

# Diploma in Financial Management & Accountability

*- a joint initiative of TISS & FMSF*

## Course Material



Project Fund Accounting  
Paper - V

Module - III  
Faculty - Sanjay Patra

## **UNIT- 4 . NGO INHERENT CHARACTERISTICS NECESSITATING FUND ACCOUNTING**

### **Learner's objectives:**

- To understand the characteristics typical of an NPO which necessitate Fund Accounting.
- To understand each characteristic and its significance.

### **4.1 FUNCTIONAL ASPECTS**

A significant advantage of fund accounting is that an organization can devise the accounting system according to the functions or activities of the organization. As discussed in earlier chapters, NGO work in various capacities simultaneously as they work on behalf of various donors. As a result, the functional responsibilities undertaken for each fund becomes more important for which independent analysis of each fund/project is necessary. Further, it is not necessarily a donor driven system. An organization may use fund accounting for identifying and tracking its own functional activities. For instance, an organization can prepare a separate income and expenditure account only for, say, the overall administrative expenses of the NGO and analyse the appropriation of such expenditure into various restricted and unrestricted projects.

Fund accounting could be applied for a particular activity whether funded from internal or external sources. Fund accounting can be applied at various levels. For instance, within a large fund or a project there may be sub-projects which can be segregated on the basis of the functional differences. Fund accounting can be wholistically applied over the entire project by consolidating the statements of all the sub-projects.

Therefore, it can be seen that fund accounting need not necessarily arise on the basis of a particular source of fund. It may be applied on the basis of activities or functions. An NGO instead of maintaining fund accounts for particular donor may maintain separate account for a particular activity. For example, fund accounts may be maintained for “*Tsunami Relief*”, in such a case fund accounting will be done for all the expenditures made for a particular cause rather than for all the funds received from a particular donor. In such fund account, grant received from all the donors for “*Tsunami Relief*” shall be accounted.

To sum up, fund accounting is not an accounting system influenced by donor or anybody else. It is an unconditioned tool available, which the NGOs can use. It may be for preparing individual donor-wise statements. It may also be used for preparing individual activity-wise or function-wise financial records and statements.

#### **4.2 FISCAL ASPECT**

Each project and each fund is treated as a fiscally independent body where the budgets and legal obligations can be separately and independently assessed. A fund or a project is treated as a legally separate body where all the financial and legal computation and assessment for that particular fund or project are made independently and separately. For instance, under section 35AC of the Income Tax Act of India, a project can separately avail exemption for Income Tax purposes. In other words, the organization may not enjoy certain privileges, which are available to one of its project. There are many NGOs in India one of whose project has 35AC exemption. In such a case if donations are made to that particular project then the donor will get 100% exemption. But if the donor makes a voluntary contribution to the same NGO then it may not get any tax exemption. Therefore, fund accounting becomes important in order to maintain the fiscal independence of various funds and projects. The NGOs in order to comply with the legal requirements may have to show a project as an independent fiscal entity. Otherwise also, an organisation should be in a

position to retain and reflect fiscal independence of all of its projects and funds.

The fiscal independence and identity of funds and projects is analogous to the concept of “*cost centre*” and “*profit centre*” normally used in commercial accounting. In a commercial organisation, a company might be doing profit but whether each and every division of its activities is performing equally well is also judged. Therefore, the profit and losses of each division is computed separately and if there are any loss making divisions then remedial measures are taken. A company will not be in a position to identify its loss making divisions if it is not able to compute the division-wise profits and losses. In such a process, each division is treated as a fiscal entity. It may not have any legal or statutory identity but for the sake of financial analysis it is treated as a separate entity.

Similarly, NGOs need to identify various fiscal entities within the sphere of its activities and resources, which can be treated distinctly through application of fund accounting.

Fiscal independence in other words means that a particular fund is independent in terms of its sources as well as expenditures.

#### **4.3 ENTITY ASPECTS**

In order to maintain the fiscal and legal independence of the project it is necessary to treat them as separate entities, at least, for procedural purposes. Each fund or a project is treated as an independent entity. Therefore, all those financial statements, which are prepared for an organization are also prepared for the specific fund/project. It is more like the holding company and subsidiary company concepts of accounting. A project or a fund is like a wholly owned subsidiary of the NGO. It is 100% owned by the NGO, but at the same time it is a separate entity.

#### **4.4 STEWARDSHIP / TRUSTEESHIP ASPECT**

An NGO is a trustee on behalf of the donor for the beneficiary. Therefore, simultaneously an NGO may have a large number of donors and numerous categories of beneficiaries. The stewardship/trusteeship function of NGOs requires specific duties to be performed for specific donors as well as beneficiaries. NGOs have to cater to a multiple and heterogenous group of donors and beneficiaries and each having its specific requirement. Therefore, a single set of consolidated statements cannot do justice to its stewardship/trusteeship function. The NGO has to satisfy its donors as well as each class of beneficiaries individually. A consolidated income and expenditure account makes very little sense to a donor who cannot find the break-up of the funds provided by it or the beneficiary who cannot link the activities with the expenditures on the project of his area. Therefore, an NGO being a trustee as a legal entity also as project holder for various donors/stakeholders has a multi-dimensional responsibility which requires individual and specialized financial systems and records.

##### **Self- Assessment Exercise**

1. Fund accounting can be applied at various levels. How?
2. How do the functional aspects related to an NGO necessitate the application of fund accounting?
3. What is the exemption provided by section 35AC of the Income Tax Act, 1961?
4. Explain the stewardship aspect with reference to NGOs?