid and not when the receipt or payment is due.

In the Accrual basis of accounting, an entry is recorded in the books of account when the amount is due for payment or receipt, whether or not payment is made or amounts received.

For example, salary to an employee for the month of March 2002 is paid on 04.04.2002. In the Cash system of accounting, the entry will be recorded on 04.04.2002. In the Accrual system of accounting, the entry will be recorded as expenditure on 31.03.2002 and will be shown as outstanding for payment. When the payment is made on 04.04.2002, the entry will be adjusted against the outstanding account.

ACCOUNTING PROCESS

The transactions are documented by preparing vouchers and receipts. The transactions are classified headwise and recorded in the books of account, namely, CashBook, Petty Cash Book and Journal Book. Thereafter the transactions are posted to the ledger. A Trial Balance is extracted, summarising the transactions and financial statements such as Receipts and Payments Account, Income and Expenditure Account and Balance Sheet are drawn up. These financial statements are used for analysing the ratios such as administrative cost to programme cost, return on investments etc.

ACCOUNTING STRUCTURES

The accounting structure is depicted by the flow chart to facilitate easy understanding. Under the Foreign Contribution (Regulation) Act, 1976, separate books of account are required to be maintained for foreign contribution without mixing with local contribution. Organisations need to maintain Main Cash Book, Ledger, Project Cash Book and Project Ledger which will facilitate to arrive at the balances unutilised for each project and promote proper reporting to Government, Donor Agencies in a transparent manner.

PROGRAMME BASED FUND ACCOUNTING

Non-Profit organisations receive funds from Governments, Donor Agencies and others for a particular project, purpose or programme. They need separate accounting and reporting for each project. In these cases the concept of fund accounting fulfills the objective. The fund accounting facilitates that each fund has its own Income, Expenditure, Assets & Liabilities and the overall organisational financial statement can be prepared by consolidating the fund accounts of the various projects.

LINKAGE BETWEEN BUDGETING AND ACCOUNTING SYSTEM

The account heads in the accounting system must be in line with budgeting heads approved for the project. This will facilitate proper reporting to the funding agencies and monitoring through budget comparison report. The accountant needs to have a copy of the approved budget head along with the amount in order to account the expenses at the appropriate head.

CHART OF ACCOUNTS

Chart of accounts is a list of accounting heads agreed in an organisation. Any expenditure has to be classified to the agreed head of account and not to any other head of account. The head of account and the nature of expenditure to be booked under the respective heads has to be clearly specified.

In conclusion, it can be said that accounting should also be viewed as an Information System for the simple reason that it would help focus attention on the information provided by it. Accounting helps users in taking better decisions by providing relevant, timely and cost-effective information on the financial and operational parameters.

ACCOUNTING CONCEPTS, CONVENTIONS AND ACCOUNTING POLICIES IN NON-PROFIT ORGANISATIONS

INTRODUCTION

Accounting is the discipline, which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organisation.

Accounting is the tool for a proper financial management. Sound financial management is essential to all organisations - profit or non-profit where funds are involved. It attempts to use the funds in the most economic manner.

The prime objective of preparing financial statements is to present a true and fair view of the state of affairs of the organisation as disclosed by the books of accounts and to that end, it exhibits the assets, liabilities, funds etc., as they exist on a specific date.

ACCOUNTING CONCEPTS

Accounting is a Business Language, in order that there is consistency in the universal understanding of the language, it is necessary to follow certain accounting concepts. These are:

The **"Money Measurement"** concept : Only those transactions that can be measured in monetary terms are to be recorded in the Accounts.

The **"Entity"** Concept : The entity of an organisation is separate from that of the individuals who operate, thus its accounts are different from those of the individuals who manage it.

The **"Historical Cost"** Concept : All transactions are recorded at the price paid to acquire it, i.e. at its cost, and that this cost is the basis for all subsequent transactions.

The **"Going Concern"** Concept : It is assumed that the organisation will exist for a long time, Transactions are therefore, recorded in such a manner that the benefits likely to accrue in future from money spent now or the future consequences of events occurring now are also taken into consideration.

The **"Dual Aspects"** Concept : Every transaction recorded/entered into by an organisation has two aspects a Debit Aspect and a Credit Aspect, every debit must have a correspondent credit and every credit must have a correspondent debit.

Capital = Assets-Liabilities

Assets = Liabilities+Capital

The **"Realisation"** Concept : It is a fundamental rule in accounting that profit is not recognised or recorded to have been earned till it is realised in Cash or a third party has legally become liable to pay the amount.

The **"Accrual"** Concept : Known expenditure/liabilities even if not incurred/paid should be taken into account.

ACCOUNTING CONVENTIONS

In addition to the above mentioned concepts, the under mentioned accounting conventions are also followed :

Consistency : All transactions are to be treated on the same basis from year to year. In case of any change in the basis of treatment, the same must be adequately disclosed in the notes to the Accounts.

Disclosure : Alongwith disclosures legally required, the final accounts should disclose all significant accounting policies on the basis of which the accounts have been prepared.

Conservation : Financial Statements are to be drawn up on a conservative basis, showing the true position of the accounts.

CAPITAL AND REVENUE

All financial transactions can be classified into two categories i.e. Capital and Revenue. The transactions are recorded under each category depending on its nature.

Capital Expenditure : Capital Expenditure in common parlance is an expenditure of enduring nature. In other words an expenditure whose utility is not finished within a small period of time but continues for a longer period over the years. There is much divergence of opinion and practice in the classification of expenditure between Capital and Revenue. However, the following indicators have been laid down as establishing the fact that the expenditure is of capital expenditure :

(a) Any expenditure which is undertaken for the purpose of increasing surplus either positively by way of increasing earning or negatively by decreasing working expenditure.

(b) If the expenditure, whether increasing the earning capacity or not, produces an asset comparatively permanent in character, it is capital expenditure. Capital expenditure may therefore, be described as an expenditure resulting in the increase/acquisition of an asset or increase in the earning capacity/efficiency of a business/organisation.

Revenue Expenditure : Any expenditure which is incurred for the maintenance of the earning capacity, including the upkeep of fixed assets and administrative costs of running an organisation is considered to be a revenue expenditure.

Capital Receipt : Any amount received as a specific capital, Grant-in-aid, Life Membership Fees from members and monies/donations which forms a part of the Corpus of the Organisation is considered as Capital Receipt and is shown as Capital Fund/Assets Fund/Corpus Fund/General Fund on the Liabilities side of the Balance Sheet.

Revenue Receipt : Any amount received as a result of the day to day activities/transactions of an organisation, including annual membership fees, general donations, interest on bank accounts, etc., is considered as Revenue Receipts, and is taken as income and credited to the Income and Expenditure Account.

Surplus /Deficit : Broadly, revenue income minus revenue expenditure pertaining to a stated period will be the surplus/deficit for that period and shown as addition/deduction from the "General Fund" on the Liabilities side of the Balance Sheet.

METHOD OF ACCOUNTING

As per the provisions of Section 145 of the Income Tax Act, 1961, the Income chargeable under the head "Profit and Gains of Business or Profession " or "Income from other sources" is to be computed in accordance with either cash or accrual system of accounting regularly employed by the assessee (which also includes voluntary organisations). Accordingly, from assessment year 1997-98, all voluntary organisations are required to maintain their books of account either in Cash or Accrual system of accounting on regular basis.

Cash Basis : In cash basis of accounting, all transactions whether of capital or revenue nature are recorded only as and when effected. For example, goods and services purchased/availed are recorded as assets or expenses at the time they are paid while revenues, including grants and donations, are recorded at the time of actual receipt or transfer of funds.

Accrual System : In accrual system of accounting, goods and services purchased/availed are recorded as assets or expenses at the time the goods are received and services availed irrespective of the fact as to whether actual payment by cash/cheque is effected or not by the organisation. Similarly, revenues including grants are recorded at the time when they are earned or become due irrespective of the fact as to whether the amount has actually been received or not.

ACCOUNTING POLICIES

The Need

The views presented in the financial statements of an organisation of its state of affairs and of the surplus or deficit can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from organisation to organisation. Therefore disclosure of significant accounting policies and notes followed are necessary if the view presented is to be properly appreciated by the user.

In fact, the disclosure of some of the accounting policies followed by an organisation in the preparation and presentation of the financial statements is required by law in some cases.

CONSIDERATION IN THE SELECTION OF ACCOUNTING POLICIES

The primary consideration in the selection of Accounting Policies by an organisation is that the financial statements, prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the organisation as on the Balance Sheet date and of the surplus or deficit for the period ended on that date. For this purpose, the major considerations governing the selection and application of accounting policies are :-

Prudence

In view of the uncertainty attached to future events, income are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Substance over form

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

Materiality

Financial statements should disclose all "material" items, i.e., items, the knowledge of which might influence the decisions of the user of the financial statements.

Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

AN ILLUSTRATIVE LIST OF ACCOUNTING POLICIES

An illustrative list of accounting policies and notes to be disclosed in the preparation of financial statements is as under :

Accounting Policies :

Basis of accounting

The financial statements are prepared on historical cost basis.The organisation follows the accrual basis of accounting except to the extent specified at appropriate places.

Fixed Assets

a) Fixed Assets purchased are stated at cost. Cost includes purchase value plus all expenses incidental to its acquisition/installation.

b) Assets, purchased out of specific grants are transferred to "Assets Fund Account" by debit to the specific grant account and those purchased out of general contributions are appropriated out of Income and Expenditure Account by credit to "Asset Fund Account".

Depreciation

a) Depreciation on fixed assets is provided on the written down value method as per the rates prescribed in the Income Tax Rules, 1962.

OR

Depreciation on fixed assets is provided on the straight-line method as per the rates basedon the useful life of assets as estimated by the management.

OR

No depreciation is provided on fixed assets acquired out of specific grants, as the same are expensed in the Income and Expenditure Account.

b) Depreciation is adjusted against “Asset Fund Account”, when such fund is created at the time of acquisition of fixed assets.

Foreign Currency Transactions

All grants, voluntary contributions and gifts received in kind in foreign currency from a foreign source in the nature of a foreign contribution are accounted for at the rate(s) of exchange prevailing on the date of receipt/ amount credited in the bank account.

Donations of Articles received in kind

Donation of articles received in kind are valued as per the information provided by the respective Funding Agency (ies) or at its approximate value as assessed by the management.

Investments

Investments are stated at cost.

Provision is made for the decline in the market value of investments at the year-end, if in the opinion of the management the decline is considered permanent. In case of units of mutual fund, the Net Asset Value (NAV) as at the year end is shown in the respective schedule /place where such investments are shown.

Investments are made in accordance with the forms and modes specified in section 11(5) of the Income Tax Act, 1961.

Interest on investments is accounted for on accrual or receipt basis.

Grants Receivable/Payable

The organisation receives grants from National and International funding agencies in support of its work and for specific projects. Grant income is brought into the financial statement either in line with the expenditure or over the period of the grant where a time restriction is stipulated.

The organisation makes grants for charitable purposes both as per the direction of the funding agency(ies) or as a part of its own grant making programme. Such grants are included in the financial statements at the time grant becomes payable.

Retirement Benefits to Staff

The organisation makes regular contributions to its duly constituted and approved funds set up for Provident Fund and Gratuity.

OR

The provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 are not applicable to the organisation.

The liability for gratuity is accounted for on cash basis i.e., in the year in which it is actually paid to the concerned staff.

Interest Earned on Investments against Surplus Funds

Interest earned on investment of surplus funds is credited to specified Grants Account, where specified by the funding agencies, on the basis considered appropriate by the Management.

K. N. Gupta
Chartered Accountant

ACCRUAL BASIS OF ACCOUNTING IN NGO'S AND ITS IMPLICATIONS

INTRODUCTION

- Accounting is the discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organisation.

- Accounting is the tool for proper financial management. Sound financial management is essential in all organisations - profit or non-profit - where funds are involved. It attempts to use the funds in the most productive manner.

BASIS OF ACCOUNTING

- The term 'basis of accounting' refers to the timing of recognition of revenues, expenses, assets and liabilities in accounts. The commonly prevailing bases of accounting are:
  (a) Cash basis of Accounting; and
  (b) Accrual basis of Accounting.

CASH BASIS OF ACCOUNTING

Under cash basis of accounting, transactions whether of capital or revenue nature, are recorded **when the related cash receipts or cash payments take place.**

- Thus, revenue (e.g., from donations, grants, etc.) is recognised when cash is collected.

- Similarly, expenditure on acquisition and maintenance of assets used in rendering of services as well as on employee remuneration and other items is recorded when the related payment take place.

- The end-product of cash basis of accounting is a statement of Receipts and Payments that classifies cash receipts and cash payments under different heads.

- A statement of assets and liabilities may or may not be prepared.

ACCRUAL BASIS OF ACCOUNTING

- Accrual basis of accounting is the method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue.

- The accrual basis of accounting includes considerations relating to deferral, allocations, depreciation and amortisation.

- This basis is also referred to as 'Mercantile Basis of Accounting'.

- Accrual basis of accounting attempts to record the financial effects of the transactions and other events of an enterprise in the period in which they occur rather than recording them in the period in which cash is received or paid by the organisation.

- Accrual basis recognises that the economic events that affect an organisation's performance often do not coincide with the cash receipts and payments.

- The goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenues) and the efforts (measured in terms of costs) so that the reported net income measures an organisation's performance during a period rather than merely listing its cash receipts and payments.

- Apart from income measurement, accrual basis of accounting recognises assets, liabilities or components of revenues and expenses for amount received or paid in cash in past and amounts expected to be received or paid in cash in future.

LEGAL POSITION

The Companies Act, 1956

- NPOs registered under the Companies Act, 1956, are required to maintain their books of account according to accrual basis as required in section 209(3) (b) of the said Act.

- If the books are not kept on accrual basis, it shall be deemed as per the provisions of the aforesaid section that proper books of account are not kept.

The Indian Trust Act
and
The Societies Registration Act, 1860

- There is no specific provision with regard to the methods of accounting to be followed by NPOs covered under the aforesaid acts.

- Generally, non-company NPOs maintain their books of account on cash basis as it is considered simple.

PROVISIONS OF INCOME TAX ACT, 1961 RELATING TO METHODS OF ACCOUNTING

- Section 145 of the Income Tax Act, 1961 specifies that the income chargeable under the head "Profits and Gains of Business" or Profession or "Income from other Sources" is to be computed in accordance with either cash or accrual system of accounting **regularly employed** by the assessee (which also includes voluntary organisations). Accordingly, from assessment year 1997-98, all voluntary organisations **are required to maintain their books of account either in Cash or Accrual system of accounting on regular basis.**

RECOMMENDATIONS FROM INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

- Accrual is the scientific basis of accounting and has conceptual superiority over the cash basis of accounting. It is, therefore, recommended that all NPOs, including non-company NPOs, should maintain their books of account on accrual basis.

FOREIGN CONTRIBUTION (REGULATIONS) ACT, 1976

- As per the provisions of FCRA and rules framed therein, NPO's are required to submit a statement of Receipt and Payment Account in respect of receipt and utilisation of foreign contributions alongwith a Balance Sheet.

- This implies that FCRA recognises Cash Basis of Accounting.

FUNDING AGENCIES

Most of the funding agencies primarily require their assisted NPOs to submit a financial statement in a prescribed form or otherwise at periodical intervals to show :

a) the actual receipts;
b) disbursements;
c) utilisation of grant amounts;
d) and unutilised balances :

thereby approving the Cash Basis of Accounting.

ACCRUAL BASIS AND ACCOUNTING STANDARDS

- Accounting is often said to be a social science. It operates in an open and ever-changing economic environment.

- The nature of transactions entered into by various enterprises and the circumstances surrounding such transactions differ widely.

- This characteristic of accounting measurements historically led to the adoption of different accounting practices by different enterprises for dealing with similar transactions or situations.

- Comparability is one of the important qualitative characteristics of accounting information.

- This implies that the information should be measured and presented in such a manner that the users are able to compare the information of an organisation through time and with similar information of other organisations.

- Adoption of different accounting practices by different organisations for similar transactions or situations tends to reduce the comparability of accounting information.

- Recognising the need for bringing about a greater degree of uniformity in accounting measurements, the trend all over the world now is towards;

  a) following the accrual basis of accounting;
  b) formulation of accounting standards to be adopted in preparation of accounting information and its presentation in financial statements.

- Accounting standards lay down the rules for measurement and presentation of accounting information by different organisations.

- In India, the task of formulating accounting standards has been taken up by the Institute of Chartered Accountants of India.

- Accounting Standards issued by the Institute are based on the fundamental accounting assumption of accrual basis of accounting.

- These standards thus reflect, what can be construed as, proper application of accrual accounting to different types of transactions and events.

ICAI RECOMMENDATION ON APPLICABILITY OF ACCOUNTING STANDARD

- *As per ICAI, Accounting Standard issued by the Institute do not apply to an NPO if no part of the activity of such entity is commercial, industrial or business in nature. The standards would apply even if a very small proportion of activities is considered to be commercial, industrial or business in nature.*

RECOGNITION OF REVENUE RECEIPTS AND EXPENDITURE ITEMS AS PER CASH BASIS AND ACCRUAL BASIS OF ACCOUNTING

Revenue Receipts

- Revenue Receipts normally consist of ;
  - Grants
  - Interest on Investments

- Annual Subscriptions
- Donations
- Miscellaneous Receipts

- Revenue Expenditure normally consist of;

  - Programme Expenditure
  - Programme Coordination – Administrative Expenditure
  - Others
  - Depreciation

- The treatment of the above major items of revenue receipts and expenditure under cash basis and accrual basis of accounting is given in the next page:

REVENUE RECEIPTS

Particulars	Cash Basis of Accounting	Accrual Basis of Accounting
1. Grants	on actual receipts basis	on actual receipts basis/sanction letter basis.
2. Interest on Investments	on actual receipt basis	on due basis (whether actually received or not).
3. Annual Subscription	on actual receipt basis	on due basis (whether actually received or not).
4. Donations	on actual receipt basis	on actual receipt basis
5. Miscellaneous Receipts	on actual receipt basis	on actual receipt basis

REVENUE PAYMENTS/ EXPENDITURE

Particulars	Cash Basis of Accounting	Accrual Basis of Accounting
Programme Expenditure	on actual payment basis	on actual payments plus year end adjustments on accrual / due basis.
Programme Co-ordination-Administrative Expenditure (Rent, Salaries, Telephones, Vehicle Running Expenses etc.)	on actual payment basis	on actual payments plus year end adjustments on accrual /due basis.
Others	on actual payment basis	on actual payments plus year end adjustments on accrual /due basis.
Depreciation	Normally not charged	Charged as per Straight Line/ Written Down Value Method as per Income Tax Rates /on independent assessment basis.

Purnima Wadhawan

Project Monitoring Officer, FMSF

PREPARATION AND PRESENTATION OF ANNUAL FINANACIAL STATEMENTS

Accounting is the tool for proper financial management. Sound financial management is essential for all organisations: profit making or non-profit making. It attempts to use the funds in the most appropriate and efficient manner.

Therefore, a well designed accounting system has in it an in-built information system by which matters are brought to the notice of the concerned authorities who are charged with the responsibilities of taking long and short term decisions.

NEED TO PREPARE ANNUAL ACCOUNTS

It is important to ascertain the precise financial situation at a given date, and to review the financial activities of the organisation during the period. The following people are interested in the annual accounts:

THE MEMBERS

It is difficult to identify the "owners" of a development organisation. Generally, the members of an organisation play the role of the owner of an organisation. It is the foremost duty of the members to see that the organisation is working towards the attainment of the objects of the society and to safeguard the assets and property of the organisation. Therefore, they have the primary interest in the annual accounts of the organisation. The General Body consisting of all the members looks and approves the accounts of the organisation at the Annual General Metting.

The General Body consisting of all the members may not be able to examine the underlying records themselves and therefore, appoints auditors to check that the accounts are correct. The auditors prepare the report which is presented alongwith the accounts to the General Body in the Annual General Meeting.

THE MANAGEMENT COMMITTEE

The managers and the management committee need to review the financial activities of the organisation at the end of the organisation's financial year. They may be interested to compare the actual financial results with what they planned to do in the budget for the year for reviewing the activities of current year as well as for further decision making.

They also need to "give an account" of their stewardship to the members, funding partners and the community whom they serve. The preparation and presentation of annual accounts is a most confidence building exercise. Even if some people do not understand the accounts the fact that they are freely available will encourage further support and interest in the organisation's activities.

FUNDING PARTNERS AND EXISTING OR POTENTIAL DONORS

The annual accounts form part of the Annual Report which gives details of the activities as well as financial results. This is of interest to donors and prospective supporters of the organisation.

THE BENEFICIARIES

Now-a-days the concept of Social Audit is gaining acceptance all over the world. It is a process in which the beneficiaries, who are the people benefiting from the activities of the organisation, also have the opportunity to see the accounts.

GOVERNMENT AGENCIES

In India, there is a specific requirement to file the accounts of the organisation with the Government agencies e.g. Ministry of Home Affairs, Income Tax Department.

In conclusion, openness and transparency will be a key aim of management. This will inspire confidence and increase support. The annual accounts are a part of this process.

WHEN THE ANNUAL ACCOUNTS ARE PREPARED

These should be prepared as soon as possible after the end of the financial year; for example within 6 weeks. In this way the information is up-to-date and useful for management purposes. Year end account balances can be carried forward to the New Year thus ensuring that accounting records and monthly reports can continue to be prepared on a timely basis.

INFORMATION AVAILABLE IN THE ANNUAL FINANCIAL ACCOUNTS

The annual accounts show in a summary form where money has come from; for what purpose it has been received and how it has been spent. Annual accounts of a NGO basically consist of Balance Sheet, Income & Expenditure Account, Receipts and Payments Account, Notes to the Accounts and Audit Report.

BALANCE SHEET

Balance Sheet is a statement of the financial state (assets, liabilities, funds etc.) of an organisation on a particular date. The objective of the Balance Sheet is to show in a summary form, the financial state of affairs of the organisation as disclosed by the books and to that end it exhibits the assets, liabilities, funds etc., as they exist on a particular date.

It is like a status report. In simple terms, Balance Sheet will tell you what were the assets and liabilities of an organisation on a particular date, say 31st March 2003.

The assets and liabilities in the Balance Sheet are usually classified into the following categories:

Assets :

- Fixed Assets
- Investments
- Cash and Bank Balances
- Loans and Advances
- Other Current Assets
- Losses & Expenditures (to be carried over)

Liabilities :

- General Fund (unrestricted funds)
- Restricted Funds (funds earmarked for specific purposes)
- Assets Fund
- Unutilised grants
- Loans (Secured/ unsecured)
- Current liabilities.
- Surplus of Income (to be carried over)

Balance Sheet can be prepared in two forms: the traditionally horizontal and the trendy vertical. Most NGO Balance Sheets are prepared in the horizontal form. This has two sections : right and left. Assets are shown on the right side and liabilities are shown on the left. The vertical form of Balance Sheet is mostly prepared by the corporate sector and is rarely seen in the NGO's. It has two sections : Sources of Funds and Application of Funds.

INFORMATIONS AVAILABLE IN BALANCE SHEET

How much Reserves and Funds: The Balance sheet will tell what reserves and funds were held at the year end for different programmes, donor agencies and the organisation itself in the form of General Fund, Trust Fund or Corpus Fund.

Earmarked Funds: Certain funds are earmarked for defined purposes. The use of such funds is restrictive for certain defined purposes only. Contributions and transfers towards such funds are directly creditable to the respective fund balance. From the Balance Sheet, you can know the earmarked funds of the organisation and their utilisation.

Loans and Advances : If the organisation has taken any loans or advances or given any loans or advances, you can know it from the Balance Sheet.

Types of Assets : From the Balance Sheet, you can also know what type of assets represent the above reserves and funds

How much cash : Cash in hand is important for day-to-day expenditure. But large amount of cash increases the risk of theft and misuse. Normally, a cash balance for five days payment is sufficient. A large balance may indicate improper financial management, unusual circumstances (planned purchase of land), several field offices, lack of planned withdrawals or even a partially fictitious cash balance.

How much bank balance : Money lying in a savings account or current account is no good for anyone except the Bankers. This is because, the rate of interest payable on savings bank account is lower than that of term or fixed deposits. Good financial management will show small bank balances (sufficient for a month or 45 days), with the rest of the money lying in short term bank deposits.

Basis of Accounting : If debtors, creditors, receivables or payables appear on the Balance Sheet, the organisation is probably following Accrual or Mixed Basis of Accounting.

Status of Revolving Fund Loans : Revolving Fund Loans are often treated as one time expenditure in the accounts and thereafter managed by the community. In such a case, no such loans appear on the assets side of the Balance Sheet.

Purchase of Fixed Assets: Sometimes, fixed assets purchased for the programme are charged off to programme expenditure in the accounts. If such assets have been donated to the community, then they will not appear in the Balance Sheet. However, if such assets belong to the organisation although purchased for programmes, then it is suggested to include them in the Balance Sheet. Otherwise, the Balance Sheet of the organisation will not reflect the true value of fixed assets.

SOME MORE TIPS ON READING THE BALANCE SHEET……..

- If the Balance Sheet is not a consolidated one, then it will carry some comments below the heading such as FCRA Accounts, EED Project Accounts etc.
- It is also useful to compare this year’s figure with last year to ascertain the changes in the funds status. Also, one can see if some amounts of loans, advances, payables etc., have remained unchanged.
- Ascertain some meaningful ratios. Ratio analysis means realising a relationship between two figures when there is a relationship. For example, there is a relation between the programme conducted and infrastructure needed. So, one can see the relationship between value of fixed assets and amount of programme expenditure.These ratios can be compared with the previous year’s ratio for better analysis.

INCOME & EXPENDITURE ACCOUNT

Income & Expenditure Account is like an activity report prepared in financial terms - it shows what an organisation has done during one year. Mostly this account is prepared for a year though it can be prepared for a longer or shorter period also. It shows all the income for the year on right side and all the expenditure on the left side. The difference between the two sides is shown as ‘surplus’ or ‘deficit’. If the income side is more, you get a surplus. If the expenditure side is more, it means you spent more than you earned - the result is a ‘deficit’.

The Income & expenditure Account can also be prepared in two forms : Horizontal or Vertical. Most NGO’s prepare the Income & expenditure Account in horizontal format, which has been discussed above. Another form is Vertical in which Income items go on the top. Below these the Expenditure items are shown. Total expenditure when subtracted from the Total Income gives the Surplus or Deficit. There is no major advantage in vertical Income & Expenditure Account except that it is easier to type and file and shows Total Income & Total Expenditure clearly.

INFORMATION AVAILABLE IN THE INCOME & EXPENDITURE ACCOUNT

For a good analyst, a decently prepared Income & Expenditure account is sometimes better than an annual narrative report. It can tell you :

- How much the organisation received from different sources:
  - Grants
  - Donations
  - Interest
  - Income from other sources such as sale of assets etc.

- How did the organisation spend the funds -
  - Administration - Salaries, Travel, Rent, Printing & Stationery etc.
  - Programme work

SOME MORE TIPS ON READING THE INCOME & EXPENDITURE ACCOUNT……..

- Compare this year’s figure with the previous year’s figure to know:
  - Whether the income of the NGO is rising or stagnating
  - Which type of expenses are growing at a higher rate than others.

- Compare Narrative/ Activity report of the organisation with the Income & Expenditure account to know that they correspond with each other.

- the efficiency of work done by the organisation.

RECEIPTS AND PAYMENTS ACCOUNT

Receipts and Payments Account is a summarized copy of the Cash Book classified under major heads of accounts instead of recording the transactions date wise. All receipts (on left side) and payments (on right side) whether of capital or revenue nature are included in it. The opening and closing cash balances are shown as the first item on the debit side (left) whereas the closing cash and bank balances are shown as the last item on the credit side (right) of the Receipts and Payments

Account.

This form of account is mostly used by societies, associations, trusts or voluntary agencies for reflecting the movement of funds over a certain period under various broad heads of accounts which helps to know as to how the funds are received and paid.

What can the Receipts and Payments Account tell us?

The Receipt and Payments Account should show all cash and bank transactions. This includes loans given and received during the year. It even includes those loans that were given out and received back during the same year.

For instance, a trustee of a Trust took a loan of Rs.5,00,000 from the Trust on 1st April 2001 and returned the entire amount of Rs. 5,00,000 on 31st March 2002. The loan was interest free. Then again, on 1st April, 2002, he took another loan of Rs. 5,00,000 and retuned the same on 31st March, 2003. This loan can't be figured out from the Balance Sheet or Income and expenditure Account. As per the accounting practices, this transaction should come in the Receipts and Payments Account.

However, most accountants and auditors have forgotten the basic requirements of Receipts & payments Account. These days they simply prepare it from the Balance sheet and the Income & Expenditure Account. As a result, transactions settled during the year do not show at all.

The Receipts and Payments Account also serves another useful purpose. Looking at the Receipts and Payments Account, you can easily know the extent of funds utilised by the organisation.

NOTES TO THE FINANCIAL STATEMENTS

Accounts are always based on certain assumptions and framework of specific policies, which may vary from organisation to organisation. The prime objective of preparing financial statement is to present a true and fair view of the state of affairs of the organisation. To provide clarity to the statements and to know the modus operandi behind their preparation, suitable notes are always given for the benefit of the user. Therefore, notes to accounts becomes so very important, because unless the facts/ assumptions behind the transactions are known it is not possible for anybody to form any authentic opinion.

SOME SUGGESTED PRACTICES TO BE FOLLOWED DURING PREPARATION OF THE FINANCIAL STATMENTS

It is said that the preparation and presentation of accounts is also a confidence building exercise. A list of some suggested practices has been provided below which can be followed by the organisation in the process of confidence building among its various constituencies. The list is not exhaustive but recommendatory in nature.

A sample format of the Audit Report, Balance Sheet (in vertical form), Income & Expenditure

Account (in vertical form) and Notes to the Accounts has been provided as Annexure-I to this chapter.

- Previous year figures should be provided.

- Notes to the accounts should be given regarding :

  - Accounting policies followed in the preparation of the accounts.
  - Any change in the accounting policy during the current year.
  - Contingent Liabilities e.g.
    - ★ Claims against the society not acknowledged as debts.
    - ★ Disputed property tax demands under appeal, before appropriate authorities relating to financial years……Rs…….
    - ★ Outstanding capital commitments.

  - Basis of Accounting- Cash or Accrual
  - Basis of recording the Fixed Assets.
  - Depreciation policy
  - Basis of recording the grants.
  - Accounting of specific grants.
  - The organisation should follow the concept of Fund Accounting for the restricted revenue grants and donations. A format for Fund based Receipts and Payments Account has been provided as Annexure-II to this chapter.
  - The audited Financial statements should also be signed by the Trustees/ Office Bearers.
  - Loans to and from Directors, Secretary, Treasurer and Staff should be shown separately on the face of Balance Sheet.
  - In the Income & Expenditure Account, the Programme and Administration expenditure should be shown separately.
  - In the Receipts and Payments Account, the loans and advances squared up during the year should be shown.

SAMPLE FORMAT

REPORT OF AUDITORS TO THE MEMBERS OF "DEVELOPMENT FOR ALL"

We have audited the attached Balance Sheet of Development for All, New Delhi, as at March 31, ….. and the Income & Expenditure Account for the year ended on that date, which are in agreement with the books of accounts maintained by the said society.

These financial statements are the responsibility of the management. Our responsibility is to express an opinion on these financial statement based on our audit. We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material mis-statement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of the audit. In our opinion, proper books of accounts have been kept by the society at its corporate office and other branches of the society visited by us, so far appears from our examination of the books.

In our opinion and to the best of our knowledge and according to the information and explanations given to us, the said accounts give a true and fair view, read together with the significant Accounting Policies followed by the society in framing the financial statements and Notes to the Accounts.

In case of the :

1. Balance Sheet of the state of affairs of the society as on March 31, …...
2. Income & Expenditure Account of its Excess of Income over Expenditure or Expenditure over Income for the year ended on that date.

Place :

Date : (Signature of the Auditors)

Significant Accounting Policies

(Followed in the financial statement for the year ended March 31, …..)

1. In conformity with its objects, the society has undertaken direct welfare projects :
   a) for imparting education by way of running schools for the under privileged.
   b) rehabilitation of street children to the main course of life.
   c) Attending to health and sanitation needs, skill development leading to income generation/ enhancement and community organisatiion,
   d) Provide gender equity and women development

   For the benefit of the urban poor living in the slums, who form the back bone of the modern industrialisation and commerce and the rural poor, who are the mainstay of agriculture and allied activities.

2. All expenses incurred directly for such purpose either for the benefit of the individual beneficiaries or for the common use of the groups have been treated as Direct Project Expenditure and are so stated in the accounts.

3. All the grants/ financial assistance received as well as paid are accounted for on cash basis, whether in capital or revenue nature, as revenue. Though this may be in contradiction to the terms of contract of certain donor agencies, this treatment is given to meet local tax law requirements. Ascertained incomes on investments are also recognised as income. Yet, funder wise accounts are also maintained through an integrated accounting system. However, by way of abundant caution all known and ascertained liabilities are provided for.

4. The expenditure on the projects taken up with the support of donor agencies is, as far as possible incurred according to the plans and budgets agreed upon.However, deviations from agreed plans and budgets often occur at the time of project execution depending upon various circumstances, such as location, awareness among the beneficiaries, local customs, availability of inputs, legal restrictions etc. Such variations are monitored regularly, intimated to the donor in advance.

5. Any income or grant generated, described as Community Contribution, out of the projects supported by foreign funding agencies is taken as Indian Income and so accounted for.

BALANCE SHEET AS ON	*Schedule*	200.. (Current Year)	200.. (Previous Year)
SOURCES OF FUND:			
Capital Fund	1		
Specified Fund	2		
TOTAL			
APPLICATION OF FUNDS :			
Fixed Assets	3		
Investments	4		
Current Assets, Loans & Advances			
A. Current Assets	5		
B. Loans & Advances	6		
Less : Current Liabilities	7		
Net Current Assets			
TOTAL			
Fund based Receipts & Payments Account	8		
Notes to Account	9		

INCOME & EXPENDITURE ACCOUNT FOR THE YEAR ENDED ON................	Schedule	20.. (Current Year)	20.. (Previous Year)
INCOME Contributions/ Grant Received -Foreign Contribution -Local Contribution Other Income Income bn Investments	 10 11 12 13		
TOTAL			
PROGRAM EXPENDITURE **ADMINISTRATION EXPENDITURE** Salary, Wages and Other Benefits Rent Professional Expenses Repair & maintenance Travelling & Conveyance Books, Periodicals & Stationery Vehicle Running & Maintenance Communication Cost Electricity & Water Expenses Audit Fees Miscellaneous Expenses Depreciation Excess of income over expenditure	14		
TOTAL			

ANNEXURE - II

FUND BASED RECEIPTS AND PAYMENTS ACCOUNT FOR THE YEAR ENDED ON ....

Funding Agency	Opening Balance	Receipts			Recurring Expenses					Non-Recuring Expense	Total Payments	Closing Balance
		Contri-bution	Other Income/ Interest	Total	Direct Program Expenses	Program Salaries	Professional Payments	Program support Staff & Admin.	Total			
Foreign												
Local												
Total												

SCHEDULES TO ACCOUNTS AS ON	200.. (Current Year)	200 (Previous Year)
Schedule 1: Capital Fund & Reserves		
Membership Fund		
Corpus Fund.		
Opening Balance		
Additions during the period		
Capital/ Assets Reserve		
Opening balance		
Additions during the period		
General Reserve		
Opening balance		
Add :Excess of income over expenditure		
TOTAL		
Schedule 2 : Specified Funds		
For Building :		
Opening Balance		
Add : Out of contribution		
Less: Utilised		
For Others :		
Opening Balance		
Add : Out of contribution		
Less : Utilised		
TOTAL		

Pooja Bagga
Project Monitoring
Officer, FMSF

MEMORANDUM OF ASSOCIATION OF THE SOCIETY AND ITS RULES AND REGULATIONS UNDER THE SOCIETIES REGISTRATION ACT, 1860

[*This is the second article in the series of articles dealing with the various aspects of the Societies Registration Act, 1860.*]

As stated in the previous article, a society can be formed by "Any Seven or more persons associated for any literary, scientific or charitable purpose, or for any such purpose as described in Section 20 of this Act, may, by subscribing their names to a memorandum of association, and filing the same with registrar of joint stock companies (or as amended by respective state acts) form themselves into a society under this Act.

In other words the memorandum is the charter of the society. It is the document depicting and describing the objects of its existence and its operations.

The memorandum as per the Principal Act (Section 2) and Acts passed by various state governments should contain the:

- Name of the Society
- The objects of the Society
- The names, addresses and occupation of the members of the governing body
- The place of the registered office of the Society

The memorandum should be a neatly typed document on good quality durable paper with serially numbered pages since these documents are to be kept as permanent records. Also, there should be a one and a half margin on left side of each sheet of paper while typing and it should be typed on one side only.

The memorandum should also contain the names, addresses and full signatures of the seven and more persons subscribing their name to the memorandum of association. The signatures should be duly witnessed and attested. A sample format of the memorandum of association is given as an annexure at the end of this article.

Along with the memorandum of association, a certified true copy of the Rules and Regulations of the Society signed by atleast three of the members of the first governing body should be filed.

Rules and Regulations:

The rules and regulations of the society are framed to guide the members of the governing body or the persons entrusted with management of the society to regulate the functions of the society and for its internal management.

These rules and regulations help in achieving the objects of the society and are binding on its members.

A copy of the rules and regulations certified to be correct by not less than three members are required to be filed with the registrar along with the other documents at the time of the registration of the society.

The rules and regulations also lay down the rules for the meetings. The rules should normally contain guidelines for meetings, quorum, proxy, minutes, and resolutions.

It cannot be presumed that a society is duly registered under the Act by just obtaining the certificate of registration from the registrar, but it is presumed to be registered by the copies of the Rules and Regulations and the Memorandum of Association being certified under Section 19 of the Act.

Every society registered under the Act may sue and be sued in the name of the President ,Chairman or Principal Secretary or Trustees as determined by the rules and regulations of the society. A sample format of the rules and regulations is also given as an annexure at the end of this article.

Member(s) in the memorandum shall be a person(s) who has been admitted according to the rules and regulations of the society and should have paid the subscription and signed the list of members. No person shall be entitled to vote or be counted as a member in any of the proceedings of the society whose subscription has been in arrears for a period exceeding three months.

The rights and duties of these members are:

Rights:

- Right to receive notices
- Right to vote
- Right to receive copies of the bye laws
- Right to receive statement of accounts
- Right to attend general meetings

Duties and Liabilities:

- To work towards attainment of the objectives of the society
- To attend the meetings regularly and exercise their democratic right as and when necessary.
- A society may act against the members for:
  - recovery of arrears of membership subscription
  - recovery of any retained property or damages to the property caused by the members
  - for mis-utilisation/ mis-appropriation of funds of the society
  - forging any deed, document, money receipt etc., causing loss of fund or loss of credibility of the society.

Governing Body:

Governing Body under the Act can be said to be consisting of the Governor's Council, Committee, Trustees or some other body by whatever name called to whom or to which by the rules and regulations of the society the management of its affairs is entrusted. Property belonging to the society registered under the Act is deemed to be vested in the Governing Body of the society if not vested in trustees.

General Body:

General Body comprises all the members who have subscribed to the memorandum of the society. In certain NGOs, there is no distinction between the General Body and the Governing Body. It is permissible to have common members among both the General Body and the Governing Body. However for good governance, sometimes there are more members in the general body from which the Governing Body is elected in the Annual General Meeting

Meetings:

General Meetings: Annual General Meeting (AGM) is a meeting of the general body i.e., of all the members who have subscribed to the memorandum of the society normally held once in a year to discuss and approve the important matters like review of yearly activities, approval of audited accounts, and appointment of auditor. The AGM is to be conducted within six months of the end of the financial year since the annual activities and accounts are adopted in this meeting.

Other general meetings can also be called during the year to discuss certain matters of importance if required. Such meetings are called the Extraordinary General Meeting (EGM).

All members of the society have a right to participate in the meeting.

Board Meetings / Governing Body Meetings: The meetings of the Governing Body are held to take administrative decisions for the organisation. These meetings are held as per the time interval specified in the rules and regulations of the society. They can also be held more frequently if need arises for them. Generally the meetings should be held at atleast in an interval of three months if the time interval for holding the governing body meetings is not specified in the rules and regulations. These meetings are important for an organisation since in these meetings the matters related to management of the organisation is taken in collective manner.

Notice: A notice for every meeting should be given to all the members according to the time limit as mentioned in the bye-laws and the time limit for issue of the notice for any meeting should be provided in the bye laws. The notice for the meetings has to be given in writing. Generally a 21 days notice should be given for a general meeting and 7 days notice for a governing body meeting.

Agenda: Along with the notice for the meeting, the 'Agenda' for the meeting should be enclosed which provides the details regarding the relevant items to be discussed during the meeting.

Quorum: The bye-laws of the organisation should also specify the quorum required for different meetings. 'Quorum' implies the minimum number of members who must be present in the meeting to make the proceedings of the meeting valid. If the required quorum is not present then the meeting is generally adjourned to the same day of the next week, at the same time and the same place. In case the quorum is still not present in the adjourned meeting then the meeting can be taken as a valid meeting. However proxies are not considered as part of the quorum.

Proxy: A member entitled to attend and vote in a meeting can appoint a proxy on his behalf who can attend and vote in the meeting who is referred to as the Proxy. A proxy form has to be filled up and submitted at least 2 days before the date of the meeting of the society.

Minutes: It is important to record the minutes of the meetings since they are the formal record of the proceedings of the meetings. The minutes can be recorded on loose sheets chronologically prepared and bound together or a bound register. The pages of the minutes should be serially numbered.

The minutes of the previous meeting are to be read and confirmed at the beginning of a meeting. Thereafter the minutes are signed by the chairman and subsequently they cannot be altered or corrected.

The members are required to sign the attendance register during the meeting.

In case of a combined general body and governing body meeting, care should be taken to write separate minutes for the General Body meeting and the Governing Body meeting. Also care should be taken to maintain the required quorum as required for the type of meeting being conducted

Resolutions: For any decisions taken at the meetings by the members, to formally apply the decisions, a resolution stating the decision taken has to be passed in writing. It is required for the organisation to mention the decision taken during the meeting in the shape of a resolution along with the number of votes in favour and against the decision

While framing the rules and regulations the number of members required to pass a resolution is to be mentioned in the rules and regulations.

(To be continued)

Sample Format for Memorandum of Association

1. **Name of the Society**:
   The name of the society shall be…………………………………………………….

2. **Registered Office:**
   Registered office of the society shall remain in the ………………………… (Mention the state) and at present it is at the following address:
   ____
   ____

3. **Aims and Objects:**
   The aims and objects for which the society is established is as under:
   (a)
   (b)
   (c)
   (d) and so on……..

4. **Governing Body:**
   The names, addresses, occupation and designation of the present members of the governing body to whom the management of the society is entrusted as required under Section 2 of the Societies Registration Act, 1860 ,are as follows:

S.No.	*Name (full in capital)*	*Addresses*	*Occupation*	*Designation in the society*

(1)
(2)
(3)
(4)
(5)
(6)
(7) and so on

5. **Desirous person**
   We the undersigned are desirous of forming a society namely "…………………" under the Societies Registration Act,1860 in pursuance of this Memorandum of Association of the Society.

S.No.	*Names and Addresses*	*Age*	*Occupations*	*Signatures*

(1)
(2)
(3)
(4)
(5)
(6)
(7) and so on

Note:

1) The memorandum should close here.
2) Following paragraph should be added as last paragraph:
   " All the incomes, earnings, movable or immovable properties of the society shall be solely utilised and applied towards the promotion of its aims and objects only as set forth in the Memorandum of Association and no portion thereof shall be paid or transferred directly by way of dividends, bonus, profits or in any manner whatsoever, to the present or past members of the society or to any person claiming through any one or more of the present or the past members. No member of the society shall have any personal claim on any movable or immovable properties of the society or make any profit, whatsoever, by virtue of his membership

Attested the signatures from No. 1 to 7 (or more)

Signatures of two witnesses other than the members of the society with addresses

Signatures of the Attesting Officer with Official Seal

(1)

(2)

Certified that this is the true and correct copy of the Memorandum

Signatures of any three members of the Governing Body

President **Secretary** **Treasurer**

STANDARD FORMAT OF RULES AND REGULATIONS OF A SOCIETY

1. Rules and Regulations

- i) Name of the society
- ii) Membership defined
- iii) Admission and qualification of the members
- iv) Subscription
- v) Cessation of membership
- vi) Rights and privileges of membership
- vii) Code of Conduct

2. General Body:

- i) General body defined
- ii) Powers and duties/functions of the general body
- iii) Quorum and notice of meeting and periodicity of meetings

3. Managing/Governing Body/Executive

- i) Managing/Governing Body/Executive Committee defined
- ii) Composition
- iii) Minimum and maximum strength including office bearers
- iv) Election and its mode
- v) Term of the office of the Governing Body
- vi) Powers/duties/functions of the Managing/Governing Body/Executive
- vii) Powers and duties of the office bearers
- viii) Quorum and notice of the meetings
- ix) Filling up of casual vacancies

4. Sub-Committee if any,

- i) Formation
- ii) Composition
- iii) Duties and functions

5. Sources of Income and Utilisation of Funds

6. Financial Year

7. Audit of Accounts

8. Operation of Bank Accounts

9. Annual List of Managing/Governing Body(Sec 4 of the Act)

10. Legal proceedings(Sec. 6 of the Act)
The society may sue or be sued in the name of the President/Chairman/Secretary as per the provisions laid down under Section 6 of the Societies registration Act,1860

11. Amendments/Alteration, extension or abridgement of 'purposes' aims and objects or change of name, Section 12 and 12A of the Societies Registration Act.The amendment shall be made under this section

12. Dissolution and adjustment of affairs
If the society needs to be dissolved, it shall be dissolved as per provisions laid down under Section 13 and 14 of the Societies Registration Act, 1860

13. Application of the Act:
All the provisions under all the sections of the Societies Registration Act, 1860 shall apply to this society

14. Certificate:
Certified that this a true and correct copy of the rules and regulations of the society

Sd/-	**Sd/-**	**Sd/-**
(President)	**(Secretary)**	**(Treasurer)**

Purnima Wadhawan
Project Monitoring
Officer, FMSF

TECHNICAL GUIDE ON ACCOUNTING AND AUDITING IN NOT-FOR-PROFIT ORGANISATIONS

Recognising the importance and impact of the Not-for-Profit Organisations (NPOs) sector in the country, the Research Committee of the Institute of Chartered Accountants of India (ICAI) has published a "Technical Guide on Accounting and Auditing in Not-for-Profit Organisations" in April 2003. The stated objectives of the Technical Guide are:

- Suggest a standardised framework for the preparation and presentation of financial statements of NPOs, so that they are able to meet the common information needs of the various stakeholders. In this regard, an attempt has also been made to examine the feasibility of:

  (a) applying the accrual system of accounting to NPOs.
  (b) applying the Accounting Standards issued by the Institute of Chartered Accountants of India to NPOs.
  (c) developing formats of financial statements for NPOs and
  (d) recommending the disclosure of relevant non- financial information in the financial statements of NPOs.

- Provide guidelines on the conduct of audit of NPOs.

THE STATE OF EXISTING ACCOUNTING PRACTICES

The existing accounting practices in the NPO sector are generally driven by the requirements of the tax and other laws such as Foreign Contribution (Regulations) Act, 1976. Also, there are different accounting practices being followed by various NPOs. As a result of the above factors, the existing accounting practices in this sector have the following characteristics:

- There is no standard basis of accounting being followed by NPOs. Cash, hybrid,accrual, modified cash/accrual basis of accounting are being followed.
- The Accounting Standards, issued by the Institute of Chartered Accountants of India, are generally not being applied.
- There is lack of uniformity in presentation of financial statements.
- There are different disclosure practices being followed by individual NPOs.
- There is diversity in terminology and accounting policies being adopted.

TECHNICAL GUIDE RECOMMENDS ACCRUAL BASIS OF ACCOUNTING FOR NPOs:

Accrual basis of accounting is the method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue rather than recording them in the period(s) in which cash in received or paid by the enterprise. The accrual basis of accounting includes considerations relating to deferral,allocations, depreciation and amortisation.

ICAI recommends that all NPOs whether registered under Companies Act, 1956, Societies Registration Act, 1860 or Public Trust, should maintain their books of account on accrual basis. However, it clarifies that where the statute such as Companies Act, 1956 governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify the report. On the other hand, where there is no such statutory requirement and the financial statements have not been prepared on accrual basis, the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification.

ICAI proposes accrual basis of accounting largely because the Accounting Standards are based on the fundamental accounting assumptions of Going Concern, Consistency and Accrual. To make Accounting Standards applicable to the NPOs it becomes important that all the above three accounting assumptions are followed. The application of accrual systems in NPOs has its own difficulties and apprehensions, as mostly NPOs prefer to follow cash basis of accounting.

APPLICABILITY OF ACCOUNTING STANDARDS TO NPOs :

The ICAI in 1995 had clarified that Accounting Standard will not apply to NPOs unless any part of its activity is commercial, industrial or business in nature. It was also clarified that even if a very small proportion of the activities of an entity was considered to be commercial, industrial or business in nature, then it could not claim exemption from the application of Accounting Standards. The Accounting Standards would apply to all its activities including those which were not commercial, industrial or business in nature.”

Now by virtue of the recent technical guide, ICAI has withdrawn its earlier position and has recommended that NPOs should follow accounting standards even if no part of its activities is commercial, industrial or business in nature.

ISSUES IN APPLICATION OF ACCOUNTING STANDARDS (AS) :

So far, ICAI has issued 28 Accounting Standards (including AS 8- Accounting for Research & Development, which has been withdrawn w.e.f 1.4.2003) and as already discussed above, all the Accounting Standards except AS 8 would now be applicable to NPOs. We are providing salient features of some accounting standards and their applicability to NPOs below, that would affect the accounting practices being followed by NPOs currently:

AS 1, Disclosure of Accounting Policies

The AS 1 recognises that due to the varying circumstances in which enterprises operate, different accounting policies may be adopted by different enterprises. In order that the users of financial statements can evaluate properly the working results and the financial position of an enterprise, the

Standard requires the disclosure of significant accounting policies adopted in the preparation and presentation of financial statements. The disclosure of significant accounting policies should form part of the financial statements and the significant accounting policies should normally be disclosed at one place.

Applicability of AS 1 to NPOs

It is recommended that AS 1 should be applied to NPOs and they should disclose significant accounting policies at one place. Also, where an NPO has followed a basis of accounting other than accrual, a disclosure in this regard should be made.

AS 2, Valuation of Inventories

AS 2 applies to the valuation of all inventories except a few exemptions described in the Standard. As per AS 2, the inventories should be valued at the lower of cost and net realizable value.

Applicability of AS 2 to NPOs.

The Technical Guide recommends that where an NPO is carrying on any trading/manufacturing activity and has inventories at the year end that are held for sale or in the process of production for such sale or in the form of materials to be consumed in the production process or in rendering of services, the inventories should be valued at lower of cost or net realizable value.

Where certain items are manufactured or purchased for the purpose of distributing to beneficiaries either free of cost or at a nominal rate, the Technical Guide clarifies that AS 2 would not be applicable on such items. In such cases, the items should be valued at the lower of cost or replacement cost, if applicable.

In certain cases, NPOs may receive items from donor agencies either free of cost or at a nominal charge for distribution to beneficiaries or for sale. Technical Guide recommends that NPOs should disclose market prices or estimated net realisable values of such items, lying at the year-end, in the notes to accounts, along with quantitative details.

AS 9, Revenue Recognition

AS 9 deals with the basis and conditions for recognition of revenue. It specifies the conditions for recognising the revenue from the sale of goods and rendering of services. The standard also specifies the basis for recognition of income arising on account of the use of the enterprise resources by others such as interest, royalty and dividends.

Applicability of AS 9 to NPOs

NPOs should follow the requirements of the Standard in their entirety for recognition of revenue arising from the sale of goods, rendering of services, and use by others of enterprise resources yielding interest, royalties and dividends.

Type of Revenue	Applicability of A S
Sale of non-mission related products for income generation	AS 9
Grants receivable from Government/ Foundations/ Donor Agencies on the basis of duly approved grant letters, specifying the timeframe/ guidelines for grant accrual	AS 12
Interest	AS 9
Royalties	AS 9
Dividend from Investments	AS 9
Donations	AS 12
Revenue from fundraising appeals, events, collections etc.	AS 9
Research & Development grants	AS 12

However, the principles of AS 9 would not be applicable for accounting of grants, donations and other subsidies received from the private donors and other donor agencies. For that, the principles enunciated in AS 12 would be applicable. Indeed, the AS 9 and AS 12 should be read together. ICAI has provided an illustrative guide on the application of AS 9 & AS 12 to NPOs :

AS 12, Accounting for Government Grants

As per AS 12, Government grants are "assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions". Government, for this purpose, includes government agencies and similar bodies whether local, national or international.

AS 12 specifies that government grants should not be recognised until there is reasonable assurance that:

(a) the grants will be received, and
(b) the enterprise will comply with the conditions attached to them.

One important aspect dealt in this Standard is the accounting of grant given for acquisition of the Fixed Asset. It recommends that a grant given for acquisition of a specific asset should be accounted for in either of the following ways:

(a) The grant should be shown in the Balance Sheet as a deduction from the gross value of the relevant fixed asset or:
(b) Alternatively, where the grant belongs to non-depreciable asset such as freehold land, it should be credited to capital reserve. However, if the grant relates to a depreciable asset, it

should be treated as deferred income, which should be recognised in the income and expenditure account by allocating it over the periods and in proportions in which depreciation on the asset concerned is charged.

It also recommends that where the Government grants are received in the form of non-monetary assets (such as fixed assets) given at concessional rate, it should be accounted for on the basis of acquisition cost. In case of non-monetary asset is given free of cost, it should be recorded at a nominal value.

Applicability of AS 12 to NPOs.

NPOs should follow the requirements of AS 12 in their entirety for accounting of government grants. However, while recording the grants, the two conditions specified above should be considered.

The Technical Guide clarifies that a mere promise from the government and other donor agencies as to the donation/grant does not provide reasonable assurance that the grant will be received and, therefore, does not require its recognition. In some cases, the reasonable assurance will be attained only when cash is received. In such a case, recognition of donation/grant on received basis does not mean that NPO has not followed accrual basis of accounting.

As per the requirement of AS 12, non-monetary grants, e.g., land, building or any other asset (whether fixed or current) received free of cost or at a concessional rate should be recognised at nominal value or actual cost to the NPO.

AS 10, Accounting for Fixed Assets

As the name suggests, this Standard lays down the principles for accounting of fixed assets. It recommends that the financial statements should disclose the gross value of the fixed assets that should be either its historical cost or a revalued amount.

Applicability of AS 10 to NPOs

AS 10, would be applicable to NPOs in entirety. The assets acquired through purchase should be recorded at the aggregate of the purchase price paid/payable and other incidental costs incurred for acquisition of the asset. The assets acquired free of cost should be accounted at a nominal value as per AS 12.

Technical Guide also addresses the problem that may arise at the time the NPOs would switch over to accrual basis of accounting. Such assets received by way of donations and endowments and not recorded in the books would be required to be identified and recorded appropriately.

AS 6 Depreciation Accounting

AS 6 applies in respect of the depreciation accounting. It requires that the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset. The depreciation method selected should be applied consistently from period to period.

Applicability of AS 6 to NPOs

The Technical Guide recognises depreciation as an important item of expense and hence, under-provision or over-provision of depreciation would vitiate the true and fair view presented by the financial statements. Therefore, it recommends that NPOs should provide depreciation in accordance with the requirements of AS 6.

However, in case of donated fixed assets, no depreciation is required to be provided since the assets are required to be recorded at nominal value (as per AS 12). The Technical Guide does not validate the argument that no depreciation need be provided in case of fixed assets which are purchased and are expected to be replaced by donors when the useful life of the assets is over. This is so because, in accounting, the purpose of charging depreciation is not to accumulate funds to replace a fixed asset; the purpose is to allocate the cost of the fixed asset over its useful life so that the periodic net result of operations of the enterprise reflects the use of the fixed asset.

OTHER FEATURES OF TECHNICAL GUIDE

- The Technical Guide also lays down the guidelines on the conduct of the audit of NPOs. The Institute has, from time to time, issued 'Auditing and Assurance Standards' (AASs) to prescribe audit principles and procedures. As per Technical Guide, the auditor of an NPO is required to be conversant with the requirements of all the AASs.

- The concern of small and medium sized NPOs, for whom adoption of Accounting Standards would be too cumbersome because of onerous requirements, has also been addressed in the Technical Guide. The Technical Guide informs that the Accounting Standard Board of the ICAI has undertaken the task of issuing a separate Accounting Standard for Small and Medium Sized Enterprises (SMEs). The said Accounting Standard would also lay down criteria for identifying SMEs. Once that Accounting Standard is issued, some of the Accounting Standards either may not apply to SMEs in their entirety or would apply with modifications suggested therein.

- The Technical Guide also provides illustrative formats of financial statements that includes general instructions and accounting principles, format for Balance Sheet and Income & Expenditure Account and instructions for preparing Income & Expenditure Account.

- It also provides an illustrative format of an Auditor's Report.

CONCLUSION

It is for the first time that ICAI has made some substantive efforts towards rationalising the auditing and accounting of the hitherto neglected NPO sector. However, it is felt that the Technical Guide is basically based on the Accounting Standards which were primarily issued for commercial, industrial or business concerns. Therefore, it seems that some of the issues needs further analysis and guidance from the ICAI to be applied by the NPOs such as:

- The Technical Guide strongly recommends the adoption of accrual basis of accounting by all the NPOs. Although it has been made clear in AS 12 that grants can be recorded on receipt basis if reasonable assurance is received after receipt of grant, however the organisation will face problems to recognise the grants as income received in advance for a period of time say 2 years, 3 years etc. Also, the organisations have to provide for prepaid and outstanding expenses.

  One more aspect of this issue is that under the Foreign Contribution (Regulations) Act, 1976, the organisations have to submit their returns on receipt basis. However, Technical Guide recommends to maintain the books of account on accrual basis.

- Also, it recommends to provide for depreciation even if the assets are expected to be replaced by the donors when the useful life of the asset is over.

- The Technical Guide does not recognise the concept of 'Own Means of Contribution'. As already stated in AS 2 (Valuation of Inventories), AS 12 (Revenue Recognition) and AS 10 (Accounting for Fixed Assets), the items and fixed assets received in kind or at concessional rates should be recorded at nominal value or at acquisition cost respectively. This would mean that such items cannot be recorded at their original cost

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ACCOUNTING STANDARDS FOR NGOs AND AS 1 (DISCLOSURE OF ACCOUNTING POLICIES)

The Institute of Chartered Accountants of India (ICAI) has recently brought out a Technical Guide on Accounting and Auditing in Not-for-Profit Organisations which 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 operating results of the activities in the financial statements. The Guide also discusses the salient feature and principal requirements of various Accounting Standards.

What are these Accounting Standards? Who formulates them and who is responsible to ensure the adherence to it? How it is applicable to NGOs? These are some of the questions that immediately comes to our mind.

Through a series of articles in this column, we aim at not only discussing and answering these questions, but also look into each of the Accounting Standards.

The dictionary meaning of "Standard" implies an object or quality or measure serving as a basis or example. It also implies a principle, which others conform or by which accuracy or quality of others is judged. Adhering or maintaining the required standards contributes to the credibility of the respective organisation.

In the context of development organisations, these standards relate not only to the quality of service delivered but also to the process of governing, accounting and also to the execution of programmes.

Here in this article, our focus is on the standards relating to accounting.

Over the years, the non-profit organisations in India have realised the importance and relevance of financial management to their programs and projects. Financial Management is one of the important tools in implementing plans and strategies towards realisation of vision, mission and objectives.

In India, accounting is guided by the Generally Accepted Accounting Principles called GAAP in short. GAAP is applicable for profit-oriented organisations as well as Not-for-profit organisations.

Although all accounting applications are based on the same set of fundamental principles, the significance of adapting them to specifications and particulars is very crucial for uniform interpretation and analysis of financial reports. This is very essential not only from the viewpoint of the stakeholders of an organisation but also for organisation itself.

It was for this purpose that the accounting standards were established. Accounting Standards are written policy documents, issued by expert accounting body or by Government or other regulatory body covering the aspects of recognition,measurement, treatment, presentation and disclosure of accounting transaction in the financial statement. In India, the Accounting Standards are issued by the Institute of Chartered Accountants of India.

The objective of Accounting Standards is to standardise the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and add to the reliability to the financial statements.

The Institute of Chartered Accountants of India, recognising the need to harmonise the diverse accounting policies and practices, constituted an Accounting Standard Board (ASB) on April 21, 1977.

So far 28 Accounting Standards have been issued by ICAI. However AS-8 on Research & Development is withdrawn consequent to issue of AS-26 on Intangible Assets.

Let us see how these accounting standards are formulated by ASB and the procedure adopted therein.

Procedure for issuing Accounting Standards by the Institute of Chartered Accountants of India

Broadly the following procedure is adopted for formulating the Accounting Standard:

i. Accounting Standard Board (ASB) shall determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

ii. In the preparation of Accounting Standards,ASB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, the members of the Institute and others will make provision for wide participation.

iii. ASB will also hold a dialogue with the representatives of the Government, Public Sector Undertakings, Industry and other organisations for ascertaining their views.

iv. On the basis of the work of the Study Groups and the dialogue with the organisations referred above, an exposure draft of the proposed standard will be prepared and issued for comments by members of the Institute and the public at large.

v. ASB finalised the draft of the proposed Standard, on the basis of comments so received and submits the same to the Council of the Institute.

vi. The Council considers the final draft of the proposed Standard, and if found necessary, modify the same in consultation with ASB.Thereafter, the Accounting Standard is issued under the authority of the Council.

Applicability of Accounting Standards to NPOs

Earlier, the ICAI has stated that in case of NPOs carrying on even a very small proportion of commercial, industrial or business activities, Accounting Standards issued by ICAI are *mandatory.*

But now, with the issuance of a Technical Guide on Accounting and Auditing in Not-for-Profit Organisations, ICAI has *recommended* that all NPOs, irrespective of the fact that no part of the activities is commercial, industrial or business in nature, should follow accounting standards issued by the Institute.

In respect of the *mandatory* Accounting Standards, while carrying out an audit of general purpose financial statements under any law, it is the duty of the members of the Institute to examine whether the Accounting Standards have been complied with in the presentation of financial statements covered by their audit. In the event of any deviation from a mandatory Accounting Standard, it is the duty of the members to make adequate disclosures in their audit reports so that the users of the financial statements may be aware of such deviations

In respect of *recommendatory* Accounting Standard, the duty of members of the Institute is to examine whether the recommendations made in the Standard have been followed in the presentation of financial statements covered by their audit. If the same have not been followed, members have to exercise their professional judgement to determine whether the departures from the recommendatory Accounting Standards are justified under the circumstances or not.

Another important point to be noted is that the Accounting Standards issued by the Institute of Chartered Accountants of India are based on the **fundamental accounting assumption of accrual**. Where the statute governing the enterprise requires the preparation and presentation of financial statement on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report.

On the other hand, where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than accrual the auditor should describe in his audit report, the basis of accounting followed, without making it a subject matter of a qualification. In such a case the auditor should examine whether those provisions of the accounting standards which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable disclosures/qualifications in his audit report accordingly.

With the above background, we will now discuss Accounting Standard 1-Disclosure of Accounting Policies and focus in detail its applicability to the development organisations.

Accounting Standard 1-Disclosure of Accounting Policies

The AS 1 defines accounting policies as the "specific accounting principles and the methods of applying those principles adopted by the organisation in the preparation and presentation of financial statements."

In practical situations, due to varying circumstances, different accounting policies may be adopted by different organisations.

What are the major areas in which this can takes place?

The major areas in which differing accounting policies are adopted include the methods of depreciation; amortisation; valuation of inventories; treatment of retirement benefits; foreign currency conversion etc.

Need for disclosure of Accounting Policies

The primary objective of this Standard is to enable the users of the financial statements to evaluate and understand correctly the financial position of an organisation.

To achieve this, the Standard requires the disclosure of the significant accounting policies adopted in the preparation and presentation of financial statements.

Salient Features and Principal Requirements

1. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed so as to promote a better understanding of the financial statements of an enterprise and facilitate a more meaningful comparison between financial statements of different organisations.

2. The disclosure of significant accounting policies should form part of the financial statements and all the significant accounting policies should normally be disclosed at one place.

3. There are three main fundamental accounting assumptions which underlie the preparation and presentation of financial statements.

They are **Going Concern, Consistency and Accrual.**

- **Going concern** assumption implies that the enterprise has neither the intention nor the necessity of closing down or curtailing materially the scale of its operation. Thus, an enterprise is assumed to continue its operation for the foreseeable future.

- **Consistency** assumption implies that accounting policies are consistent from one period to another.

- **Accrual** assumption signifies that revenues and costs are recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

4. If the fundamental accounting assumptions are followed in financial statements,specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be stated.

5. Selection of Accounting Policies:

The major considerations in selecting accounting policies are prudence, substance over form, and materiality.

Prudence refers to the accounting convention according to which profits are not anticipated but recognised only when realised. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light available information.

Substance over form implies that the accounting treatment and presentation of transactions should be governed by their substance and not merely by their legal form.

Materiality implies that financial statements should disclose all items, knowledge of which might influence the decisions of the users of the financial statements.

6. Changes in Accounting Policies :

A change in accounting policies should be made in the following conditions:

- Adoption of different accounting policies is required by statute or for compliance with an Accounting Standard.
- It is considered that change would result in more appropriate presentation of financial statement

If there is any change in accounting policies in preparation of financial statement from one period to subsequent period and such change affects the balance sheet and the income and expenditure of current period or of later period, then such change must by disclosed in financial statement. The amount, by which the financial statement is affected, should be disclosed to the extent ascertainable.

Applicability of AS 1 to NPOs

AS 1 principally requires the disclosure of significant accounting policies and specifies the manner of their disclosure. A clear statement of significant accounting policies followed in the preparation and presentation of financial statements is necessary irrespective of the type of organisation/entity presenting the financial statements. Accordingly, significant accounting policies should be disclosed at one place by NPOs.

Where an NPO has followed a basis of accounting other than accrual, a disclosure in this regard should be made.

The main aspect of this Standard is that it calls for only disclosure of accounting policies being adopted by the organisation.

Let us see the following example:

Organisation A has been following Cash basis of Accounting whereby income and expenditure are recognised only when it is received or paid.

The organisation earned bank interest of Rs.5,000 on 31st March but received it only on 5th April, in the next month.

The organisation has recognised the revenue in the month of April as it follows Cash Basis of Accounting.

If the organisation had been following accrual basis of accounting it would have recognised it as on 31st March itself as interest receivable.

In the above instance, the organisation will make a disclosure stating that it follows the Cash Basis of Accounting and all income and expenditure are recognised on the actual receipt and payment basis.

This amounts only to a disclosure and informs that user of the financial statement the accounting policy that is being followed by the organisation.

[In the next issue we will discuss on AS 2-Valuation of Inventories]

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SERVICE TAX FOR NON-PROFIT ORGANISATIONS

Services in today's spectrum of activities constitute an integral part. Today, Services cover a wide range of activities like management, banking, insurance, hospitality, administration, communication, entertainment, and various research and development activities. In today's developing world, service sector has become equally important along with the industry and other sectors of the economy. In Indian economy the share of the service sector in the GDP has risen at a very faster pace as compared to the industrial and the agricultural sector.

Services constitute a large portion of the consumption by the rich rather than the poor as the demand for services mainly depends on the income of the person.

Since services constitute a major part of the economy, the government therefore decided to tax these services due to socio economic compulsions on a selective based approach.

Service Tax was introduced on the basis of the recommendations made in early 1990's by the tax reform committee headed by Dr. Raja Chelliah. The committee had pointed out that the indirect taxes at the central level should be neutral in relation to the production and consumption of goods and should cover commodities and services.

The basic objective of introduction of Service Tax is to broaden the tax base, augmentation of revenue and larger participation of citizens in the economic development of the nation. To help in achieving this objective, Service Tax was introduced in India in 1994, Chapter V of the Finance Act, 1994 (32 of 1994) (Section 64 to 96). Certain services were listed in the Act to be covered under the purview of the Service Tax. The Act is applicable to the whole of India except the State of Jammu & Kashmir.

Service Tax is administered by the Central Excise Commisionerates working under the Central Board of Excise & Customs, Department of Revenue, Ministry of Finance, Government of India.

Taxable Services

Service Tax is levied on certain specified taxable services and the responsibility of payment of the tax is cast on the service provider. In total there are 50 services which have been covered under the purview of Service Tax. Moreover 7 new services w.e.f. 1st July'2003 have been brought under the Service Tax Act taking the total service under the Service Tax Act to 57. Also the applicability of 3 services has been extended.

Non-Profit Organisations utilise the services of certain service providers for the proper functioning of their organisation. For providing the services, the service provider raises invoices/bills in which the service provider charges the service tax. The service tax charged is on the gross value of the service provided. The service tax thus collected is deposited by the service provider with the Government. Therefore the onus to collect and deposit the service tax with the Government is on the service provider and not on those to whom the service has been rendered. For example, the organisation might be using the services of a Chartered Accountant for their Statutory Audit for which the Chartered Accountant raises professional bill comprising of audit fees and service tax @ 8% on audit fees. The organisation along with the audit fees also have to pay to the Chartered Accountant the service tax @ 8%. In turn the Chartered Accountant would deposit the service tax amount collected from the organisation with the Government.

Some of the services where the service provider may collect service tax from the non-profit organisation to whom they have rendered the service are:-

1. Advertising Agency's Services:
2. Air Travel Agents' Services.
3. Architect's Service.
4. Authorised Service Station's Service.
5. Cable Service.
6. Cargo Handling Services
7. Clearing & Forwarding Agent's Services
8. Chartered Accountant's Services.
9. Company Secretary's Services.
10. Consulting Engineer's Services.
11. Convention Services.
12. Cost and Work Accountant's Services.
13. Courier Services.
14. Custom House Agent's Services.
15. Dry Cleaning Service.
16. Event Management Service.
17. Facsimile Services.
18. General Insurance Services.
19. Life Insurance Business.
20. Management Consultant's Services.
21. Mandap Keeper Services.
22. Manpower Recruitment Agency's Services.
23. Photography Services.
24. Port Services.
25. Rail Travel Agent's Services.
26. Real Estate Agent's Services.
27. Rent-a-cab Scheme operator's Services.
28. Security Agency's Services.
29. Stock Broker's Services.
30. Storage & Warehousing Services.
31. Telegraph Services.
32. Telephone & Pager Services.
33. Telex Services.
34. Tour Operator's Services.

In case a non-profit organisation is providing services of the above nature, then they are also liable to collect tax from the persons to whom they are rendering the services and also deposit it with the Government.

However, any services provided by any person to the United Nations or any international organisation declared by the Central Government are exempt from the Service Tax applicability.

Some of the services where the non-profit organisations can be the service providers are:-

1. **Convention Services**: Any formal meeting or assembly which is not open to the general public and which does not include a meeting or assembly solely for amusement, entertainment or recreation are covered under this service. If any seminar is organized for Public Interest, then in that case, it would not be covered under the purview of the Service Tax Act. It is thus evident that if conventions are organized for Commercial purposes, then only such conventions fall under the category of taxable service.

2. **Event Management Services**: Event Management means any service provided in relation to planning, organizing or presentation of any arts, entertainment, business, sports or other event and includes any consultation provided in this regard.

3. **Management Consultant's Services**: Management consultant means any person who is engaged in providing any service in connection with the management of any organisation in any manner and includes any person who renders any advice, consultancy or technical assistance, relating to devising, development, modification, or upgradation of any working system of any organisation. Activities like policies regarding organisation structure and human resources, planning of capital structure and raising finance etc., are covered under Management Consultant's services.

4. W.e.f from July 1, 2003, seven new services have been included under the purview of Service Tax. One of the services for which a non-profit organisation can be liable to charge Service Tax is Services provided by **Commercial Training and Coaching Centre.** However vide Notification no: 9/2003-Service Tax dated 20th June 2003 vocational coaching and training services provided by typing and shorthand institutes, TV/vehicle repair training institutes, tailoring training institutes, foreign language institutes, computer training centers, hobby classes, institute teaching dancing, painting etc., would not be charged to service tax. It has also been clarified that service tax here is only on institutions and establishments.

However in case of an Advertising Agency's Services where a charitable organisation receives advertisement from various persons for publishing souvenir in the publication being brought out by the organisation, service tax liability will not be attracted if the institution has received advertisements directly without the intervention of any advertising agency since the purpose of such an organisation is charitable in nature and not commercial in nature. However if the organisation engages the services of an advertising agency for canvassing advertisements for publications in their souvenir, then the organisation becomes a client to the advertising agency and accordingly would be liable to pay service tax.

Rate of Tax

Every person providing taxable services mentioned under the Act to any other person shall pay the Service Tax at the rate of 5 % up to 13th May 2003 and 8%, w.e.f 14th May 2003, on the gross value of the taxable services provided.

Registration

- Every person responsible for collecting the Service Tax has to make an application to the concerned Superintendent of Central Excise in Form No. ST-1 for registration within 30 days from the date on which the Service Tax is levied under the Service Tax Act or within 30 days from the date of commencement of business (in case of new business).

- If a person responsible for collecting the service tax provides taxable services from more than one premise or offices but have a centralised billing system in respect of services rendered to its clients from such premises or offices, he may opt for registering only the premises or offices from where such centralised billing is done.

- However, if the person responsible for collecting the service tax does not have any centralised billing system, assessee shall have to make separate applications for registration in respect of each such premises or offices to the concerned Superintendent of Central Excise.

- Where the person is providing more than one taxable service, he may make a single application mentioning all the taxable services being provided.

- The registration certificate shall be granted by the Superintendent of Central Excise, after due verification, in Form No. ST-2 within 7 days from the date of receipt of application. If the registration certificate is not granted within the said period, then the registration applied for shall be deemed to have been granted automatically.

- In case of transfer of business by a registered assessee to another person, the transferee shall have to obtain a fresh Certificate of Registration.

- In case the assessee who ceases to provide the taxable services for which he is registered, then the assessee shall surrender the registration certificate immediately.

Payment of Service Tax

- The Service Tax which has been collected by Individuals and Firms, during any quarter, on any taxable service, has to be paid to the credit of Central Government by the 25th of the month immediately succeeding the said quarter in Form TR-6. (i.e. for quarters ending 30th June, 30th September, 31st December and 31st March, the tax should be deposited by 25th July, 25th October, 25th January and 25th April respectively).

- In case of any other assessee's other those mentioned above, the tax on the value of taxable services, received during any calendar month has to be paid in Form TR-6 to the credit of Central Government by the 25th of the immediately succeeding month.

Return of Tax

- Every assessee shall submit a half yearly return in Form ST-3, along with proof of deposit of tax, in triplicate for the months covered in the half yearly return. The returns should be submitted by the 25th of the succeeding half year. (i.e. for the half year ending 30th September and 31st March, the returns should be submitted by 25th October and 25th April respectively).

Rahul Khanna
Project Monitoring
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PERMANENT ACCOUNT NUMBER (PAN)

What is PAN?

Permanent Account Number (PAN) is a ten-digit alphanumeric number, issued in the form of a laminated card, by an Assessing Officer of the Income Tax Department. A typical PAN is AFRPP1595D.

WHY IS IT NECESSARY TO HAVE PAN?

It is mandatory to quote PAN on return of income, all correspondence with any income tax authority and challans for any payments due to Income Tax Department.It is also compulsory to quote PAN in all documents pertaining to economic or financial transactions notified from time-to-time by the Central Board of Direct Taxes. Some such transactions are sale and purchase of immovable property or motor vehicle or payments to hotels for bills or payments in cash in connections with travel to any foreign country of amounts exceeding Rs. 25,000/. It is also mandatory to mention PAN for obtaining a telephone or cellular telephone connection. Likewise, PAN has to be mentioned for making a time deposit exceeding Rs. 50,000/- with a Bank or Post Office or depositing cash of Rs. 50,000/- in a Bank.

At the same time it is also the statutory responsibility of a person receiving document relating to economic or financial transactions notified by the CBDT to ensure that PAN has been duly quoted in the document.

All existing assessee or taxpayers or persons who are required to furnish a return of income, even on behalf of others, must obtain PAN. Some such persons are Individuals, Companies, Partnership Firms, HUFs, Trusts or Representative assesses. Further, persons who intending to enter into economic or financial transactions where quoting PAN is mandatory must also obtain PAN.

In addition, the Assessing Officer may allot PAN to any person either suo moto or on a specific request from any person.

HOW TO OBTAIN PAN?

Earlier the Income Tax Department was issuing PAN free of cost. From July 1,2003 people applying for a PAN card would have to pay Rs.65 each (Rs.60/- as processing fee+Rs.5 as Form charges). Income Tax Department has signed a contract with UTI Investor Services Limited(UISL) to assist it in issuance of PAN Cards. As per the contract the PAN applications received after the above date will be forwarded to UISL and the entire process of collecting the application, to preparing PAN card and dispatching it will be undertaken by UISL. However PAN number will be ultimately allotted by IT department within 10 days of receiving the application.

In order to check for more details and for the link to downloading the PAN Form 49A please log on to our website www.fmsfindia.org