MODULE-2

CPA Services

CERTIFICATE COURSE IN FINANCIAL MANAGEMENT & ACCOUNTABILITY

BOOK KEEPING, ACCOUNTING & REPORTING

CONTENTS

CHAPTER 1

Introduction to Book Keeping & Accounting

1.1 Introduction

Accounting & book-keeping are necessary in order to record & manage financial transactions. It also helps an NPO to ascertain the financial position for a particular date as well as in the long run. Invariably most of the organisations follow double entry system of accounting. Under this system all transactions have two aspects. For example, if an NPO receives cash donation, not only our Cash Account would be increased (debited) to the extent of donation received but we should also give due credit to the Donation Account (credited). To understand the basic concepts of accounting let us take an illustration and make certain accounting entries and prepare statements out of it.

Illustration

We will take the help of a fictitious character name Nimhas, a social activist. Nimhas receives ₹50,000/- to conduct an Aids Awareness Campaign in the slums of New Delhi. He spent ₹30,000/- on preparing awareness Brochure & Banner, ₹10,000/- for a Projector, ₹5,000/- on travelling. Now in this illustration one may not feel like maintaining books of accounts as there are only two or three transactions which can be accounted for, on the finger tips.

1.2 Mutually Balancing Accounts

The problem now with Nimhas is that his Funding Partner is asking for the financial statements and the books of accounts. In the name of accounts he only had the following statement, let us try and help him out.

(i)	Grant Received	-	₹50,000/-
(ii)	Brochure	-	₹30,000/-
(iii)	Projector	-	₹10,000/-
(iv)	Travelling	-	₹5,000/-
(v)	Cash balance in hand	-	₹5,000/-

His statement contains all the facts but it does not distinguish between receipts and payments or debit and credit in accounting language, we should rewrite the aforesaid facts in the following pattern. At first he received ₹50,000/- in cash therefore we should open a Cash Account and increase its Debit Balance by ₹50,000/-. But since in Double Entry book keeping every transaction has a dual aspect, therefore here also there should be a credit entry. We have to create a Grant Account and give due credit for the grant received.

Now we have two accounts:
Cash Account Debit Balance ₹50,000/- Grant Account Credit Balance ₹50,000/-

Nimhas has further purchased Brochure & Banner worth ₹30,000/-, Projector worth ₹10,000/- and spent ₹5,000/- on travelling. We have to create three new Accounts,
i) Brochure & Banner Account
ii) Projector Account and
iii) Travelling Account

Now we have to increase the debit balance of all these three accounts by their respective sum and decrease the debit balance of cash account, as the money has already been spent. So now we have five accounts:

Particulars	Debit (₹)	Credit (₹)
Grant Received		50,000.00
Brochure	30,000.00	
Projector	10,000.00	
Travelling	5,000.00	
Cash balance in hand	5,000.00	
Total	50,000.00	50,000.00

Nimhas has to convert the balances so prepared by him in Double Entry format into individual accounts and derive the balances. To the surprise of Nimhas the accounts prepared under Double Entry System were showing balances similar to the one he had prepared with his common sense but he liked the systematic and organised presentation. From this statement he was told to prepare individual accounts, which in fact he should have prepared prior to the preparation of this statement. These five balances are converted into individual ledger accounts as shown below. These are the basic accounting heads and all the expenses incurred in each of the head will be reflected in these accounts throughout the year. Since, once the volume of transaction increases things will not remain as simple as they seem to be, one has to carefully record each and every transaction in its respective account.

Grant Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Balance c/d	50,000.00		By Cash A/c	50,000.00
		50,000.00			50,000.00

Cash Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Grant Account	50,000.00		By Brochure & Banner A/c	30,000.00
				By Projector A/c	10,000.00
				By Travelling A/c	5,000.00
				By Balance c/d	5,000.00
		50,000.00			50,000.00

Projector Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Balance c/d	50,000.00		By Cash A/c	50,000.00
		50,000.00			50,000.00

Travelling Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Cash A/c	5,000.00		By Balance c/d	5,000.00
		5,000.00			5,000.00

Brochure & Banner Account

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Cash A/c	30,000.00		By Balance c/d	30,000.00
		30,000.00			30,000.00

If you notice the balances of the five accounts as are deduced, they are exactly similar to the balances of the statement prepared by Nimhas without having any accounting knowledge, which means that ultimately nothing new resulted inspite of creating so many formats. We have only presented the informations in a systematic and organised manner so that we can prepare various statements out of it and also do not have to rely on our memory when the number of accounts become very large. We should understand that in our instant illustration we have only taken five entries just to become familiar with the basic concepts of Double Entry book keeping. Therefore we may feel that without keeping accounts also things can be managed. But in our routine life we are subjected to thousands of transactions in a particular year and unless we record them properly we cannot prepare any meaningful analysis or statement whenever we need. These five mutually balancing accounts are known as Ledger Accounts in the accounting language.

1.3 Journal Entries

Now coming back to our illustration, we have all the Debit and Credit balances available in our books of accounts. But in our haste to write the books of accounts we have ignored a basic step of accountancy, i.e. passing the requisite entries for the accounts so created. Because the accounts which we have prepared are ledger accounts reflecting the position of a particular account over a period of time, but whenever a transaction is made an entry is recorded giving the details of that transaction. This entry is known as "Journal Entry". This is the mother entry from where other accounts are prepared. In our instant illustration just for the sake of understanding we prepared the ledger account before passing the journal entries. Journal Entries help us in knowing the nature and the type of the transaction. For example though we know that the grant of `50,000/- has been received but we do not know from whom we have received, the purpose for which it is received. Journal is the gateway to all these information. Therefore at the end of each transaction, Nimhas should pass the following Journal Entries It is important for all the beginners to pass Journal Entries for each and every transaction but in the long run usually Journal Entries are passed for certain specialised accounting transactions such as book adjustments, non- cash transactions, prepaid expenses. Once a person develops fundamental concepts in accountancy, he can directly post the entries into the ledger accounts without passing journal entries at each and every stage.

Journal Entries

Date	Particulars	Ledger Folio No.	Debit (₹)	Credit (₹)
	Cash A/c Dr.		50,000.00	
	To Grant Account			50,000.00
	(Being ₹50,000/- received from xxx for Aids)			
	Brochure & Banner A/c Dr.		30,000.00	
	To Cash Account			30,000.00
	(Being Brochures printed and Banners prepared)			
	LCD Projector A/c Dr.		10,000.00	
	To Cash Account			10,000.00
	(Being an LCD Projector of xx make purchased)			
	Travelling A/c Dr.		5,000.00	
	To Cash Account			5,000.00
	(Being ₹5,000/- incurred on travelling various slums and project sites)			

Back to square one "Trial balance"

Now we see Nimhas has already made Journal entries and also prepared the respective accounts. If we prepare the summary of the Ledger Account closing balances it will be as under :

passed for certain specialised accounting transactions such as book adjustments, non- cash transactions, prepaid expenses. Once a person develops fundamental concepts in accountancy, he can directly post the entries into the ledger accounts without passing journal entries at each and every stage.

Summary of the Ledger Account Balances

Particulars	Debit (₹)	Credit (₹)
Grant Acc.		50,000.00
LCD Projector Acc.	10,000.00	
Brochure & Banner Acc.	30,000.00	
Travelling Acc.	5,000.00	
Cash Acc.	5,000.00	
Total	50,000.00	50,000.00

This summary of ledger account balances so prepared is called "Trial Balance" in accounting language. Surprisingly again this statement is exactly similar with the statement Nimhas had prepared before he had any accounting knowledge under xxxx. The message is loud and clear accountancy does not create anything new, it only systematises the financial facts of an organisation in coherence over a period of time.

1.4 Year End Bucket Accounts

At the completion of each day just as a Librarian puts back the books to their respective racks, at the end of each year, an Accountant also transfers most of the accounts to few large bucket accounts in order to close the books. The accounts which find no buckets go to the Balance Sheet. Out of the ledger balances shown in the Summary Statement Nimhas realises that only two balances have some practical relevance as far as he is concerned. They are cash balance ₹5,000/- and the LCD Projector balance ₹10,000-, because these two are still in his possession, rest all other accounts are mere entries.

Nimhas is confused, he has four different debit balances totally different from each other. The Brochure & Banner Account which shows a debit balance of ₹30,000/- is just a reminder of an expense paid earlier and therefore sooner or later Nimhas has to create a Bucket i.e. an Expenditure Account where he can transfer this account and all other expenses, as in reality they do not exist. Nimhas has to make similar treatment to the Travelling Account, but the LCD Projector was also an expenditure from Nimhas's point of view, but it still exists and will last for years together. Therefore, it would not be wise on the part of Nimhas to treat this LCD Projector Account as an expenditure. Since ₹5,000/- cash balance is still lying in his pocket, he can continue the Cash Account. Similarly Grant Account has to be transferred to some other bucket i.e. Income Account. Now after transferring Brochure & Banner Account & Travelling Account to Expenditure Account and Grant Account to Income Account, Nimhas realises that there are only two accounts which are not transferred. They are Cash Account and LCD Projector Account and therefore they are the final balances and will form a part of the assets side of Nimhas's Balance Sheet at the end of these adjustments. And surprisingly the resulting credit balance of the Income and Expenditure Account is equal to the assets side of the Balance Sheet. For the time being we should understand the Balance Sheet as a statement which is prepared at the end of a particular period and it comprises those accounts which could not be thrown into any bucket and have Closing Balances, in other words Balance Sheet is a revised statement made out of a Trial Balance after closing all the account balances whose utility is completed during that particular period. We used only **"two buckets"** (i) Income bucket (ii) Expenditure bucket and as the name suggests in one we put all the incomes and in the other we put all the expenditures. The combination of these two buckets results in one of the most important Financial Statement i.e. Income and Expenditure Account.

1.5 The Ultimate Statements

Even now the problems of Nimhas are far from over because he is not very sure about the procedure of preparing the following statements which are required.

i) Receipt and Payment Account.

ii) Income and Expenditure Account.

iii) Balance Sheet

These three statements can be easily compiled if Nimhas uses a little bit of common sense. To prepare a Receipt and Payment Account he has to prepare an analysis of whatever he has received and paid during the period of the transaction i.e. it is just an abstract of the Cash Account. To prepare an Income and Expenditure Account he has to write down the incomes and the expenditures made during the period of transactions. And finally whatever closing balances which remain with him will result in the Balance Sheet. Now let us divide this Trial Balance into these three statements :

RECEIPT & PAYMENT ACCOUNT

Date	Receipts	Amount (₹)	Date	Payments	Amount (₹)
	To Opening Cash Balance	Nil		By Brochure & Banner A/c.	30,000.00
	To Grant Account	50,000.00		By LCD Projector A/c.	10,000.00
				By Travelling A/c.	5,000.00
				By Closing Cash Balance	5,000.00
		50,000.00			50,000.00

INCOME & EXPENDITURE ACCOUNT

Date	Receipts	Amount (₹)	Date	Payments	Amount (₹)
	To Brochure & Banner	30,000.00		By Grant Account	50,000.00
	To Travelling	5,000.00			
	To Surplus (Excess of Income over Expenditure)	15,000.00			
		50,000.00			50,000.00

BALANCE SHEET

Liabilities	Amount	Assets	Amount
General Fund :		Fixed Assets :	
Opening Balance	Nil	LCD Projector	10,000.00
Add : Excess of income		Current Assets :	
over expenditures	15,000.00	Cash Balance	5,000.00
	15,000.00		15,000.00

CHAPTER 2 Books of Account

2.1 Introduction

Establishing the Book-keeping system is a serious matter, it requires a lot of thought and expertise to determine the system depending upon the type of the organisation, the volume and nature of its transactions. One has to carefully select the books and sub-books after analysing the following :

- Quantum and frequency of various transactions
- Number of bank accounts in operation
- Foreign Contribution receipts
- The number of Funding Partners and their reporting expectation
- Prevailing legal statutes
- Level of Internal Control measures required
- Level of Centralisation/ Decentralisation in operation etc.

We can broadly divide the books of accounts into 3 categories :

i) Primary Books of Accounts.

ii) Final Books of Accounts.

iii) Subsidiary registers

Each of these books of account are discussed briefly in the following paras. The flowchart prepared later in this chapter may also be referred for an overall understanding.

2.2 Primary Books of Accounts

i) Cash Book: Cash Book is the most basic book of account. Normally it records all transactions involving cash & bank receipts & payments. The most commonly followed cash book is the one

The most commonly followed cash book is the one which has a bank column to record the bank transactions. Though, an NPO may or may not record its bank transactions through a cash book.

ii) Petty Cash Book : Petty cash book as the name suggests is just a downward extension of the main cash book. An NPO may be subjected to lots of small transactions such as conveyance, postage, refreshment etc. everyday. Recording such small transactions in the main cash book sometimes makes it untidy and needlessly elaborate. Therefore, a petty cash book is maintained to record small transactions and consolidated amounts from the petty cash book are recorded in the final cash book periodically.

iii) Journal: Journal is the book where those entries are recorded which do not find a place in the cash book. Though, in strict accounting sense journal entries should be passed even for cash transactions, but for the sake of convenience cash & bank transactions are recorded directly into the cash book. The journal still remains one of the most important book of account because all non cash transactions have to be routed to the General Ledger through journal only. The journal book is normally used for the following types of entries:

- ✔ Opening Entries Closing Entries
- ✔ Rectification/Correction Entries Transfer Entries
- ✔ Adjustment Entries Non-cash Contributions
- ✔ Debit Notes received from funding agencies Exchange Rate Adjustments
- ✔ Accrued/pre-paid Expenses; and Transactions of a Special Nature.

iv) General Ledger: General Ledger is probably the most important book of account. General Ledger is the book where all the entries, whether made in a journal or in the cash book, are finally posted. It is the book where all the transactions, whether cash or non-cash are recorded separately in their individual account heads. For example, if you want to know how much money was spent on conveyance on a particular date, we may go to the cash book and see the amount spent on conveyance on that particular date. But, if you want to know the amount spent on conveyance in one complete month it might not be possible on our part to find from the cash book as the expenditure would be spread over 30 or may be more folios of that month, but we can find it easily through the ledger by going to the folio named **Conveyance Account.** All the accounts of an NPO and all the transactions of the NPO can be found in the General Ledger. Accounts are alphabetically indexed in the ledger to facilitate easy access for recording or locating particular account.

v) With the help of a General Ledger, we can know the debit balance or the credit balance of any account on any day during the year. The list of closing balances of all the accounts of the General Ledger at the end of the year is known as the **trial balance** which in turn is used to prepare financial statements.

vi) Sub-ledger: While writing the Main Cash Book as discussed earlier Nimhas felt the need of maintaining a Petty Cash Book. Similarly Nimhas realised that under certain accounts, the ledger was running into several pages and the General Ledger was becoming fatter and fatter and he was finding it very difficult to handle all the accounts in one book, General Ledger. Therefore he decided to take away certain accounts involving huge number of transactions and create separate books for these accounts where the details would be recorded. However the periodic sum total of these transactions would find place in the General Ledger so that his General Ledger balances would also tally, at the same time he can record the transactions more systematically without making the General Ledger cumbersome.

2.3 Subsidiary Registers / Records

NPO should maintain subsidiary books and records in addition to the main registers for the purposes of internal control and transparency in the state of affairs. The following flowchart in the next page illustrates the various types of subsidiary records & registers

Flow Chart Showing Various Books Of Accounts

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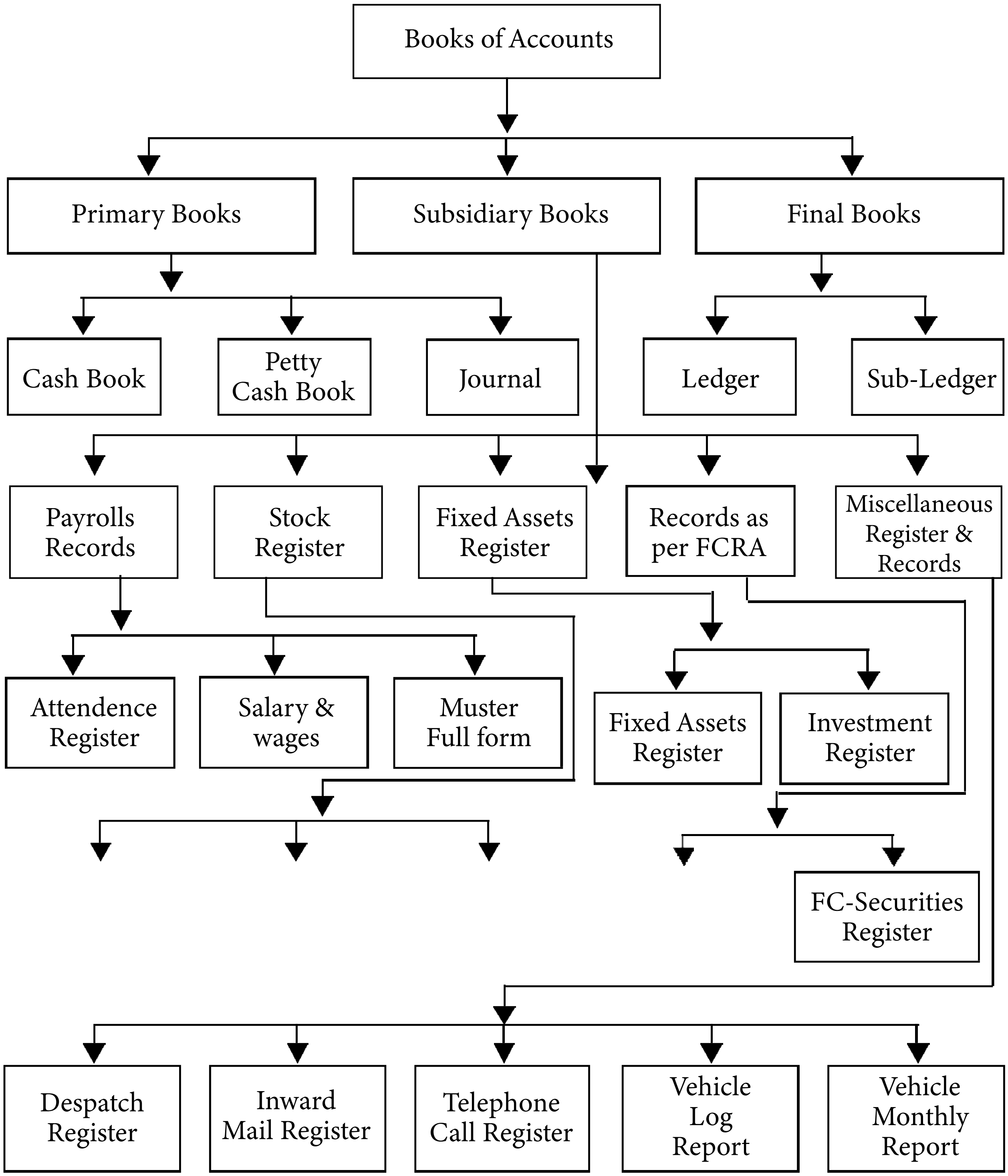


CHAPTER 3 Method of Accounting in NPOs

3.1 Cash Basis of Accounting

In cash basis of accounting, all transactions whether of capital or revenue nature are recorded only as and when effected. An entry in the books of account is made only when cash is received or paid except for closing, opening & few adjustment entries. 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. Amounts payable, liabilities outstanding or amount receivable are ignored and not accounted for in the books.

3.2 Accrual Basis of Accounting

Accrual basis of accounting, is also known as the Mercantile Basis of Accounting. Under this method goods and services purchased/availed are recorded as assets or expenses at the time the goods are received and services are 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. This is the most acceptable and popular method of accounting though in the NPO sector, Cash Basis of Accounting is more widely used.

To understand the difference between Cash and Mercantile system of accounting, let us take an illustration : Nimhas after receiving ₹50,000/- when he purchased the Brochure & Banner worth ₹30,000/- actually he paid only ₹20,000/- to the supplier and ₹10,000/- was agreed to be paid later and while travelling the actual expenditure was ` 4,000/- but Nimhas paid ₹5,000/- an additional amount ₹1,000/- was paid as advance.

are two additional accounts, Outstanding Expenses Account and Prepaid Expenses Account. In one sense Mercantile Method is more scientific and appropriate as it helps us in knowing what we have to pay in future and what we have already paid for the future. But Cash Basis of Accounting is widely followed only due to the simplicity and clarity embedded in its operation.

The cash basis of accounting is widely preferred by the voluntary organisations over mercantile basis for reasons of simplicity in its application. Even non accountants, who have a good grasp of the principle of debit and credit, can fairly perform the job. Many voluntary organisations also view that accrual basis of accounting is useful for profit-making organisations and income generating projects.

Further, most of the funding agencies and provisions of Foreign Contribution (Regulations) Act, 1976 primarily require the actual receipt and disbursement utilisation/application of funds/grants/income, thereby approving the cash basis of accounting.

Entries to be passed on Cash Basis Accounting

Date	Particulars	Ledger Folio No.	Debit (₹)	Credit (₹)
	Brochure & Banner A/c Dr. To Grant Account (Being Brochure & Banner of ₹30,000/- Purchased out of which ₹20,000/- is paid & ₹10,000/- remains outstanding)		20,000.00	20,000.00
	Travelling A/c Dr. To Cash Account (Being ₹5,000/- incurred for travelling including ₹1,000/- as advance for next year)		5,000.00	5,000.00

Trial Balance as per Cash Basis Accounting

Particulars	Debit (₹)	Credit (₹)
Cash Account	25,000.00	
Brochure & Banner Account	20,000.00	
Travelling Account	5,000.00	
Grant Account		50,000.00
Total	50,000.00	50,000.00

(Assuming a Cash Donation Receipt ₹50,000/-)

Entries to be passed on Cash Basis Accounting

Date	Particulars	Ledger Folio No.	Debit (₹)	Credit (₹)
	Brochure & Banner A/c Dr.		30,000.00	
	To Grant Account			20,000.00
	To Grant Account			10,000.00
	(Being Brochure & Banner of ₹30,000/- Purchased out of which ₹20,000/- is paid & ₹10,000/- remains outstanding)			
	Travelling A/c Dr.		4,000.00	
	Prepaid Expense A/c Dr.		1,000.00	
	To Cash Account			5,000.00
	Being ₹5,000/- incurred for travelling including ₹1,000/- as advance payment to be adjusted for next year).			

Trial Balance as per Accrual Basis Method of Accounting

Particulars	Debit (₹)	Credit (₹)
Cash Account	25,000.00	
Brochure & Banner Account	30,000.00	
Outstanding Expense Account		10,000.00
Travelling Account	40,000.00	
Prepaid Expenses Account	10,000.00	
Grant Account		50,000.00
Total	60,000.00	60,000.00

(Assuming a Cash Grant Receipt ₹50,000/-)

CHAPTER 4

Accounting Structure & Charts of Account

4.1 Introduction

The Chart of Accounts is probably the most important organizing tool for the accounting and reporting processes. There are many kinds of financial transactions taking place in NGOs. We buy a wide variety of goods and services to help achieve our objectives – from rent for the office to tools for a garden project and receive different kinds of income, for instance - grants, donations and membership fees. To make sense out of these financial activities, it helps to 'sort' the different types of income and expense into a series of pre-determined categories or Accounts. held in the Chart of Accounts. The same categories are used in the organization's budget and financial reports, promoting consistency and transparency.

4.2 Heads of Accounts

There is no standard accounting framework for NGOs. Since, NGOs are largely dependent on donor funds which are normally bound by grant conditions, its usage therefore is restricted. In financial parlance, these natures of funds are termed as 'restricted fund'. This means, the usage of such funds are restricted to the extent of the conditions imposed by the donor. Again, as part the of donor reporting, organizations need to submit financial statement, which needs to be in line with the budget structure/heads as prescribed by the donor. An organization in order to generate such report need to structure the accounting in a manner which is able to provide financial statements that fulfils the need of donor as well as other stakeholders requirements. Thus, creating correct 'Heads of Account' is critical for seamless accounting and reporting purposes. Therefore, the ideal way to create heads of accounts is to make it in line with the approved budget head. In order words, budget heads also become the accounting head.

4.3 Development of Charts of Account

As explained above there are different nature of income and expenses which need to be categorized in a logical order to determine the quantum/ volume of transaction that has occurred under particular nature income and expenses. This further supports the presentation of financial statements in a manner and form that is needed by various stakeholders.

Step-1 – Creation and identification of four main Heads

In common terms, chart of accounts means, ledger accounts and group accounts shown in books of accounts. For different types of business activity and entity, chart of accounts is different. To maintain uniformity throughout the financial year, it is advisable to segregate the financial transactions under the following four broader heads:-

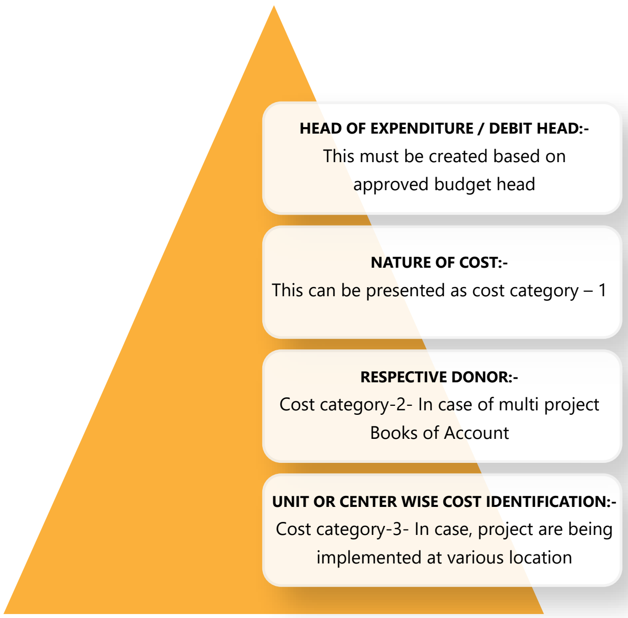
- Assets (Fixed Assets, Current Assets, Loan & Advances)
- Liabilities (General Fund, Restricted Fund, Reserve & Surplus, Current Liabilities)
- Income
- Expenditure

Note:- Chart of Accounts also includes even balance sheet items. There are mainly two types of Balance Sheet items, some of which are same from year to year like Fund Account or Corpus Fund Account or Building Reserve Fund Account, Name of Bank Accounts etc and others are changing in nature like Salary Payable Account, Audit Fees Payable Account etc. One has to incorporate both these type of balance sheet items in the list.

Step-2 – Identification of the Income Head

The traditional understanding of income is that it should constitute inflows which are unconditionally available or increment in assets or decrease in liability, at the end of the year. The income of an NPO would generally include the following :

- Voluntary Contributions/Donations
- Unrestricted Grants
- Income from business or incidental activities.
- Consultancy
- Interest and dividend
- Fund raising activity, one time events
- Membership fees
- Other miscellaneous income



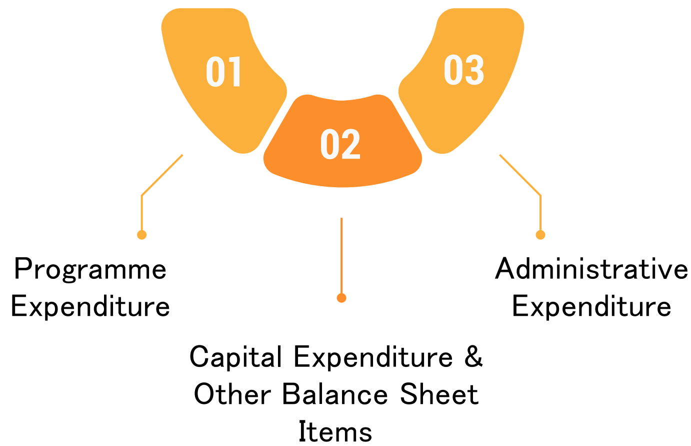
While creating charts of accounts, organisations need to categorize the heads of Income as per its nature of work, donor guidelines. The above heads of income can be categorized as the sub-head of income and the specific name of the donor can be created as the ledger under the sub-head of income. A sample example is given below: -

Code	Head	To be created as	Remarks
1.	Income	Main Group	Head of Income
1.2.	Restricted Grants/Income	Sub-group/Head	Under main group
1.2.3	US-AID	Ledger	Under Sub-group/Head
1.3	Un-restricted Grants/Income	Sub-group/Head	Under main group
1.3.1	Collection from Donation Box	Ledger	Under Sub-group/Head

Step-3 Categorization of the Broader Expenditure Head or Group

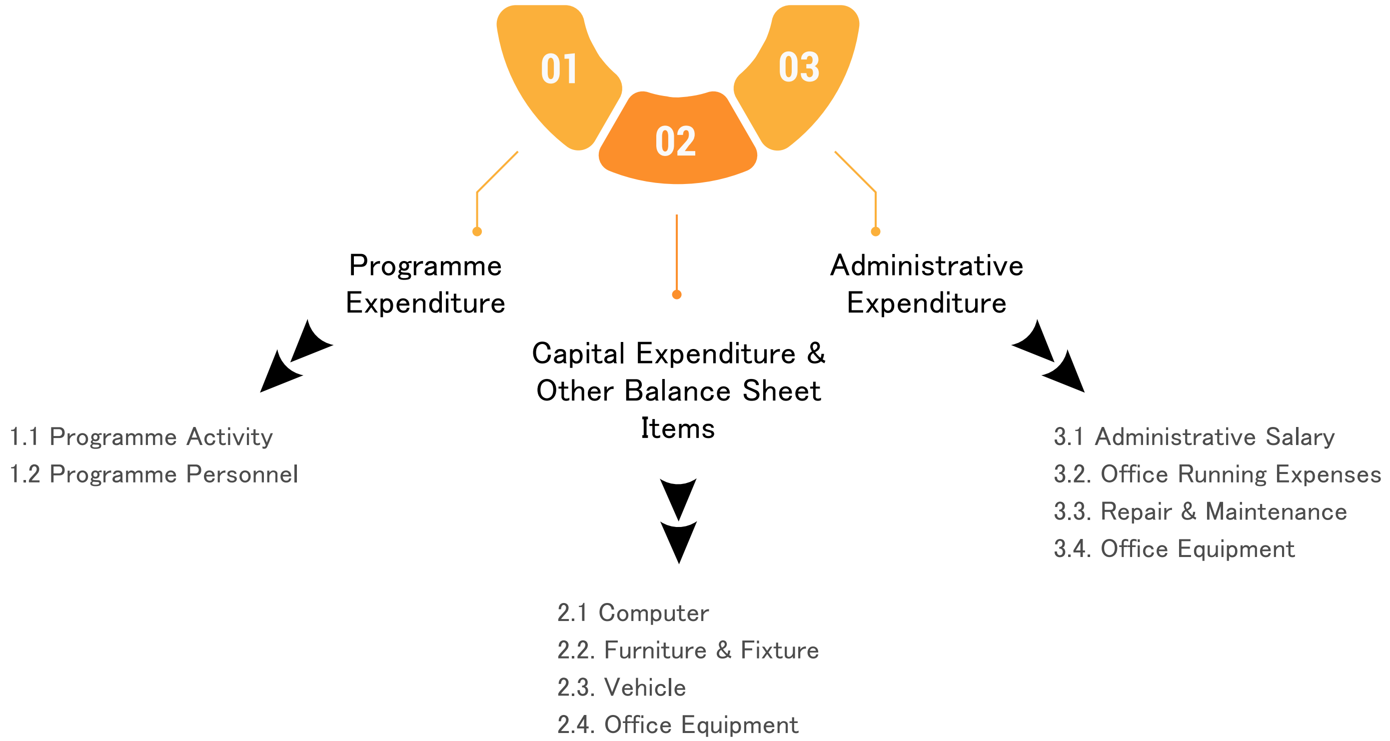
While developing the charts of accounts specially for the expenditure heads, organisations must remember that at the end of the year Receipt and Payment Account, Income & Expenditure Account is the account prepared by an NPO at the end of the year showing all income & expenditure. This gives a clear picture of the organisation's source of income and nature of work being conducted. Therefore, the creation of expenditure heads is very important under the charts of accounts.

Ideally, NPOs should categorized their expenditure head in the following 3 broader heads:-



Step 4– Identification of sub-group of the expenditure

After the identification and creation of the above broader heads organisation should create the sub-group of expenditure heads based on the nature of its activity and project. A sample example for the next step has been given below:-



Step 5 – Creation of ledgers/expenditure booking heads

This is the last stage of creating charts of accounts. A ledger is a book or collection of accounting heads in which account transactions are recorded. This should be created in such manner where different types of reporting can be generated for various stakeholders:-

1.1 Programme Activity

- *1.1.1 Awareness Training Programme on HIV AIDS*
- *1.1.2 Resource Person Fees & Travel*

1.2 Programme Personnel

- *1.2.1. Community Organiser*

2.1 Computer

- *2.1.1 Dell 4015*
- *2.1.2 Lenovo*

2.2 Furniture & Fixture

- *2.2.1 Officer Chair*

2.3 Vehicle

Step-6 Enter Chart of Accounts in Accounting Software

Once an exhaustive list of accounts are prepared, it should enter into Accounting Software maintained by an NGO. Either you have to enter a chart of accounts manually in the software or you can import excel into accounting software if such a facility is there. For example, In Tally ERP9, you can easily import charts of accounts from excel sheets.

Conclusion

Considering the huge expectation from the various stakeholders like donors, applicable legal compliance (Government), NGOs should develop their charts of account in such a manner so that reporting can be generated for donors and various government departments at an adequate rate at any given period of time. For example, the accounts department of NGOs should be able to share the following information for any specific period of time at any given period of time:-

1. What is the Income of the organisation?
2. What is the expenditure incurred towards administration?
3. What was the capital cost?
4. What was the programme activity cost?

If an organisation develops their chart of accounts based on the above budget heads and updates their Books of Accounts on a daily basis, the above question can be answered at any given period of time.

CHAPTER 5

Accounting Treatment for the Project Funds

5.1 Understanding The Income Of NPOs

The traditional understanding of income is that it should constitute inflows which are unconditionally available or increment in assets or decrease in liability, at the end of the year. The income of an NPO would generally include the following:

- Voluntary Contributions/Donations
- Unrestricted Grants
- Income from business or incidental activities.
- Consultancy
- Interest and dividend
- Fund raising activity, one time events
- Membership fees
- Other miscellaneous income

5.2 Accounting Of Project Grants

Understanding the exact legal and accounting treatment of project grants is a matter of importance as the entire amount of grant may be treated as taxable income in case of any violation of the Income Tax Act. The recent changes in the income tax act and the proposed provisions of the Direct Tax Code (DTC) may have serious impact on NPOs if proper accounting and legal treatment is not made with regard to project grants. Some of the legal concerns of project grant being treated as taxable income are as under:

- A charitable organisation can be treated as a commercial entity if its business activity exceeds 20% of the total income in a year. In such circumstances, the gross receipt of entire voluntary contribution received can be subjected to tax.
- Under the proposed provisions of DTC, an NPO shall have to pay taxes on its income if it is unable to spend at least 85% of its income in the year

In both the above circumstances, an NPO will have to pay taxes on the gross amount of voluntary contribution received. Currently most of the NPOs in the country treat project grants as voluntary contribution. Therefore, it becomes important to understand the exact legal and accounting treatment of project grants, especially whether they should be treated as voluntary contribution or legal obligations.

As discussed in previous chapter, specific project grants which are bound by contractual obligations should not be treated as voluntary contribution. A contractual legal obligation therefore, should not be treated as income as well. Therefore, a legal obligation should not be treated as income in the Income and Expenditure account, an income to the organisation can only be determined after the execution of the legal obligation. It is suggested that all restricted grants should be shown on the liability side of the balance sheet and any application from such grant should be reflected as a schedule to the balance sheet. An organisation is suggested to prepare "Consolidated Resources & Application A/c." the formats of suggested financial statements is annexed herewith.

The concept of income and accounting treatment as per International Accounting Standards and Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) is discussed in the following paras.

5.3 Concept Of Income As Per ICAI In This Regard

Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India (ICAI) defines income as follows:

> *"Income is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."*

The Framework further explains income as follows :

> *"73. The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent."*

As per the Framework, the income is recognised as follows:

> *"91. Income is recognised in the statement of profit and loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).*
>
> *92. The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in this Framework. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty."*

Going by the definition of income provided by ICAI, there should be an increase in economic benefits either in the form of inflows or enhancement of assets or decrease in liability. In other words, there should be an enhancement of the assets (net of liabilities) which does not happen in case of a restricted grant. A restricted grant comes with an equal liability which is legally enforceable. Therefore, it may not be correct to treat it as income as there is no increment in the equity or the net worth of the organisation, which is a necessity to come under the definition of income.

It is also important to understand that **a grant may be given to an organisation as a beneficiary or as a trustee.** For example if a company receives capital subsidy from Government then the company itself is the beneficiary of the subsidy received and therefore it should be treated as income of the company. On the contrary if a charitable organisation receives grant form specific charitable activities then such grant are in the nature of legal obligation and cannot be treated as income. There is nothing in Accounting Standards issued by ICAI to suggest that a legal obligation be treated as income.

5.4 Indian And International Accounting Standards

The relevant Accounting Standard in India is AS 12 which is titled 'Accounting of Government Grants'. The corresponding International Accounting Standard with the same nomenclature is IAS 20. Both the Accounting Standards talk about the recognition of grant as income. According to these standards every donation or grant is an income because it results in enhancement of assets. However, in practice, certain donations and grants are not recognised as income in the Income and Expenditure Account. For example, grants of the nature of promoters' contribution as per Accounting Standard (AS) 12 issued by the ICAI are recognised as capital grants and recognised in equity and not recognised in the Income and Expenditure Account.

However, the corresponding International Accounting Standard, namely, IAS 20, recognises all grants as income irrespective of whether they are of the nature of promoters' contribution. In that sense, AS 12 currently is not recognising capital grants as income, therefore, is not in consonance with IAS 20 which does not distinguish between revenue and capital receipts.

- the asset is controlled by the enterprise as a result of past events;
- it is probable that future economic benefits associated to the asset will flow into the enterprise and
- the fair value or the acquisition/production cost can be measured reliably.

Further, IAS 41.35 allows the recognition of an income only when the conditions imposed for giving the subvention are fulfilled. Moreover, the existence of an obligation of reimbursing the grant is not allowed.

In the light of the above, a restricted grant does not envisage any economic benefit flowing into the organisation at the inception itself. Secondly, if the recognition of the revenue is permissible only after the conditions are fulfilled, then no revenue would be left. Therefore, going by IAS 41 restricted grant can not be considered as income.

5.5 Receipts & Payments Account

In the light of the discussion so far, it becomes very important that a Receipts & Payments Account (R&P) is properly prepared. A Receipts & Payments Account can be more informative than an Income & Expenditure Statement (I&E) because all receipts including restricted grants may not get reflected in an I&E statement.

Receipts & Payments Account is like a cash flow statement and provides the detail of all the receipt and payment made during the year irrespective of the use or nature.

Under FCRA also the reporting is required to be made on the basis of R&P Account. However it is suggested that a R&P Account should be prepared for the entire organisation and not only for FC contribution.

5.6 Income & Expenditure Account

Income & Expenditure Account is the account prepared by an NPO at the end of the year showing all income & expenditure. It is a well accepted fact that all receipts are not income and all payments are not expenditure. Therefore, an I&E Account may not provide the correct picture of the activities of the NPO during the year, unless the NPO is treating all restricted grants as a part of the I&E Account.

5.7 Grant Account Or Fund Account

When a restricted grant is not treated as income, then it becomes very important to prepare proper grant account or fund account. When a project grant is received, it is treated as a liability and all payments and expenditures made out of it are directly debited to this account. At the end of the year an independent statement of inflow and application out of this account is prepared.

If independent project accounts are prepared treating them as separate fiscal entities, then it will be possible to know the closing bank balance, investment and assets available against each such project. Under the conventional reporting, we do not provide projectwise bank balances and investments. As a result the exact status of each project is not available. For instance, the NPO may have overall positive bank balance but some projects might be having negative cash balance because of inter-project transfers.

For accounting purposes the restricted fund should be recognised on the basis of receipt. The expenditure should be charged on cash or accrual basis depending on the method of accounting followed by the organisation.

The total activities of an NPO can only be assessed if the I&E Account and other Grant or Fund

Accounts are seen at the end of the year in one consolidated statement. It may so happen that an NPO may not have significant income but is handling large amount of restricted funds. Therefore, it is of utmost importance that principle of Fund Accounting is followed for accounting as well as reporting of project activities.

5.8 Consolidated Resources And Applications (CRA) Statement

It is advisable that a consolidated statement should be prepared comprising both the I & E Account and other Grant and Fund Accounts to provide a holistic picture of the total funds mobilised during the year (including both income and restricted grants) and the application made towards charitable purposes.

However, a grant received from a donor, might relate to a period, say for 3 years. In such an instance, it is advisable that the CRA Statement reflects only that part of the grant that has been applied during the year.

For example, if an organization receives a grant of ` 5,00,000 from a donor agency during the year ending 31.03.2000 which is towards a project to be implemented in 3 years. Of this grant, if the organization has utilized only ` 1,50,000 during the year ending 31.03.2000, then it is advisable to reflect ` 1,50,000 as Income in the Resource side of the CRA Statement.

An R & P Account is not a proper statement for assessing the annual activities of an NPO, because it may include certain payments or expenditure which are not towards charitable purposes. It may also include receipts and payments which are towards the corpus or capital of the organisation and not intended to be applied for charitable purposes.

It should be noted that the entire Income and Expenditure Account should be merged with various projects and funds to the extent applied during the year. In other words, amount only to the extent applied during the year is shown on the income/resource side. The application and expenditures are shown as per actual.

Currently many NPOs prepare the same Consolidated Resources and Applications Statement in the name of I & E Account, by treating restricted grant as income. However, it is important that income and other receipts are distinguished. Therefore, it is advisable to prepare a CRA Statement on the basis of the above principles.

5.9 Balance Sheet

Balance Sheet is a statement signifying the financial position of an organisation on a particular date. Normally a Balance Sheet is drawn at the end of the year to know the financial status of an entity. The assets and liabilities side of the balance sheet can be classified as under :

5.10 Assets

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

5.11 Liabilities

- Fixed Assets
- Investments

- Restricted Funds (funds earmarked for specific purposes)
- Designated Fund
- Endowment Fund
- Assets Fund
- Unutilised grants
- Loans (Secured/unsecured)
- Current liabilities

Balance Sheet can be prepared in two forms i.e. horizontal and vertical form. Most charitable organisations' Balance Sheets are prepared in the Horizontal form. The vertical form of Balance sheet is mostly prepared by the corporate sector and is rarely seen in the charitable organisation.

CHAPTER 6

Voucher Management and Documentation

6.1 Introduction

Generally, an accounting system includes various procedures for documenting and reporting accurate and up-to-date financial information. The system should also contain procedures to assist management in controlling day-to-day operations/transactions. Any financial transaction has to be supported by documents, which validate that the said transaction has actually taken place.This is where vouchers play a crucial role.

Vouchers refer to the documents that summarize the transaction along with the supporting documents as evidence for the same. Vouchers are known as 'cash equivalent', which means that for every payment, we generate a cash/bank voucher. Therefore, in effect, vouchers assume the same importance as that of cash.

Vouchers are also required for transactions other than cash & bank. These vouchers are required while passing adjustment entries and are known as ***Journal Vouchers.***

6.2 Objective of Vouchers

Vouchers are prepared to have proper evidence/ supporting of financial transactions. The presence of a proper vouchers makes a financial transaction independent and verifiable. The vouchers also are necessary to establish safe administrative procedures and enable proper recording of transactions.

6.3 Understanding Vouchers

Vouchers are helpful for following reasons :

- **Proper recording of transactions**
- **Providing proper evidence/supporting of financial transactio**ns
- **Establishing safe administrative procedures**

6.4 Recording Of Transactions

When any activity/transaction occur, the first place where the recording is done is the voucher. Various information that are required for basic bookkeeping such as the date, account head, mode of payment, etc. are captured in the voucher.

6.5 Evidence/Supporting

Vouchers as a record of transaction contain evidence of occurrence of such transaction, activity or event. The evidence may be bills, receipts, invoices, purchase orders, agreement paper and other summaries like list and signature of participants (in case of training, workshop, etc.) For example, all capital items purchase require that three quotations from three different vendors must be obtained and then the purchase order should be placed based on the comparative analysis. It would be important to mention here that all capital items above the value of Euro 410 require three competitive quotations as part of documentation.

Voucher / Supporting = cash

Since, voucher and supporting is equivalent to cash, organisation should preserve voucher and supportings in the safe custody in the premises of office. Ideally, all the Books of Account should be preserved for 8 years (as prescribed in the Income Tax Act)

a) Verifiability of the vouchers and its supporting

Generally, payments made to the various vendors and external person towards expenditure. In-such case organisation obtains the supportings or evidence of transactions such as bills, invoices, receipts etc. against the payments made to various vendors. It is very important to note that organisation keeps only supporting documents against the payments made and therefore voucher and its supporting is equivalent to cash.

As discussed above, organisation keeps voucher along with the supportings or evidence of transactions against the payments made to various vendors. It is very important that the voucher and supporting documents should provide all the required information that can be verified by the any external authority easily. In addition, the supportings of the organisation should provide enough information to the end receiver of funds.

b) What in-case supportings documents is not available

In case of NGOs who operate at remote locations, setting appropriate external evidence as described in previous sections can be a challenging task. In some locations, it may be challenging or not enough explored how to get proper bills, invoice, money receipts, etc. In cases where only self-receipts are prepared the external evidence is very weak. Therefore it is very important that these evidences MUST be strengthened through strong and verifiable circumstantial evidence.
A circumstantial evidence is indirect evidence that supports the fact that the expenditure has incurred. For example, if there is expenditure on food for a meeting at the village level, circumstantial evidence can be the list of participants in the meeting, their signatures, , the activity plan of the organization signifying that the meetings have taken place, e.g. signed minutes of the meeting, photographs and certification for participants by the field coordinator. These will contribute to provide greater evidence to support the incurred expenditures. For local travel, the purpose of travel with the number of Taxi/rickshaw and if possible the signature and telephone number of the driver and/or photo should be obtained.

NOTE: All vouchers and for that matter specifically circumstantial evidences must be approved by an authorized person other than the accountant who prepares the vouchers

c) Internal Vs External

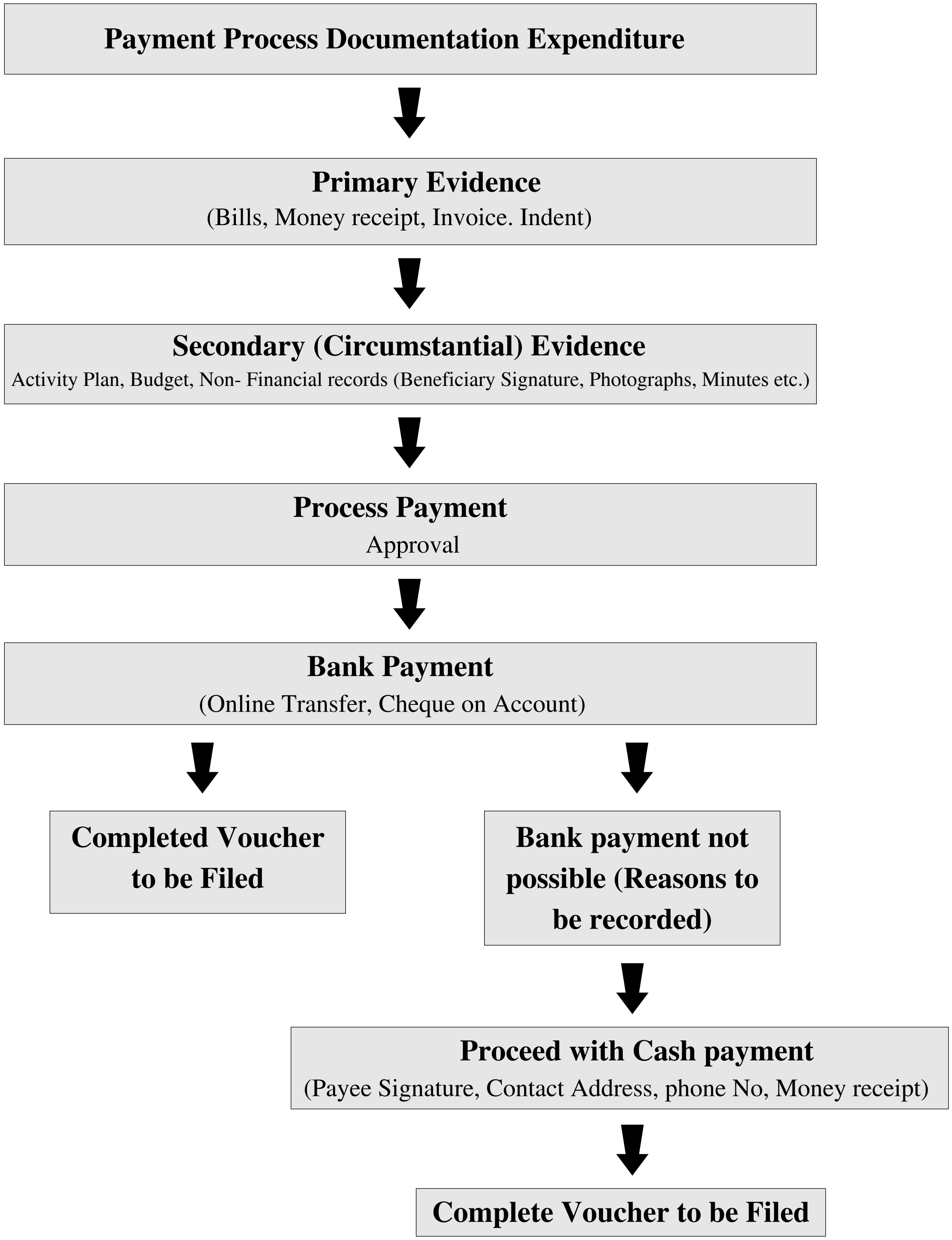
Internal: The internal side refers to the internal processes of a voucher. They are the voucher details like date, voucher no., head of account, narrative explanation etc., and internal steps like Prepared, Checked and Approved. External: The external side of the voucher is as (or even more) important than internal side.

The external side voucher is for the payment by an external party and thereby strengthens the claim of payment. Examples of external process are:

- Bills
- Money receipt
- Invoice
- Way bill
- In exceptional cases a Self-receipt A balanced voucher is:

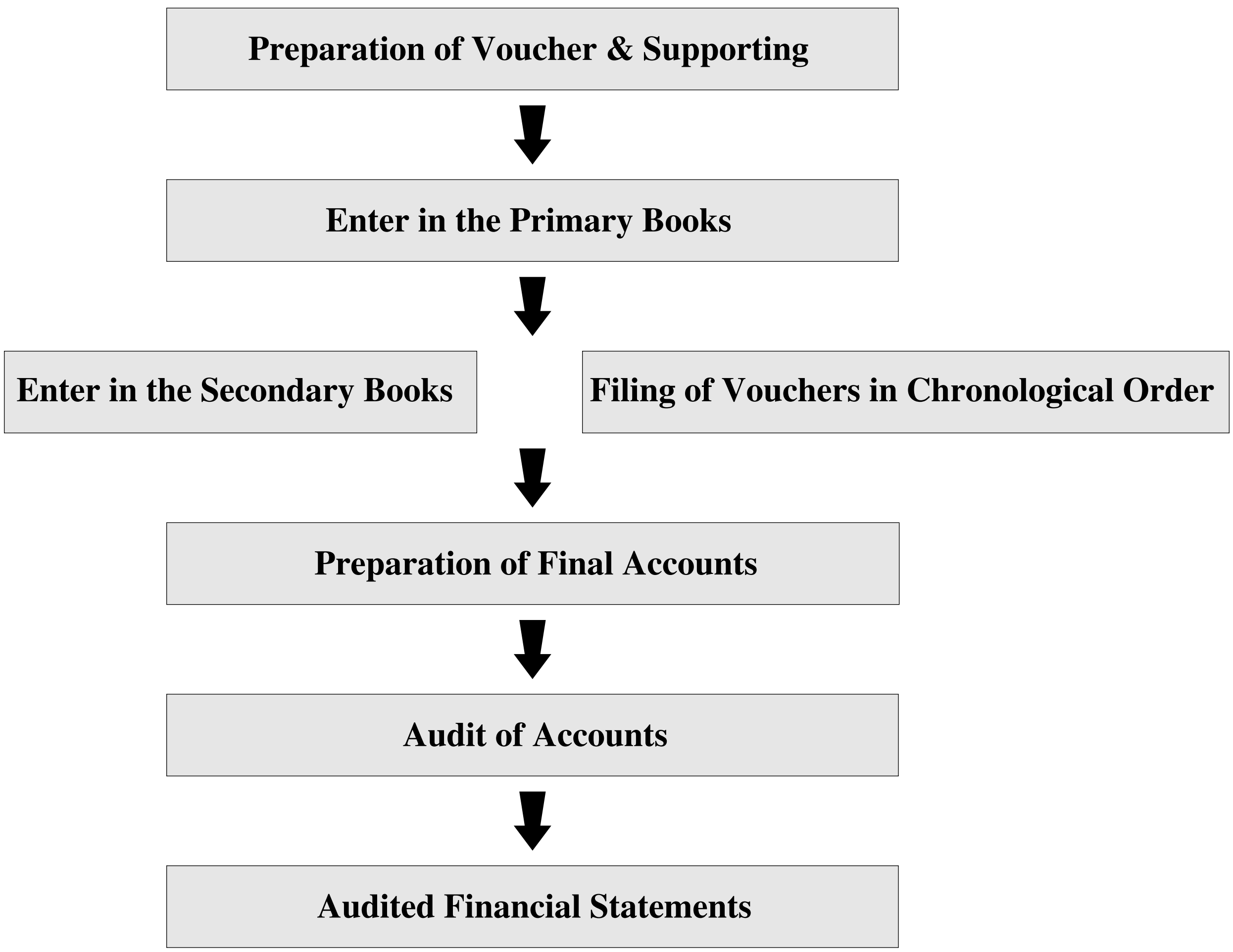
6.6 Administrative Procedure

Voucher makes the requirement of verification and approval compulsory and properly followed. Therefore, it promotes healthy internal processes. Vouchers make the financial transaction independent and verifiable. Normally, a voucher discloses information such as details of the goods purchased, amount paid for the goods purchased, date and mode of payment, name of the supplier, name of persons passing or approving the purchase, name of the person making the payment and purpose for which the purchase was made.



For voluntary organizations dealing with more than one project and funding agencies, the project name or number and the funding agency to which the expenditure is required to be charged must also be disclosed in the voucher. This would provide information as to under which the expenditure has been incurred. If, there are common costs, which are part has been incurred.

If, there are common costs, which are part of more than one project, the basis of allocation should be mentioned clearly on the voucher and the supporting document. The supporting document in that case should contain the information of both the projects and the amount charged to each project.



6.7 Notes In Preparation Of Vouchers

All vouchers should contain the following information :

- Voucher Number
- Date of transaction
- Nature of transaction
- Amount in words and figures

- Account head to be debited/ credited
- Person who has prepared the voucher
- Authority who has passed it
- Supporting documents

Each voucher should be supported by third party documents such as bills, cash memos, letters, etc. Where secondary support documents are not available then self attested documents may be given in their place. In such cases all the details must be narrated so as to make it convincing to the auditors, funding agency and statutory authorities. The self-generated vouchers should be approved specifically by the requisite authority.

All vouchers, whether cash or bank or journal, should be approved by an authorised person, other than the accountant who prepares the vouchers.

For payment above `5000/- a revenue stamp of appropriate value must be affixed and the payee or the person authorised by the payee should sign and write his/her name and address.

If the voucher is supported by a third party bill cash memo then no receipt on the voucher with a revenue stamp is required.

It is suggested that a rubber stamp in the name of the respective funding agency should be stamped on the voucher and its support. This would ensure its correct accounting to the respective funding agency.

It is also suggested that a 'Paid' stamp be put on the supportings and voucher in order to avoid double payments being made for the same support.

The vouchers or the support documents should not be overwritten and white correction fluid should not be used unless it becomes absolutely necessary and is approved by the chief functionary.

6.8 Types Of Vouchers

Many types of vouchers are used for recording the transactions as a source document in accounting. The standard vouchers in accounting comprises of Vouchers are classified into three categories :

- Contra Voucher
- Payment Vouchers
- Receipt Vouchers
- Journal Vouchers

Contra Voucher is used to indicate transfer of funds from:

- Bank account to Cash account
- Bank account to Bank account
- Cash account to Bank account
- Cash account to Cash account

In other words, cash deposited in bank or cash withdrawn from bank are recorded through contra voucher. 'Contra' means both sides. Therefore, a contra voucher is recorded in both the receipt as well as in the payment side.

Payment Voucher is a document prepared at the time when payment is to be effected and it serves as evidence for payment of goods and services that were purchased by the organization.

Receipt Voucher is documentary evidence that the sum stated thereon has been received on behalf of the organization.

Journal Voucher is documentary evidence of formal entries that need to be made in case of non-cash transactions. It records all transactions that do not involve cash and bank. Usually, journal vouchers are prepared under the following circumstances:

- Correction of accounting errors arising from misclassification
- Carrying out adjustments or transfers between accounts i.e. provision for payment in future, for depreciation, etc.

6.9 Color Coding

Vouchers are also identified on the basis of colors. For example, the following color coding may be used:

- Cash Voucher (White in color)
- Bank Voucher (Yellow in color)
- Journal Voucher (Pink in color)

CHAPTER 7

Financial Statement Reporting

7.1 Introduction

Charitable organisations, do not have any statutory obligation towards the form and content of the financial statement. The law governing charitable institutions is more than 100 years old and they do not have any prescribed framework for preparation of financial statements, as in the case of companies registered under The Companies Act, 1956.

7.2 Various Stakeholders

The preparation of financial statements in a transparent, intelligible and user friendly manner is very important. A lot of people depend on the results/performances of the charitable organisations. People as well as the society at large also have a right to be apprised of the financial state of affairs. Some of the important stakeholders of charitable organisations are as under:

i) The General members: The general members in some sense are the real owners of the organisation. The general members have the right to be informed about the financial affairs of the organisation, assuring them that it is working towards the vision and mission and the assets of the societies are properly managed and protected.

ii) The Management Committee: The management committee or the trustees need to analyse the financial functions in order to take future decisions as well as review the current activities. In a charitable organisation, all the trustees or board members may not have a financial background. Therefore, it is important that annual statements are prepared in a comprehensive as well as understandable form.

iii) The Beneficiaries: The beneficiaries are the most important stakeholders but unfortunately very little information is disseminated to them. The development sector is trying to come up with various measures for participation of the beneficiaries in the financial functioning of the organisation. Some organisations have started preparing village level statements which are displayed in each village in the local language.

iv) The Donors : The donors being the source of finances have a right to the annual statements assuring them that their funds were properly utilized. Proper preparation of statements will also help in impressing the prospective donors.

v) Government Agencies: The Trust laws or the Societies Registration Act have not prescribed any criteria for the presentation of annual accounts. However various other Government Agencies such as Ministry of Home Affairs for FCRA and the Income Tax department have specific reporting requirement.

7.3 Preparation Of The Balance Sheet

The assets and liabilities side of the balance sheet can be classified as under :

a) Assets

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

b) Liabilities

- Corpus Fund
- General Fund (unrestricted funds)
- Restricted Funds (funds earmarked for specific purposes)
- Designated Fund
- Endowment Fund
- Assets Fund
- Unutilised grants
- Loans (Secured/unsecured)
- Current liabilities

Balance Sheet can be prepared in two forms : The traditionally horizontal and the trendy vertical for the suggested format of Balance Sheet). Most charitable organisational 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 sheets are mostly prepared by the corporate sector and is rarely seen in the charitable organisations. It has two sections : Sources of Funds and Application of Funds. In any case, the Auditor should ensure proper clarification of the following :

i) Corpus Fund: Corpus fund is analogous to the equity share capital of a company. However, since profits cannot be distributed in a charitable organisation, no member has a right or claim over the corpus fund. Corpus fund should be properly classified and the addition and earning from corpus fund should be clearly stated.

ii) General Fund: General fund is the unrestricted fund available with the organisation. Such fund should be distinguished from designated fund

iii) Restricted Fund: Restricted fund is the fund which can be used for a particular purpose (s) as may be specified by the donors or any law.

iv) Designated Fund: Designated fund is the fund set aside by the trustees/board of directors out of unrestricted or general funds for future purposes of a project of the organisation. Designated funds are different from the restricted funds, in the sense that the restriction is not external or imposed by the donors. Such funds should be separately classified in the balance sheet.

v) Endowment Fund: Endowment fund is another category of restricted fund, where the fund is kept intact but the income earned from it is required to be used for a specific purpose as per the restriction created by the donors or trustees/board members.

vi) Assets Fund: Many charitable organisations write off 100% of their capital expenditure in their Income & Expenditure account. As a result, the capital asset is extinguished from the books of account. However to give a proper reflection of the state of affairs, the assets are shown in the Balance Sheet by creating asset fund on the liability side. These assets fund are gradually reduced by deduction of depreciation from both the sides of the balance sheet.

vii) Fixed Asset: Fixed assets are required to be segregated in terms of the corpus assets and the assets purchased for project purposes. Project assets normally should be supported by asset fund on the liability side. The balance sheet with the help of suitable schedules should provide all the details in this regard.

viii) Investment : Investment of a charitable organisation may represent the unutilised closing balance of various project funds. The investment may also represent long time corpus fund or endowment fund. The balance sheet should provide with the help of necessary schedule the proper segregation in this regard. Even project investment should be shown separately for each project.

ix) Loans & Advances: Loans and Advances in a charitable organisation could include revolving fund loan and advances made for project purposes. There may be advances of administrative nature such as staff advance, travel advance, etc. Proper segregation with the help of schedules of all such advances should be shown.

x) Cash & Bank Balances: Cash and Bank Balances should reflect the closing balance of all the bank accounts at the head office as well as the project places. Similarly, cash in hand should also reflect the break-up at various places.

7.4 Income & Expenditure Account

Income & Expenditure Account (I&E) is the account prepared by an NPO at the end of the year showing all income & expenditure. It was noted that all receipts are not income and all payments are not expenditure. Therefore, an I&E Account may not provide the correct picture of the activities of the NPO during the year, unless the NPO is treating all restricted grants as a part of the I&E Account

7.5 Receipts & Payments Account

In the light of the discussion so far it becomes very important that a Receipts & Payments Account (R&P) is properly prepared. A receipts & payments account can be more informative than an Income & Expenditure Account (I&E). As because all receipts including restricted grants may not get reflected in an I&E Account.

Receipts & Payments Account is like a cash flow statement and provides detail of all the receipt and payment made during the year irrespective of the use or nature.

Under FCRA also, the reporting is required to be made on the basis of R&P Account. However it is suggested that a R&P Account should be prepared for the entire organisation not only for FC

7.6 Financial Narrative Report

It has been noticed that the programme or narrative report submitted by NPOs some times do not correspond with the financial report.

It is suggested that the half yearly/annual narrative report should be in terms of the budget heads and tangible activities taken during that period. On the other hand long term narrative report such as project period report should be in terms of achievements and fulfillment of the objectives. A financial narrative report is a report, which provides explanatory value to the various expenditures undertaken during a reporting period.

CHAPTER 8

Reporting and Monitoring

8.1 Reporting

Reporting is a process through which an organisation presents a reflection of its current status, especially the financial situation. Reporting is important because it enables not only those in authority but also the public at large to know whether activities planned have been carried out including reporting on any deviations. Further, the existence of standards of efficiency and accountability needs to be reported.

There are several ways of reporting depending on the types of organisation and the sort of information required. The following are some of the bodies / stake holders for reporting purposes:

- Board /Governing Body / Executive Committee
- Chief Functionary
- Government e.g. FCRA, IT Deptt. and Registrar of Society
- Funding Agency
- The public at large e.g. by publishing the Annual Report.

8.2 Reporting To The Board / Governing Body / Executive Committee

The following are the common reports submitted to the board:

- Half yearly Financial Report
- Annual Financial Report
- Legal Compliance Status Report

- Donor Agency Status Report
- Management letter from statutory auditors

8.3 Reporting To The Chief Functionary

While it is the board which frames Board policies, it is the Executive Director/Secretary (Chief Functionary) who implements such policies and takes care of the day to day affairs of any organisation. Therefore, the following reports would be required for the Executive Director more frequently than they are required by the Board.

- Monthly Financial Report
    - a) Receipt and Payment Account
    - b) Income and Expenditure Account
    - c) Balance Sheet
- Budget Comparison Report
- Investment Status Report
- Donor Agency Status Report
- Bank Reconciliation Statement
- Legal Compliance Report

8.4 Reporting To Funding Agency

Every agency may have specific requirements depending on the contract between the agency and the organisation. Normally the donors require narrative as well as finance reports on a half yearly interval.

8.5 Monitoring

Monitoring is a process to ensure that the people who are connected in various capacities to the organisation implement project/carry out activities in accordance with the planned objectives.

Project planning and control are two sides of the same coin. Monitoring ensures that one side of the coin, namely control is adequately exercised.

There are various levels of monitoring depending on the relationship of the people connected to the organisation e.g. The Board being the legal body is the first level of monitoring authority which is accountable and fully responsible for all the good deeds and misdeeds of the organisation.

Similarly the Government, both at the State and Central levels, monitors the activities of the organisation through various laws which cover the organisation e.g. FCRA, taxation, etc.

8.6 Monitoring Through Internal Auditing

It is suggested that periodic checking by way of internal audit be carried out to ensure that the NPOs comply with the various laws and the activities being carried out are effectively moving in the direction of achieving the proposed objectives. This internal audit must be carried out by a competent Chartered Accountant, who is to report to the management. The Statutory auditor's duty is to report to the Board hence his prerogative is to report on important matters and policies. The way the day to day and routine matters are being carried out and deviations, if any, are to be corrected is the prerogative of the internal auditors. The internal auditor should make monthly visits to ensure that systems are in place and operational.

CHAPTER 9

NPOs Audit

Audit

9.1 What is Audit?

An audit is an independent examination of records, procedures and activities of an organization which leads to a report outlining whether such activities are in good order or not.

- Funding Agency
- The public at large e.g. by publishing the Annual Report

9.2 Importance

a. Audits are important for NGOs as they demonstrate a commitment to transparency and accountability.

b. Audits provide useful learning opportunities. Auditors can provide advice on financial controls or systems.

9.3 The process

There are basically three stages of an audit:

Stage 1: Data collection

- The concerned auditors visit the organization and request the documents for gathering information.
- These documents play relevant role in determining whether the organization is working within the legal and donor guidelines.

Stage 2: Analysis of data

- During this stage, the auditors corroborate the collected data with the legal framework / donor guidelines/good practices.
- Such corroboration helps the auditor in determining the gaps existing in the organization.

Stage 3: Final report

- The final report consists of the suggestions which would help in filling up the gaps currently present in the organization.
- It also contains the comments highlighting the level of risks involved pertaining to the gaps observed during the audit.

9.4 Types of Audit

There are broadly three types of audit:

a. Statutory Audit: By law of the land every organization is required to audit their books of account every year.

b. Project Audit: These are generally undertaken for the benefit of financing partner. This is a specific purpose audit and focuses on documents affecting the respective project rather than whole organization.

c. Internal Audit: An internal audit review is undertaken at the request of the management of the organization; it focuses on systems and procedures, and utilization of resources.

9.5 Key characteristics with respect to TOR

Statutory audit: Key legal statute form the basis of audit

Project Audit: The Cooperation agreement with the financing partner form the basis of audit

Internal Audit: The policies and manuals present in the organization in addition to the good practices form basis of the audit

9.6 Duties of the organization

(i) The organization should maintain proper accounting records and implement an appropriate internal control system

(ii) The organization should make available to the audit firm the financial statement together with relevant books of accounts and related subsidiary records

(iii) The organization should provide all the information and explanations required by the audit firm for the purpose of audit

9.7 Duties of the Auditor

(i) The Audit must be completed at the organization's office where books of account related to the concerned audit is available.

(ii) The auditor shall form the following tasks:

- Examine financial statements of the organization/project and give opinion thereon
- Perform the audit in accordance to the accounting principles accepting in the country
- Examine the systems of internal control established in the organization
- Examine whether the bank accounts are operated by the persons as authorized by the Board of the organization

9.9 Reporting

9.9.1 External Reporting

Statutory Reporting: The organization should ensure that all statutory returns to the concerned government department are filed within stipulated time.

Donor Reporting: The organization should send progress reports to the financing partner timely and in accordance to the provisions mentioned in the cooperation agreement.

9.9.2 Internal Reporting

Internal reporting is for the senior management and the board. This includes:

- Trial balance and fund wise statement to the senior management in regular intervals
- Presenting budget variance analysis to the senior management of the organization
- Bank reconciliation statement

9.10 Key points to remember

1. Requesting the auditors to share a management letter. Such management letter should clearly specify the observations with respect to:
    a. Legal Compliances applicable on the organization
    b. Compliance of Finance policy of the organization
    c. Lapses observed in systems and processes
    d. Quality of voucher and supporting documents
2. Preparation of action taken report based on the auditor's report/management letter
3. Ensure independence of auditor by introducing the policy of rotation of auditor

CHAPTER 10

Suggested Notes / Disclosures in Financial Statements and Audit Report

10.1 Suggested Notes And Disclosures

The notes and disclosures normally required are as under :

- Method and charge of depreciation,
- Cost/market value of investments
- Contingent liabilities
- Retirement benefits
- Valuation and verification of fixed assets
- Valuation of investments etc.
- Related party disclosures

In addition to the above, NPOs should consider the following :

i) A note about the method of accounting and accounting assumptions taken.

ii) In certain project based charitable organisations, the assumption of going concern may not be relevant. This can happen in the case of charitable organisations funded by a single donor. If the project funds are stopped, then the project as well as the organisation may cease to exist. Similarly, under the FCRA law, the charitable organisation may be banned from receiving foreign grants. The Auditor should provide proper notes in this regard.

iii) The Auditor should report that the expenditures were in conformity with the objects of the society such as :

a) Relief of the victims of natural calamities.

b) Empowerment and rehabilitation of poverty stricken and street children into the main stream of the society.

c) Gender equity and women development.

d) The welfare of urban slum dwellers.

iv) The Auditors' report should provide that the project taken on behalf of the donors were implemented according to the approved budgets and variations if any were within the permissible limits.

v) A note should also be provided on the contribution received in kind and the method of accounting and valuation followed.

vi) A note with regard to income generated by the communities and the local contributions received should be provided

vii) A note on project assets distinguishing them from the corpus assets should be provided.

viii) Fund and project wise segregation of investments, assets and liabilities.

ix) Details of the restricted and other funds with contractual obligation, if any.

x) Conflict of Interest or related party transactions, such as salary and other benefits to functionaries, use of properties by functionaries, consultancy contracts to related or interested persons etc.