ACCOUNTING OF NPOS
Quantitative Aspect of Accounting System

- Identifying the Economic Event
  - Measuring
  - Supporting
  - Recording
    - Primary Books (Cash Book, Bank Book, Journal)
  - Summarizing
    - Ledger
- Communicating the required information
  - Financial Report
Qualitative Aspect of Accounting System

Understandability

Usefulness in Decision Making

Relevance

Reliability

Comparability

Timely

Stakeholder requirement

Internal Control

Verifiability

Certification

Accounting Standard
KEY ISSUES
Key Issues

(A) MULTIPLICITY

- Books
- Project
- Donors
- Locations
- Requirement
- Accounting
- Board
- Beneficiaries
- Legal (FC)
- Functional
- Natural
- Donor
Key Issues

(B) Accounting framework in terms of the requirement of various stakeholders

1) Maintenance of books of account:

Books of Accounts

- FC Grant (FCRA)
- Non-FC Grant
- Income Generation Program (I. Tax)
- Unrestricted/Designated (Management)
Key Issues

(C) BANK ACCOUNT

FC Designated Bank A/c

Non-FC Grant (Mother A/c)

IGP

Unrestricted Fund

F I

F II

F III

F I

F II
**Key Issues**

(D) **No Common Indicator for Measurement of Performance**

1) Profit/loss widely accepted performance indicator for profit sector.

2) No such universally accepted indicator for NGO sector.

3) Various stakeholders have therefore adopted different tools to measure the performance.

(E) **Accounting Software**

1) No accounting software specific for NGO sector

2) Present software not able to generate Special Purpose Report or General Purpose Report.
Key Issues

(F) Cash basis vs. Accrual basis

1) Reports

General Purpose

Special Purpose

2) Use of accrual basis of accounting is widely advocated for general purpose report.

3) However, in an NGO more focus is on specific purpose report and the requirement can be met by following cash basis of accounting.

4) Most of the transactions are non-exchange transactions.

5) Hence the relevance of accrual basis of accounting should be studied in terms of requirement of:
   a) Specific Purpose Report; and
   b) Non-Exchange Transactions

6) Suggested Option: Cash basis during the year & then adjust to accrual system at the end of the accounting period.
### Key Issues

**Financial Reports**

1. Reports are vehicles for communication.

2. Essential conditions.
   - **Reports should convey the same meaning to the Reader.**
   - **Should contain the information which is required by the reader.**

3. There are three types of reports:

<table>
<thead>
<tr>
<th>TYPES OF REPORT</th>
<th>USER</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) INTERNAL REPORT</td>
<td>MANAGEMENT</td>
</tr>
<tr>
<td>2) SPECIFIC PURPOSE REPORT</td>
<td>DONORS, FCRA, Income Tax</td>
</tr>
<tr>
<td>3) GENERAL PURPOSE REPORT</td>
<td>GENERAL BODY, EXISTING DONORS, PROSPECTIVE DONORS</td>
</tr>
</tbody>
</table>

(G) **Financial Reports**

1. General purpose Report is the consolidated financial report.

2. Consist of:
   - Receipts & Payments A/c
   - Income & Expenditure A/c
   - Balance Sheet
   - Cash Flow
   - Surplus/Deficit for the period
   - Financial position as on date

Key Issues

(G) **Financial Reports**

1. Receipt & Payment A/c should disclose the total receipts/payments on each thematic area on which the organisation is working.

   However, the present practice is:
   Receipt & Payment A/c disclose the details of receipts & payments from various funding sources instead of on various thematic areas.

2. Income & Expenditure A/c should correctly reflect the surplus & deficit for the period.

   However, the present practice is:
   Income & Expenditure A/c disclose surplus & deficit which are not correct surplus & deficit for the period.
3. The Balance Sheet should disclose the financial position, meaning thereby it should disclose separately –

(a) Restricted Fund  
(b) Unrestricted Fund  
(c) Designated Fund  
(d) Capital Asset Fund, etc.

However, the present practice is:

Balance Sheet in most of the cases does not disclose the position of various funds and all the funds are found to be mixed as a Capital Fund or General Fund.
### Key Issues

#### (G) Financial Reports

**Balance Sheet:**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>100.00</td>
<td>Fixed Assets</td>
<td>40.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cash &amp; Bank Balance</td>
<td>60.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>50.00</td>
<td>Fixed Assets</td>
<td>40.00</td>
</tr>
<tr>
<td>Restricted Fund</td>
<td>50.00</td>
<td>Cash &amp; Bank Balance</td>
<td>60.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>10.00</td>
<td>Fixed Assets</td>
<td>40.00</td>
</tr>
<tr>
<td>Fixed Assets Fund.</td>
<td>40.00</td>
<td>Cash &amp; Bank Balance</td>
<td>60.00</td>
</tr>
<tr>
<td>Restricted Fund</td>
<td>50.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>
Key Issues

(H) **Accounting & disclosure of Project Specific Grant**

1) Generally Project Specific Grants are considered as income both in accounts and also while computing Total Income.

2) As a result Income & Expenditure A/c shows the surplus or deficit which is not real & at the same time NGO has to exercise option under Income Tax Act to meet the deficit of application of income to the extent of 85%.
## Key Issues

(H) **Accounting & disclosure of Project Specific Grant**

### RECEIPT & PAYMENT ACCOUNT

<table>
<thead>
<tr>
<th>RECEIPTS</th>
<th>PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Grant Received</td>
<td>By Revenue Expenses 7.00</td>
</tr>
<tr>
<td></td>
<td>By Capital Expenses 2.00</td>
</tr>
<tr>
<td></td>
<td>By Cash &amp; Bank Bal. 1.00</td>
</tr>
<tr>
<td><strong>TOTAL :</strong> 10.00</td>
<td><strong>TOTAL</strong> 10.00</td>
</tr>
</tbody>
</table>

Rs. in Lacs
### Key Issues
(H) Accounting & disclosure of Project Specific Grant

#### INCOME & EXPENDITURE ACCOUNT

<table>
<thead>
<tr>
<th>EXPENDITURES</th>
<th>INCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Revenue Expenditure</td>
<td>7.00</td>
</tr>
<tr>
<td>By Grant Received</td>
<td>10.00</td>
</tr>
<tr>
<td>To Surplus transferred to G. fund</td>
<td>3.00</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>10.00</strong></td>
</tr>
</tbody>
</table>

#### BALANCE SHEET

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>General fund</td>
<td>3.00</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>2.00</td>
</tr>
<tr>
<td>Cash &amp; Bank Balance</td>
<td>1.00</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>3.00</strong></td>
</tr>
</tbody>
</table>
**Key Issues**

**H) Accounting & disclosure of Project Specific Grant**

Suggested Options are –

a) Project Specific grants are bound by contractual obligations & therefore should not be treated as voluntary contribution.

b) Restricted grant comes with an equal liability & therefore, it may not be correct to treat it as income.

c) All restricted grants should be shown on the liability side of the Balance Sheet

d) Amount spent out of restricted grant may either be:

   i) reflected as a schedule to the Balance Sheet or

   ii) can be a part of Income & Expenditure A/c by recognising income to the extent of amount utilized so that there is no surplus or deficit on this account.
### Key Issues

H) Accounting & disclosure of Project Specific Grant

**Suggested Options:**

**INCOME & EXPENDITURE ACCOUNT** [Recommended]

<table>
<thead>
<tr>
<th>EXPENDITURES</th>
<th>INCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Revenue Expenditure</td>
<td>7.00</td>
</tr>
<tr>
<td>By Income from Grant</td>
<td>9.00</td>
</tr>
<tr>
<td>To Surplus</td>
<td>0.00</td>
</tr>
<tr>
<td>Less : Transfer to Capital Asset Fund</td>
<td>2.00</td>
</tr>
<tr>
<td>TOTAL :</td>
<td>7.00</td>
</tr>
</tbody>
</table>

**BALANCE SHEET** [Recommended]

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unspent balance (restricted fund)</td>
<td>1.00 Fixed Assets</td>
</tr>
<tr>
<td>Capital Asset Fund</td>
<td>2.00 Cash &amp; Bank Balance</td>
</tr>
<tr>
<td>TOTAL :</td>
<td>3.00 TOTAL</td>
</tr>
</tbody>
</table>
Key Issues

1) **Accounting Standards**

1. India set up an Accounting Standard Board in 1977.

2. At that time the organized NPOs were limited in number and there was also a very little public discussion.

3. As a result the ASB did not include charitable organizations in its mandate, which was drafted in 1979.

4. By 1994 ASB has issued 15 standards designed basically for profit oriented sector.

5. In 1994 the ICAI announced that these standards would also apply to charitable organizations.

6. However, after understanding the technical Flaw that Preface to Statement of AS did not cover the NPO sector, ICAI settled down to restrict the applicability of these standards to organizations with some profit making activities.

7. Technical guide issued by the Institute examines the feasibility of the applicability of the existing Accounting Standards to this sector.
Way Forward

Hence it is suggested that the Institute should come out with separate Accounting Guideline including the following key areas:

1) Accounting & disclosure of Project Specific Grant
2) Basis of Accounting: whether cash or accrual
3) Valuation & accounting for contribution received in kind
4) Issue of joint costs and its allocation.
5) Accounting for Revolving Fund
6) Accounting & disclosure for assets acquired out of grant.
7) Presentation of financial statements disclosing the position of various funds.
8) Documentation of field level expenses.
9) Expenses/incomes through internal billings.
TIME FOR DISCUSSION
AUDITING OF NPOS
Audit is:

SYSTEMATIC

INDEPENDENT

EXAMINATION OF FINANCIAL RECORDS

TO EXPRESS AN OPINION

FOR A STATED PURPOSE
Requirement of Audit

AUDIT

STATUTORY

Income Tax

FCRA

Societies/Co. Act

DONOR

Separate Report from the same Auditors

INTERNAL

Separate Report from separate Auditors
Requirement Of Audit Under FCRA, 2010

A) CERTIFICATION AT THE TIME OF FILING RETURN

a) Certificate with Form FC 6 / FC-7 / FC 8

b) The opening balance, amount of foreign contribution received & the balance of un-utilised foreign contribution at the end of the year.

c) That the books of accounts & other records are maintained in terms of Section 19 of FCRA read with Rule 16 of Foreign Contribution (Regulations) Rules, 2011

B) CERTIFICATION AT THE TIME OF MAKING APPLICATION

a) Last three years Statement of Income & Expenditure A/c to be certified by a Chartered Accountant in the case of new application for registration.

a) Main requirement is to certify Form 10B

b) The certification includes:

i) amount of INCOME of the previous year applied to charitable/religious purpose in India during the year.

ii) Application or use of income or property for the benefit of person referred to under Section 13(3).

iii) The option to spend in subsequent year and the accumulation for five year.
Key Challenge Areas

a) To understand the meaning of income for the purpose of Section 11:

i) As per Section 11 income should be computed in commercial sense & not as per the provision of Income Tax Act, 1961.

ii) The concept of income is important because an NGO has to utilise 85% of the income during the year.
**Key Challenge Areas**

Take an example:

- Donation Received: 100.00
- Fund raising Expense: 20.00
- Program Expense: 65.00

**PRESENT PRACTICE:**

<table>
<thead>
<tr>
<th></th>
<th>Option-I</th>
<th>Option-II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donation Received</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Less: Fund raising exp.</td>
<td>0.00</td>
<td>20.00</td>
</tr>
<tr>
<td>Income</td>
<td>100.00</td>
<td>80.00</td>
</tr>
<tr>
<td>Less: Fund raising exp.</td>
<td>20.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Less: Program exp.</td>
<td>65.00</td>
<td>65.00</td>
</tr>
<tr>
<td>Surplus</td>
<td>15.00</td>
<td>15.00</td>
</tr>
<tr>
<td>Less: Statutory acc.</td>
<td>15.00</td>
<td>12.00</td>
</tr>
<tr>
<td>Surplus (subject to tax)</td>
<td>NIL</td>
<td>3.00</td>
</tr>
</tbody>
</table>
Key Challenge Areas

iii) Treatment of exempt income U/S. 10 for the purpose of Section 11.

iv) Treatment of Restricted Grant for the purpose of Section 11.

b) Requirement of Tax Audit : Business Income

i) Section 11(4)

ii) Section 11(4A)

iii) Section 2(15) where charitable activities itself, is like a business activity and that too for the last limb
Status of Audit

Independence of auditors is more relevant and necessary for NGO because:

1. it deals with the public funds
2. the fund enjoys tax exemption
3. the fund is received for the purpose of beneficiaries which have no direct control over the governance of NGO.

However we find:

1) Voluntarism is the guiding factor & therefore process of audit lacks professionalism
2) Lack of knowledge about the applicable statutory regulations.
Status of Audit

3) Human resource conducting the audit mainly comprises of articled clerks & the limited availability of self time of the chartered accountants.

4) More Focus on Transaction Audit

5) Professional fees in certain cases are low which does not justify the cost involved.

6) Additional role like preparation of Balance Sheet, etc.
Way Forward

Hence it is suggested –

1) As an auditor we should give due attention while undertaking Audit.

2) To have specific knowledge of programme & the laws applicable to the NGO and to be more specific of Income Tax Act & FCRA.

3) Review the Financial Management System as a whole before designing the audit programme & should not focus only on the transaction audit.

4) Transaction audit should not focus only on payment but also on utilisation & the expenses should be linked with its utilisation.

5) Use & adherence with the Auditing Standards.

6) Institute should issue a separate guidance note for audit of NGOs/NPOs.
THANK YOU
TIME FOR DISCUSSION