

# NGOs' Financial Facets, Accounting Calisthenics & Taxation Tableau



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**Success of an enterprise depends on how effectively and efficiently the financial resources are put to use by it. Indeed, NGOs are no exception to this maxim. With NGOs receiving grants from various donor organisations, it is their duty to maintain financial discipline and ensure transparency in dealings. Moreover, with Governments granting tax exemptions, a sound accounting and financial reporting system needs to be in place in NGOs to deal with queries from stakeholders. This article discusses the financial perspective, accounting aspects and Income Tax matters concerning the operation of NGOs.**

**N**on-Governmental Organisations (NGOs) act as catalysts of social development. Addressing social issues is quintessential for creating social harmony. And social harmony is the bedrock of a vibrant nation. The business community has seized of this fact. Which is why we find corporates focusing on social issues, be it rehabilitation of tsunami victims or AIDS prevention. The corporate sector has factored societal development in their mission statement.

## Financial Facets

It is obvious that finance is needed for operating any enterprise whether it is commercially driven or socially inclined. This is

stressed upon more in an NGO since it has to look for voluntary contribution for achieving its social objectives.

An NGO may receive contributions from different donors like individuals, corporates, foundations or trusts supported by corporate groups, or persons of philanthropic orientation. NGOs involved in providing micro credit approach banks for their financial requirements. They can also enter into commercial ventures, which can make them sustainable enterprises.

**Donations:** Donations continue to be a major source of funding to NGOs to fulfil its mission objectives. There are no pre-registration formalities for receiving contributions from local sources other than those required under the Income Tax Act, 1961, like when an NGO seeks to avail tax exemptions and the donor too is serious of the tax benefit available to him. However, contribution to NGOs from overseas is governed by the Foreign Contribution (Regulation) Act, 1976 (FCRA). The salient features of the governing statute FCRA are as follows:

**Registration:** As per Section 6(1) of the FCRA an association with definite cultural, economic, educational, religious or social programme shall accept foreign contribution after such association registers itself with the Central Government. The application for registration shall be made in Form FC-8 and shall be as per Rule 3(3A).

**Receipt of Contribution:** The NGOs in order to receive donations shall have to obtain prior permission from Ministry of Home Affairs. Such applications shall be made in Form FC -1A.

**Definitions:** Section 2(1)(a) defines "association"

to mean association of individuals, whether incorporated or not, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), or not, and any other organisation, by whatever name called.

Section 2(1)(c) defines "foreign contribution" to mean donation, delivery or transfer made by any foreign source-

- (i) of any article, not being an article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, does not exceed one thousand rupees,
- (ii) of any currency, whether Indian or foreign;
- (iii) of any foreign security as defined in clause (i) of Section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973).

It has further explained that donation, delivery or transfer of any article, currency or foreign security by any person, who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause. Section 2(1)(d) an inclusive definition defines "foreign source" which contains an exhaustive list and it is an inclusive definition.

Maintenance of Accounts: Section 13 of FCRA and Rule 8(1) of Foreign Contribution Regulation rules requires the NGO to maintain:

- (a) an account of any foreign contribution received by it, and
- (b) a record as to the manner in which such contribution has been utilised by it.

Submission of Accounts: The accounts of NGOs shall be duly certified by a Chartered Accountant [in Form FC-3 along with a balance sheet and statement of receipt and payment] shall be furnished in duplicate, to the Secretary to the Government of India, in the Ministry of Home Affairs, New Delhi, within four months of

the closure of the year (i.e. before 31st July).

1.02 Loan from Banks/ECBs: NGOs involved in extending micro credit to its programme beneficiaries need to avail bank finance for its financing activity and capacity building.

- An NGO involved in providing micro finance credit is allowed to avail External Commercial Borrowings provided that it complies with Reserve Bank of India Circular A.P. (DIR Series) Circular No. 5 dated August 1, 2005.
- Reserve Bank of India has released a Master

**Where the NGO avails tax exemption under Section 11 or under Section 12 on its income, it shall obtain certificate of non-deduction of tax from the assessing officer. The terms and conditions to be adhered to for seeking the certificate of non-deduction are set out in Rule 28AB.**

circular on Micro credit No. RPCD. No. Plan. BC.24/04.09.22/2005-06 dated July 30, 2005.

Snapshot of RBI circulars:

- NGOs engaged in micro finance activities are eligible to avail ECB. Such NGOs should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank.
- NGOs engaged in micro finance activities can raise ECB up to USD 5 million during a financial year.
- NGOs engaged in micro finance activities may utilise ECB proceeds for lending to self-help groups or for micro-credit or for bonafide micro finance activities, including capacity building.
- All other ECB parameters such as minimum average maturity, all-in-cost ceilings, restrictions on issuance of guarantee, choice of security, parking of ECB proceeds,

prepayment and refinancing of ECB under the Automatic Route, should be complied with.

Moreover, RBI has released Frequently Asked Questions on 19th October 2005 on micro finance credit.

*“1.03 Commercial ventures: Increase in competition to share limited source of donations compels the NGOs to generate revenue on their own for supporting their mission. Commercial ventures by NGOs, irrespective of their size of operation, would supplement the funding requirement.”*

The NGOs operating in specific areas like women empowerment, tribal development, forest conservation, etc. can use their expertise and distribution channels to create wealth for the programme beneficiaries instead of merely acting as distributors of donations. However, establishing a sustainable business, particularly by NGOs with societal commitment, is no easy task. They face several challenges like requirement of capital, brand building, etc. This is where a partnership with corporates would help the NGOs learn from their expertise. Ideally, an NGO-Corporate partnership, in developing the commercial arm of an NGO, would help in supporting the social cause on a sustainable basis.

The statutory compliance requirements as applicable to a commercial enterprise would automatically follow once the NGOs embark on commercial ventures.

### Accounting Calisthenics

Basis of accounting: NGOs may be Trusts, Societies or Section 25 Companies. Section 25 companies are under compulsion to follow an accrual basis of accounting as per Section 209 (3)(b) of the Companies Act, 1956. The trusts and societies continue to maintain books of accounts on cash basis or hybrid basis.

It is strongly suggested that NGOs adopt accrual basis of accounting since this brings about uniformity in reporting and a true and fair representation of financial information to the stakeholders.

Applicability of Accounting Standards: It is the lack of awareness among NGOs about the accounting functions due to which they are yet to adopt the Accounting Standards propounded by ICAI.

As per paragraph 3.3 of the Preface to Applicability of Accounting Standards,

**The accounts of NGOs shall be duly certified by a Chartered Accountant [in Form FC-3 along with a balance sheet and statement of receipt and payment] shall be furnished in duplicate to the Secretary to the Government of India, in the Ministry of Home Affairs, New Delhi, within four months of the closure of the year (i.e. before 31st July).**

*“...Accounting Standards apply in respect of any enterprise... irrespective of whether it is profit oriented or it is established for charitable or religious purposes. Accounting Standards will not, however, apply to enterprises only carrying on the activities, which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities, Standards would apply to all its activities including those which are not commercial, industrial or business in nature.”*

All the Accounting Standards applicable

to Level III enterprises would be applicable to NGOs.

There are a number of NGOs which are devoid of commercial content in their dealings. However, it would be prudent to follow the

AS Number	Title
AS 1	Disclosure of Accounting Policies
AS 2	Valuation of Inventories
AS 4	Contingencies and events occurring after the Balance Sheet date
AS 5	Net profit or loss for the period, prior period items and change in accounting policies
AS 6	Depreciation accounting
AS 7	Construction contracts
AS 9	Revenue recognition
AS 10	Accounting for fixed assets
AS 11	The effects for changes in foreign exchange rates
AS 12	Accounting for government grants
AS 13	Accounting for investments
AS 14	Accounting for amalgamations
AS 15	Accounting for retirement benefits in the financial statements of employers
AS 16	Borrowing costs
AS 19	Leases
AS 22	Accounting for taxes on income
AS 24	Discontinuing operations
AS 26	Intangible assets
AS 28	Impairment of assets
AS 29	Provision, contingent liabilities and contingent assets

Accounting Standards laid down by ICAI, which would help the NGOs to maintain uniformity in presentation of financial statements, proper disclosure and transparency. And transparency

in turn translates into a higher comfort level for the stakeholders.

The NGOs shall maintain a separate set of accounts for contributions received from overseas and those received from local sources, revenue from commercial ventures, project specific grants received, etc. as these are needed for reporting under the Foreign Contribution (Regulation) Act, Income Tax Act, and perhaps to the stakeholders and funding agencies as well. It would be more appropriate to have different bank accounts too for proper recording of transactions.

Format of Audit Report & Financial Statements: No standard format has so far been prescribed under law for financial reporting. ICAI's "Technical Guide on Accounting and Auditing in Not-For-Profit Organisations" has given an indicative format, which may be adopted with suitable modifications, depending on the nature of services carried on, volume of operations, etc.

### Taxation Tableau

Definition of an NGO: As per sub-section 15 of Section 2 of the Income Tax Act, 1961, "charitable purpose" includes relief to the poor, education, medical relief, and advancement of any other object of general utility.

The above definition is an inclusive definition and NGOs are well covered under this.

Registration: Section 12A and Section 12AA of the Income Tax Act, 1961 sets out the conditions and procedures for registration of trusts. And Rule 17A of the Income Tax Rules 1962, lays down the form and manner in which the application shall be made to the Commissioner for seeking registration.

The trust shall make said application in duplicate in Form 10A within one year from the creation of trust or formation of the charitable institution accompanied by the following documents.

The following Accounting Standards, though not mandatory, may be adopted for reasons mentioned hereunder.

AS Number & Title	Reasons for Adoption
AS 3 – Cash Flow Statements	To analyse the movement of financial resources.
AS 17 – Segmental Reporting	In cases where the NGO carries out diverse service functions (business segment) or operates in different geographical limits (geographical segment).
AS 18 – Related Party Disclosure	For instance, when an NGO floats a business arm (as referred to in paragraph 1.03 above) partnering with a corporate entity that has direct/indirect influence on the functioning of the NGO.
AS 23 – Accounting for Investments	Relevant when an NGO promotes an independent business arm or supports another NGO.
AS 27 – Financial reporting of Interests in Joint Ventures	Here again reference is made to an independent commercial venture of an NGO, as referred to above, which is floated collaborating with a corporate entity or another NGO.

- Trust deed or instrument evidencing formation of the charitable institution – both in original and one copy or
  - If trust or charitable institution is not created under an instrument, the document evidencing the creation of such trust/charitable institution
  - Photocopy of the latest certificate issued under Section 80G, in case of renewal.
  - True copies of assessment orders of the 3 preceding years.
- If there is a delay in seeking registration, the Commissioner may condone the delay if he is satisfied that there were sufficient reasons for the delay in making the application for registration. Else, the necessary tax exemptions would be applicable from the first day of the financial year in which the application is made.
- Tax Benefits to NGOs: An NGO shall apply to the Income Tax authorities in such a manner as may be prescribed to avail tax exemption in respect of its income.
- Form 56, as referred to above shall be accompanied by the following documents:
- Copy of the trust deed/bye laws/Memorandum & Articles of Association.
  - List of major office bearers together with settler/members of the governing body.
  - Photocopy of the latest certificate issued under Section 80G, in case of renewal.
  - True copies of assessment orders of 3 preceding years.
  - Photocopy of communication received from the Commissioner with reference to application made by it for registration under Section 12A.
- An NGO may claim exemption of income from a property held in trust as per Section 11 of the Income Tax Act, 1956, subject to following conditions:
- That the NGO complies with Sections 11(1) and 11(1B) regarding application of income.
- Form 56D, as referred to above shall be accompanied by the following documents:
- Copy of the trust deed/bye laws/Memorandum & Articles of Association.
  - List of major office bearers together with settler/members of the governing body.
  - Photocopy of the latest certificate issued under Section 80G, in case of renewal.
  - True copies of assessment orders of 3 preceding years.
  - Photocopy of communication received from the Commissioner with reference to application made by it for registration under Section 12A.

Section Reference	NGO Description	Relevant Income Tax Rule	Form No.	Other Aspects
10(21)	Scientific research association approved under Section 35(1)(ii)	Please refer under paragraph 3.04		
10(23C)(iiiab)	Educational institutions	-	-	
10(23C)(iiiac)	Medical institutions	-	-	These are wholly or substantially financed by Government.
10(23C)(iiid)	Educational institutions	2BC		Applicable where the annual receipts of such institution is Rupees One Crore.
10(23C)(iiiae)	Medical institutions	2BC		
10(23C)(iv)	Fund/Institution established for charitable purposes	2C	56	Application to be made to Director General (Income tax, Exemptions) through the Commissioner of Income Tax.
10(23C)(v)	Trust/Institution established for public religious/charitable purposes	2C	56	
10(23C)(vi)	Educational institutions (other than those covered under Section 10(23C) (iiib) & (iiid))	2CA	56D	Application to be made to Chief Commissioner or Director General through the Commissioner of Income Tax or Director of Income Tax
10(23C) (via)	Medical institutions (other than those covered under Section 10(23C) (iiic) & (iiie))	2CA	56D	

- That in the event of accumulation of income it shall be in accordance with Sections 11(2), 11(3), and 11(3A), and mode of investment of such accumulated income shall be as per Section 11(5).

Section 13 of the Income Tax Act, 1961 lays down circumstances under which exemptions, under Section 11 or Section 12, would not be made available to an NGO. For instance, where property is held under trust for private religious purposes, the NGO is created for a particular religious community, etc.

**Tax Benefits to Donors:** The donors shall be eligible for deductions in respect of payments to NGOs provided the NGOs have made applications to the necessary authorities and obtained express sanction that donations/ payments to such NGO are eligible for tax deduction.

An NGO having Sections 35(1) (ii) & 35 (1) (iii) exemptions shall:

- Maintain separate accounts for sums received and expended for scientific research.
- Submit to the Central Government every

year audited accounts together with Balance Sheet and Income & Expenditure accounts.

- Have the auditor of the NGO specifically certify that the amount has been expended for scientific purposes.

Reference may be made to Rule 11L, which has mentioned the documents to be attached to the application seeking approval of schemes under Section 35AC. An NGO that has been approved under Section 35AC shall furnish certificates in Form 58A or 58B as applicable for expenditure by way of payment in respect of eligible projects or schemes.

Form 10G for seeking Section 80G exemption for donors shall be made by the NGO in triplicate accompanied by;

- Copy of registration granted under Section 12A or copy of notification issued under Section 10(23) or Section 10(23C).
- Notes on the activities of the NGO since its inception.
- Copies of the accounts of the NGO since its inception or during the last three years, whichever is less.

Section Reference	Expenditure Description	Relevant Income Tax Rule	Form No.	Other Aspects
35(1)(ii) & (iii)	Scientific research	6(2)	3CF	Application to be made to Commissioner of Income Tax. The donor gets 125% of the amount paid as deduction.
35AC	On eligible projects or schemes	11(F) to 11(O)		Application to be made to the Secretary to the National Committee for promotion of Social and Economic Welfare, New Delhi.
80G(2)(a)(iv)	Donations to certain funds, charitable institutions, etc	11AA	10G	Application to be made to the Commissioner of Income Tax. The donor gets a maximum of 50% of the amount paid as deduction.

**Accounts and Audit:** The Income Tax Act requires the accounts of the NGO to be audited. In cases where the total income of the NGO before giving effect to Section 11 and Section 12 is audited, the auditor issues a report as prescribed under Rule 17B. The audit report shall be in Form 10B.

**Income Tax Deduction:** Where the NGO avails tax exemption under Section 11 or under Section 12 on its income, it shall obtain a certificate of non-deduction of tax from the assessing officer. The terms and conditions to be adhered to for seeking the certificate of non-deduction of tax are set out in Rule 28AB.

**Income Tax Filing:** The NGO shall file its Income Tax return in Form 3A and shall be in accordance with Section 139(4). It shall be filed on or before the due dates mentioned under Section 139(1).

Documents to accompany return of income;

- Balance Sheet
- Income and Expenditure Account
- Audit report in Form 10B
- Copy of the registration certificate
- Form 10 in where the NGO seeks to accumulate the income (under Section 11(2))

Before closing let us recall what Mahatma Gandhi said: "It is my settled conviction that no deserving institution ever dies for want of support. Institutions that have died have done so either because there was nothing in them to commend them to the public or because those in control lost faith or which perhaps the same thing, lost stamina" [Young India 15-10-1925]. Mahatma's statement is relevant even today. An NGO to be successful must be sincere in its endeavour, scrupulous in legal compliance, transparent in dealings and true in reporting.

