

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Technical Guide on Internal Audit of Not-For-Profit Organisations (NPOs)

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The views expressed in this Technical Guide are those of author(s). The Institute of Chartered Accountants of India may not necessarily subscribe to the views expressed by the author(s).



Internal Audit Standards Board
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

A strong, vibrant and innovative Not-for-Profit sector is essential to achieve a productive and inclusive nation. The Not-for-Profit sector plays a central role in enriching people through its charitable, social, cultural, educational and environmental contribution and in providing support to weaker section of the society. They are sometimes referred to as the “third sector”, the first sector being the “government” and the second sector being the “market” or private business. It is difficult to define their characteristics as these organisations are extremely varied.

Financial accountability, transparency and good governance are the need of the hour in the NPO sector. There are nearly more than three million Non-Profit Organizations (NPOs) in the country and this sector offers challenging and rewarding opportunities to Chartered Accountants in particular. They can play an important role in increasing the standards of resource mobilization, accountability and transparency in Not-for-Profit Sector.

I am happy to note that the Internal Audit Standards Board and the Committee for Co-Operatives and NPO Sectors are jointly issuing this Technical Guide on Internal Audit of Not-for-Profit Organizations for guidance of members in this crucial area. I congratulate CA. Rajkumar S. Adukia, Chairman, Internal Audit Standards Board and CA. Vijay K. Garg, Chairman, Committee for Co-Operatives and NPO Sectors and members of both the Boards on issuance of this Technical Guide. This Technical Guide comprehensively deals with the peculiar aspects of NPO sector, including various regulatory aspects and provides a step-wise approach for internal audit.

I am sure that this Technical Guide will assist the members and others in efficiently discharging their responsibilities.

March 24, 2012
New Delhi

CA. Jaydeep Narendra Shah
President, ICAI

Preface

India witnessed a rapid increase in and diversification of the NPO sector as a response to the national political scenario and increasing concern about poverty and marginalization. It has been noted that as the financial and human resources employed in this sector grow year after year, the need for proper financial planning, financial management and financial accountability is also increasing.

More efficient utilization of public resources through effective implementation of programs, minimization, if not eradication, of corruption, sensitivity to the needs of poor, providing timely information to citizens are the demands of NPO Sector. Transparency is institutionalised by recording, maintaining and providing access to relevant and timely information regarding the organization. Thus, the potential for improving the management of the sector is significant. Also NPOs have begun to view Chartered Accountants as pathfinders rather than faultfinders. The NPO sector offers challenging and rewarding opportunities for CAs in the sector.

With a view to providing appropriate guidance to the members of the Institute on the internal audit of NPOs, the Internal Audit Standards Board jointly with the Committee for Co-Operatives and NPO Sectors has issued this Technical Guide on Internal Audit of Not-for-Profit Organisations. This Technical Guide is divided into six chapters. Chapter I is introductory in nature. It also describes the history and characteristics of NPOs. Chapter II discusses about the legal framework applicable to the sector alongwith the brief description of different types of NPOs. Chapter III deals with the key concepts related to the non-profit sector including the description of accounting of fund and expenses. Chapter IV deals with the accounting and internal audit standards for NPOs. Chapter V explains the internal audit of NPOs including the concepts and objective of the internal audit. It also explains the need of internal audit of NPO sector and internal audit approach. Chapter VI deals with the audit of specific accounts balances followed with the illustrative checklist for the internal auditor reference.

At this juncture, we are grateful to CA. Meenakshi Gupta and her study group member *viz.*, CA Debaditya Gupta and also CA. Brijesh R. Shah for sharing their experience and knowledge with us and preparing the draft of this Technical Guide.

We also wish to thank CA. Jaydeep N. Shah, ICAI, President and CA. Subodh Kumar Agrawal, Vice President, ICAI, for their continuous support and encouragement to the initiatives of the Board. We must also thank our colleagues from the Council at the Internal Audit Standards Board, *viz.*, CA. Rajendra Kumar P., Vice-chairman, IASB, CA. Amarjit Chopra, CA. Shiwaji B. Zaware, CA. Ravi Holani, CA. Anuj Goyal, CA. Nilesh Vikamsey, CA. Atul C. Bheda, CA. Charanjot Singh Nanda, CA. Pankaj Tyagee, CA. G. Ramaswamy, CA. J. Venkateswarlu, CA. Abhijit Bandyopadhyay, CA. S. Santhanakrishnan, Shri Prithvi Haldea, Smt. Usha Narayanan, Smt. Usha Sankar, Shri Manoj Kumar and Shri Sidharth Birla and the colleagues from the Council at the Committee for Co-Operatives and NPO Sectors, *viz.*, CA. V. Murali, CA. Bhavna G. Doshi, CA. Charanjot Singh Nanda, CA. Jayant P. Gokhale, CA. Madhukar N. Hiregange, CA. Pankaj I. Jain, CA. Pankaj Tyagee, CA. Ravi Holani, CA. Sanjay K. Agarwal, Shri Anil K. Agarwal, Shri Ashutosh Dikshit and Shri Deepak Narain for their vision and support.

We are sure that the readers, especially members of the institute, working as internal auditors in NPO sector would find this technical guide immensely useful.

March 23, 2012
Mumbai

CA. Rajkumar S. Adukia
Chairman
Internal Audit Standards Board

March 23, 2012
Jaipur

CA. Vijay K. Garg
Chairman
Committee for Co-Operatives
and NPO Sectors

Contents

<i>Foreword</i>	<i>iii</i>
<i>Preface</i>	<i>v</i>
Chapter 1: Introduction	1-5
Characteristics	2
Definition.....	3
Objective and Scope of the Technical Guide	3
Chapter 2: Legal Framework	6-47
Types of Not-for-Profit Organisations	6
Registered Trust	6
Registered Societies	7
Section 25 Company of the Companies Act, 1956.....	8
Religious Endowments and Waqf, Gurudwara, etc.	11
Unregistered Trusts/ Societies/ NGO	11
Legal Framework	12
The Indian Trusts Act, 1882	13
Societies Registration Act, 1860	16
Religious and Charitable Endowments	18
Wakf	20
The Sikh Gurdwaras Act, 1925.....	23
Section 25 of the Companies Act, 1956.....	24
Non-Trading Corporations	25
National Policy on the Voluntary Sector, 2007.....	25
Scope of the Policy	25
Objectives of the Policy.....	26
Establishing an Enabling Environment for the Voluntary Sector	26
Partnership in Development	26
Strengthening the Voluntary Sector.....	27
Grants-in-aid from the Government of India	27
Government Schemes.....	27
Taxation	28
Charitable Purpose	28

Income	29
Business Income	30
Application of Income	30
Capital Gains	31
Anonymous Donations	31
Tax Deduction for Donors	32
Deductions under 80G	32
Deductions for Projects, Schemes, etc.	34
Foreign Contribution (Regulation) Act (FCRA), 2010	35
History of Foreign Contribution (Regulation) Act (FCRA), 1976	35
Object of Foreign Contribution (Regulation) Act (FCRA), 1976	35
History of Foreign Contribution (Regulation) Act (FCRA), 2010	36
Expanded Scope of FCRA, 2010.....	36
Provisions under FCRA, 2010	36
Definitions under FCRA, 2010.....	44
Role of Chartered Accountants	46
Chapter 3: Key Concepts.....	48-64
Revenue	48
Public Support	48
Revenue from Commercial Activities.....	49
Other Revenue.....	49
Budgeting	50
Management of Contributions	52
Creation of Corpus.....	53
Management of Endowment Funds	53
Endowment Income	55
Endowment Principal	55
Accounting Practices.....	56
Fund Accounting.....	56
Restrictions on Funds	58
Classification of Expenses	61
In-Kind Contributions	63
Accounting for In-kind Contributions.....	64

Chapter 4: Accounting Standards and Standards on Internal Audit Relevant to NPOs	65-71
Key Aspects	65
Standards on Internal Audit (SIAs)	65
Accounting Standards	66
Report to Stakeholders	69
Assessment	70
Types of Reports	71
 Chapter 5: Internal Audit - Concept and Objectives	 72-84
Need for Internal Audit in NPO	72
Methodology for Internal Audit	73
Terms of Internal Audit Engagement	73
Engagement Letter	74
Planning an Internal Audit	76
Knowledge of the Business	77
Audit Planning, Materiality and Sampling	79
Risk Assessment	80
Understanding and Evaluation of Internal Control	82
 Chapter 6: Major Areas of Internal Audit Significance.....	 85-98
Receipts.....	86
Donation or Exchange.....	87
Internal Control over Donations.....	87
Cash Receipts	88
Cheque Received and Issued	88
Internal Audit of Donations	89
Internal Audit of Funds	92
Utilisation of Endowment Funds.....	92
Restricted Funds.....	92
Donated Property, Plant and Equipment	93
Internal Audit of Small or Used Items	94
Donated Services.....	94
Grant Management	95

Chapter 7: Illustrative Internal Audit Checklist	99-116
Knowledge of Business	99
Budgeting	101
Internal Control	103
Finance.....	106
Donation and Grants Received	108
In Kind Contribution	109
Compliances – FCRA, 2010	110
Appendices.....	117-159
Appendix 1: Laws for Societies, Trusts, Wakfs and other Endowments.....	117-129
Appendix 2: Comparative Analysis between Various State Legislations on Societies.....	130-140
Appendix 3: Various Schemes as Sponsored by Various Central Government Ministries	141-146
Appendix 4: Frequently Asked Questions (FAQs) Related to FCRA, 2010	147-159
References	160-161

Chapter 1

Introduction

1.1 Philanthropy has been an important part of life in India since ancient times. The word is derived from the Greek term Philanthropos, which means the "love of humanity". Philanthropy broadly encompasses any altruistic activity intended to serve others, or the act of donating money, goods and services to support a socially beneficial or humanitarian cause, with no financial or material reward to the donor. Charity is a similar concept, except it is usually linked to religion... While Hindus believe in daana (giving) and Buddhists have bhiksha (giving to a monk), Islam directs its followers to give in the form of sadaqah (voluntary charity), and zakat (obligatory charity). Charity focuses on providing a solution to the immediate need of an individual or a group, whereas philanthropy attempts to deal with the root cause of the problem to prevent them from happening. For example, providing food to a hungry person would be charity but providing education so that the person can find a job and fend for himself is philanthropy. In recent times the focus has shifted from charity to philanthropy, with the ancient tradition of donating to temples and to needy and destitute giving way to contributing for social causes like women's empowerment, promotion of education, social welfare, etc.

1.2 There has been corporate involvement too in the philanthropic movement. Jamshedji Tata launched the J N Tata Endowment Scheme in 1892, long before the first major foundation was formed in the US. His biggest contribution was the establishment of the Indian Institute of Science. Similarly, Ardeshir Godrej's gave a generous donation to the Tilak Fund for the upliftment of Harijans .The Tatas and the Murugappas pioneered charitable contributions to hospitals and schools. Now, companies are entering into newer areas like environmental conservation and preservation of history and art and have institutionalised their philanthropic activities in the form of family foundations. While the Azim Premji Foundation and the Infosys Foundation support education initiatives, industrial houses such as Bajaj, Birla, Reddy laboratories etc., have foundations which support an array of development initiatives. Various socio religious institutions like Satya Sai Sewa Trust, the Chinmaya and the Ramakrishna Missions have increased their scope to include developmental activities, like, rural development, healthcare, etc.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

1.3 Elsewhere, the concept of Non-Government Organisation gained impetus after the formation of United Nations. The UN introduced the term "NGO" to distinguish between the participation of international private organizations and intergovernmental specialized agencies. The UN defined them as organizations that do not form part of the government and are not conventional for-profit business. "NGOs" cannot seek to diminish a nation's government in the shape of an opposing political party; NGOs also need to be non-criminal and non-profit. They operate independently outside the realm of government by excluding government representatives from membership in the organization though financially they depend on government and private business.

1.4 There is a growing movement within the sector to define itself in a more constructive, accurate way as the term NGO focuses not on the organization's purpose but what it is not. The terms "Social Benefit Organization" (SBO), "Civil Society Organization" (CSO) and Not-for-Profit Organizations) are being used by a growing number of organizations. In this Technical Guide we will use the term Not-for-Profit Organization as the term is widely understood and is also being used all over the world by professional accounting bodies.

Characteristics

1.5 Not-for-Profit Organisations (NPOs) form a significant segment of the economy due to their sheer numbers and the extent and nature of their activities. They are sometimes referred to as the third sector", the first sector being the "government" and the second sector being the "market" or private business. It is difficult to define their characteristics as these organisations are extremely varied. Their range of activities include health, economic and social assistance, education, promotion or defence of various causes etc., The services are not limited to merely charitable causes and include training, recreational services, artistic or cultural endeavours(museums, theatres), professional associations, farmers' networks, academic centres, labour unions etc. Many of these activities are not exclusive to NPOs and there are for-profit organisations doing the same for a fee. For instance, Profit oriented sports clubs, theatres also exist.

1.6 They cannot be categorised through size or legal structure. Though the majority of them are small and have a limited budget, there are NPOs with national and even international reach. In India, there is Child Rights and You (CRY) and Helpage which are national level entities. Some of the well known international names are Amnesty International, Rotary International,

Carnegie Corporation of New York, the Red Cross and Red Crescent Organizations, United Nations Educational Scientific and Cultural Organisation (UNESCO) and World Wide Fund for Nature. There are various legal forms prevalent in the sector.

1.7 Many NPOs need to have their financial statements audited under statutory or donor requirements. The Income tax Act requires filing of annual returns and audit report for certain NPOs. Some of the state legislations relating to trusts and charitable institutions provide for compulsory audit even where the income is below the maximum amount which is not chargeable to income tax. Such ceiling limits are dependent in terms of the statutory provisions of the relevant State Acts. Many donors demand annual accounts and audit report when applying for grant. Some donors give consideration to the fact that the not-for-profit organizations may not have audited financial statements but may require a yearly audit after the funds are transferred.

It has to be kept in mind that the above characteristics may not be applicable to all NPOs. Depending on the size, nature and objectives, some features may be significant for one and non-existent for another.

Definition

1.8 The World Bank defines NPOs as *“Private organisations that pursue activities to relieve suffering, promote the interests of the poor, protect the environment, provide basic social services, or undertake community development”*.

1.9 The Canadian Institute of Chartered Accountants (CICA) handbook defines them as: *“Non Profit organisations are organisations in which there is normally no transferable ownership interest and from which the members or contributors do not receive any direct economic gain and that are formed, for example, for social, educational, religious, health or philanthropic purposes.”*

Objective and Scope of the Technical Guide

1.10 This Technical Guide is intended to assist internal auditors in carrying out internal audit of not-for-profit organisations. It is aimed to provide an insight into the functioning of the not for profit organisations, its concepts and its peculiar characteristics. As the size, legal structure, functioning, nature of activities may vary widely from one NPO to another; the Technical Guide cannot cover all the aspects of functioning of entities within such a wide spectrum. Therefore, the various aspects and principles enunciated in this

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Technical Guide should be applied mutatis mutandis, exercising professional judgement.

This Guide is not intended to dwell on the basic internal audit procedures, which are common to all types of organisations. It purports to provide insight into the special aspects of the not-for-profit sector.

The Guide also discusses special areas of compliance applicable to this sector that call for internal auditor's scrutiny.

1.11 The management in concurrence with the internal auditor has to take into consideration- the various pronouncements of ICAI and the regulatory requirements, assessment of control environment and business domain knowledge to decide the scope of the internal audit. The scope and criteria of internal audit would be determined by the following:

- (i) entity's policies
- (ii) entity's systems
- (iii) entity's procedures
- (iv) entity's processes
- (v) entity's products
- (vi) entity's standards
- (vii) entity's laws and regulations
- (viii) entity's systems
- (ix) entity's specification
- (x) entity's contract requirements

This Technical Guide deals with the operational areas of entities operating in this sector with emphasis on compliance of various regulations as applicable to such entities.

1.12 The following organisations are not included under NPO in this Guide:

- (i) Public sector organisations formed under central or state governments (municipalities, corporations and other government owned corporations)
- (ii) Organisations formed under special acts of Parliament.
- (iii) Private or public hospitals and other public health organisations
- (iv) Political parties

- (v) Unions
- (vi) Pension funds

1.13 Some examples of NPOs that fall into the scope of this Technical Guide are as follow:

- (i) Charitable organisations
- (ii) Foundations
- (iii) Endowment Funds
- (iv) Religious organisations
- (v) Chambers of commerce
- (vi) Professional bodies and associations
- (vii) Artistic and cultural organisations
- (viii) Museums and art galleries

Chapter 2

Legal Framework

2.1 There are innumerable NPOs in India, engaged in wide varieties of activities. India has possibly the largest number of active non-government, not-for-profit organizations in the world. In spite of this, there is no national regulatory body or framework governing the sector. NPOs are governed under the statute or state law under which they are formed.

2.2 The Constitution of India guarantees the right of all citizens to form associations or unions is under Article 19(1)(c). Also, Article 30(1) in the Constitution gives all minorities, whether based on religion or language the right to establish and administer educational institutions of their choice. Thus, non-profit/voluntary organisation can be set up without any kind of registration or recognition under any of the entries mentioned above. In fact, some of the community based organisations like village committees, small religious groups and many welfare Associations function in this manner. However, to claim exemptions under the Income Tax Act, 1961 and for availing of other benefits from the Government, there is insistence on formal registration.

Types of Not-for-Profit Organisations

2.3 A not-for –profit organisation can be set up either as:

- (i) Registered Trust
- (ii) Registered Societies
- (iii) Non-trading Corporations
- (iv) Section 25 Company of the Companies Act, 1956
- (v) Religious Endowment and Waqf, Gurudwara, etc.
- (vi) Government Acquired Trusts
- (vii) Unregistered Trusts/ Societies/ NGO

Registered Trust

Trusts are usually set up when someone wishes to set apart either property or money for a specific purpose, usually a charitable cause and wants to limit control over the distribution and administration to selected persons only. These persons are known as trustees. Trusts can be public or private. Public charitable

trusts are governed by the Public Trust Act, if any (e.g. Maharashtra, Gujarat, Rajasthan, and Madhya Pradesh) applicable in the relevant State. In the absence of such an act in any particular state or territory the general principles of the Indian Trusts Act 1882 are applied. A public trust can be set up by registration of the trust deed with the registrar. Public charitable trusts, as distinguished from private trusts, are designed to benefit members of an uncertain and fluctuating class. To determine whether a trust is public or private, the key question is whether the class to be benefited constitutes a substantial segment of the public.

Registered Societies

A registered society is viewed as an independent juridical 'person'. It is different from the people who form it. Property which is vested in the members of an unregistered society becomes "property belonging to the society" after registration, and there is no transfer of ownership.

Features of Society v. Trust

Features	Society	Trust
Objects	Charitable, Literary, Scientific, etc.	Non-profit activities
Formation	Procedure is simple and easy	Procedure is complicated
Name	Selection of name is not difficult	Name approval by Registrar of Companies
Management	Easy and simple and not much restrictions imposed under the Act	Provisions of the Companies Act have to be complied with and are complex, rigid and time consuming
Meetings	Annual Meeting of society to be held as per provisions in the Act. Meetings of the Governing body are held as prescribed in the Rules of the Society	All the meetings are to be held as per provisions of the Companies Act, 1956

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Penalties	Very few offences and penalties have been prescribed	Provisions under the Companies Act are more stringent and attract penalties
Reputation	Registered societies enjoy same reputation as companies	Same
Legal Entity	Registered Society is a legal entity with certain limitations	Is a legal entity.

Section 25 Company of the Companies Act, 1956

The Companies Act, 1956, which principally governs for-profit entities, permits certain companies to obtain not-for-profit status as "section 25 companies." Such a company can be formed with the objective of "promoting commerce, art, science, religion, charity or any other useful object" provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members. It requires at least three individuals to form a section 25 company. The founders or promoters of have to submit application to the Regional Director of the Company Law Board along with copies of the memorandum and articles of association of the proposed company, as well as a number of other documents, including a statement of assets and a brief description of the work proposed to be done upon registration.

A Section 25 company is governed by directors or a managing committee or a governing council elected by its members.

Comparative Analysis of Society, Trust and Non-Profit Company

Particulars	Company	Society	Trust
Statute/ Legislation	Companies Act, 1956	Societies Registration Act, 1860	(Bombay) Public Trusts Act, 1950
Jurisdiction	Registrar of Companies (or charity commissioner as in Maharashtra)	Registrar of Societies	Charity Commissioner
Objects	Non-profit Activities	Charitable, Literary,	Charitable, Socially

Legal Framework

		Scientific, etc.	Beneficial
Main Document	Trust deed	Memorandum of Association and Articles, Rules and Regulations (bye-laws)	Memorandum and Articles of Association
Alteration of Objects	Complex legal procedure	Simple procedure	Bound by covenants of Trust Deed; Normally only Settlor can modify and is almost always impossible to modify if settlor is deceased
Formation	Complex Procedures; Three to six months required	Simple and easy	Simple and easy
Number of Members Required	Minimum seven and no upper limit	Minimum seven and no upper limit	Minimum two and no statutory limit
Registration	As a company under section 25 of the Companies Act	Both as a society and a trust in some States, e.g., Maharashtra	As trust
Stamp Duty	No stamp paper required for Memorandum of Association and Articles	No stamp paper required for Memorandum of Association and Rules and Regulations	Trust required to be executed on non-judicial stamp paper (Valued at 4% of the trust property)
Name	Prior approval required from the Registrar of Companies in the relevant State/U.T.	Comparatively simple	Comparatively simple

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Board of Management	Board of Directors/ Managing Committee	Governing Body	Trustees
Management	Formalities of company law in terms of the Companies Act, 1956 to be observed	Few restrictions imposed under the Act	Very few restrictions imposed under the Act
Mode of Succession in the Management	Usually by election by members	Usually by election by members	By appointment
Meetings	To be held as per provisions of company law which are quite extensive	Annual Meeting according to provisions of law. Governing body meetings as prescribed in Rules of the Society	No provisions laid down
Penalties	Various offences and corresponding penalties for violations have been provided	Few offences and penalties have been prescribed	Very Negligible
Legal Status	Full legal status	Legal status with certain limitations	Legal status with certain limitations
Statutory Regulation	Exhaustive but mature	Very limited	Nominal
Transfer of Membership	Totally free or controlled, as desired	Not possible	Not applicable
Admission of New Members	Controlled by general body or Board through issue of capital	Controlled by Governing Body	Not applicable
Removal of Members	Not possible without consent	Possible without consent	Not applicable
Dissolution of	Very difficult	Possible	Possible

take-over by State			
Payment to Members	As approved by deed company and State	Not restricted	As specified in Trust

Religious Endowments and Waqf, Gurudwara, etc.

Religious Endowments and Waqfs are variants of Trusts which are formed for specific religious purposes e.g. for providing support functions relating to the deity, charity and religion amongst Hindus and Muslims respectively. Unlike Public Trusts, they may not necessarily originate from formal registration, nor do they specifically emphasise on a triangular relationship among the donor, Trustee and the beneficiary. Religious endowments arise from dedication of property for religious purposes. The corresponding action among the Muslim community leads to the creation of Waqfs. Waqfs tie up the property and devote the usufruct to people.

Waqfs in India

The concept of Waqf is rooted to the Quranic injunctions, which deal with charity. It gained prominence under Muslim rule when the rulers generously dedicated property such as land and its revenue rights to Waqf created with the purpose of maintaining mosques, tombs, orphanages (yatimkhanas), madrasas, etc.

Waqf implies the endowment of property, moveable or immovable, tangible or intangible to God by a Muslim, under the premise that the transfer will benefit the needy.

Unregistered Trusts/ Societies/ NGO

As mentioned earlier, in India, there is a plethora of acts under which any group desirous of commencing a not-for-profit, voluntary or charitable work can organize themselves into a legal body depending on the type of activity, purpose, beneficiaries, etc. They can register themselves under the applicable Act (or a combination of Acts). However, for most entities, these provisions are not mandatory and therefore, there exists a vast group of voluntary bodies which have not registered themselves under any of the available provisions.

An unregistered association is not recognised as an independent juridical person under law. Failure to register the associations gives it no legal face and only the trustees in charge of the fund have a legal status.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Although registration is not compulsory, unregistered not for profit organisations miss out on important advantages of incorporation. Some of them are:

- (i) the organisation acquires legal status to sue and/or be sued as a separate and distinct “person”
- (ii) Incorporation bestows legal rights to the members to hold property in a common name. It also enables the not-for-profit organization to open bank account(s) against its registered identity.
- (iii) Any property held by the organisation can pass from one generation of managers to another without having to pay any transfer fees or taxes and without any cumbersome documentation.
- (iv) Only incorporated organizations can get benefits of tax-exemptions, and other benefits.
- (v) Registration under the Foreign Contribution Regulation Act (FCRA), 1976 is more easily granted if the not-for-profit organization is incorporated.*

Legal Framework

2.4 Trusts, Endowments and Waqfs are legally created as modes of property arrangement/ settlement dedicated for definite charitable and religious purposes. The law concerning Societies, Trusts, Waqfs and other religious and charitable endowments in India can be placed in three broad groupings.*

- (i) Societies registered under the Societies Registration Act, 1860, States amendments on it after 1947 and various State Registration Acts;
- (ii) Those engaged in pure religious and charitable work registered under the Religious Endowments Act, 1863; the Charitable and Religious Trusts Act, 1920; the Waqf Act, 1995 and similar other State Acts;
- (iii) Trusts and charitable institutions registered under the Indian Trusts Act, 1882; Charitable Endowments Act, 1890; the Bombay Public Trusts Act, 1950; and similar other State Acts.

2.5 The mode of incorporation, organisational structure and distribution of functions and powers are governed by the provisions of the specific law under

* <http://www.pria.org/publication/Legal%20Framework%20for%20Non-profit%20Institutions%20in%20India%20%20Working%20Paper%202.pdf>
* www.arc.gov.in/9threport/ARC_9thReport_Ch3.pdf

which they are registered. Broadly, such organisations can assume a legal personality in the following five ways:

- (i) By way of formal registration before the Charity Commissioner / Inspector General of Registration under the respective State Public Trusts Act e.g., the Bombay Public Trusts Act, 1950.;
- (ii) By invoking interference of civil courts to lay down schemes for governing a Trust under Sections 92 and 93 of the Civil Procedure Code;
- (iii) By registering the Trust deed of a Public Charitable Trust under the Registration Act, 1908;
- (iv) By notifying an organisation in the list of Charitable Trusts and Religious Endowments which are supervised by the Endowments Commissioner of the State or by a Managing Committee formed under the Charitable Endowments Act, 1890 or under other State laws on Hindu Religious and Charitable Endowments; and
- (v) By creating a Waqf to be managed under the provisions of the Waqf Act, 1995.

The main features of these enactments are indicated in the **Appendix 1**.

2.6 In addition to meeting the requirements of legislation mentioned above, the not-for-profit organizations are also required to follow the provisions of law as applicable to their functional areas. For example, a NPO whose working affects the natural resources or environment needs to take into account the provisions of Water (Prevention and Control of Pollution) Act, 1974, the Air (Prevention and Control of Pollution) Act, 1981 and the Forest (Conservation) Act, 1980, etc.

The Indian Trusts Act, 1882

Introduction

2.7 After the establishment of British rule in India, it was felt all over that there was no comprehensive enactment in India governing the private trusts. The very question of enacting a law relating to the trust was treated as one of the important matter which was referred to the Indian Law Commission of 1879 which reported the advisability of the Codification of the Trust Law.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

In the words of Justice Phear “*There is, probably no country in the world where fiduciary relations exhibit themselves so extensively and in such varied form as in India, and possession and dominion over property coupled with the obligation of use it wholly or partially, for the benefits other than the possessor, is, I imagine familiar to every Hindu*”. Muslims also had concept of entitlements too. But with the exceptions of certain provisions of Penal Code, Code of Civil Procedure (Sections 92 and 93 related to power of Civil Courts and Collector) and couple of other Acts, the Indian Statute book was silent on this matter. An attempt was made to define and amend the law relating to private trust and the Indian Trusts Act, 1882 came into being. It applies to private trusts other than religious or charitable endowments. Also it does not affect the rules regarding waqf or mutual relations of members of an undivided family.

The most fundamental distinction between private and public trusts depends upon the character of the person for whose benefit they are created.

The decisions in *Radhavallabh v. Damodardas*, AIR 1955 NUC (MB) 3799; (1983) 144 Tax LR (MP) 108 that the act applies to private trusts only and in *Shri Ram Krishna Mission v. Dogar Singh*, AIR 1984 All 72; *Shanti Devi v. State*, AIR 1982 Del 453 that the provisions of the Act do not apply to public (charitable or religious) trusts should be considered in the light of observations of the Hon'ble Supreme Court.

2.8 Under Schedule 7 of the Indian Constitution, the subject 'Trust and Trustees' finds mention at Entry No.10 in the Concurrent List. 'Charities & Charitable Institutions, Charitable and religious endowments and religious institutions' find place at Entry No.28 of this list.

2.9 The first legislation governing public trusts is the Bombay Public Trusts Act which was meant to deal with an express or constructive Trust for either public, religious or charitable purposes or both and included a temple, a math, a Waqf, or any other religious or charitable endowment and a Society formed either for a religious or a charitable purpose or for both and registered under the Societies Registration Act, 1860 – Section 2(13). When the Bombay province got separated into the states of Maharashtra and Gujarat, both the states adopted this act with Gujarat making some variations. Only two other states - Madhya Pradesh and Rajasthan have enacted their own Public Trusts laws, others do not have any specific act. In states which have the public trust act, it is compulsory for every public trust to register with the charity Commissioner.

2.10 List of Public Trusts Act is as follows:

- (i) Rajasthan Public Trusts Act, 1959

- (ii) The Madhya Pradesh Public Trusts Act, 1951
- (iii) Bombay Public Trusts Act, 1950
- (iv) Gujarat Public Trusts Act, 2011

Scope of the Indian Trusts Act, 1882

2.11 The scope of the Act is as follows:

- (i) Creation of Trusts - Chapter II (Sections 4 to 10)
- (ii) Duties and Liabilities of Trustees - Chapter III (Sections 11 to 30)
- (iii) Rights and Powers of Trustees - Chapter IV (Sections 31 to 45)
- (iv) Disabilities of Trustees - Chapter V (Sections 46 to 54)
- (v) Rights and Liabilities of Beneficiaries - Chapter VI (Sections 55 to 69)
- (vi) Vacation of the Office of Trustees - Chapter VII (Sections 70 to 76)
- (vii) Extinction of Trusts - Chapter VIII (Sections 77 to 79)
- (viii) Certain Obligations in the Nature of Trusts - Chapter IX (Sections 81 to 94)

The *First Chapter* of the Act states that "*Trust is an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner*".

The *Second Chapter* of the Act deals with the creation of trusts. It declares that a trust may be created for any "*lawful purpose*" and states that the purpose of a trust is lawful unless it :

- (a) forbidden by law, or
- (b) is of such a nature that, if permitted, it would defeat the provisions of any law, or
- (c) is fraudulent, or
- (d) involves or implies injury to the person or property of another, or
- (e) the Court regards it as immoral or opposed to public policy.

Chapter III deals with a trustee's duties and also liabilities arising from breach of these duties. Section 20 gives a list of securities on which a trustee can invest

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

trust funds. Section 23 declares the measure of the trustee's liability in case of a breach of trust

Chapter IV treats of the rights and powers of trustees. Section 34 of the Chapter empowers trustees to apply to a principal Civil Court of original jurisdiction for advice on any questions regarding the management and administration of the trust-property. Section 36 of the Act deals with the general authority of a trustee.

Chapter V deals with disabilities of the trustee and *Chapter VI* cover the rights and liabilities of the beneficiary. *Chapter VII* deals with vacating the office of trustee and incidentally deals with the appointment of new trustees, and declares that, on the death or discharge of one of several co-trustees, and declares that, on the death or discharge of one of several co-trustees, the trust survives and the trust-property passes to the other, unless the instrument of trust expressly declares otherwise.

Chapter VIII treats of the extinction of trusts and incidentally of their revocation. Section 77 states that *a trust is extinguished* –

- (a) when its purpose is completely fulfilled; or
- (b) when its purpose becomes unlawful; or
- (c) when the fulfillment of its purpose becomes impossible by destruction of the trust-property or otherwise; or
- (d) when the trust, being revocable, is expressly revoked.

Chapter IX specifies the cases in which an obligation arises.

Societies Registration Act, 1860

2.12 The Societies Registration Act 1860 is modeled on the English Literary and Scientific Institutions Act, 1854. It was enacted mainly to give legal standing to various organisations and groups related to politics, literature, arts and science which were coming up at that time. It was also meant to enable the colonial government to keep a watch over those entities but the Act was not intrusive, it gave full freedom to the Societies/ organisations which chose to register with the government. There was minimal State interference into affairs of such institutions, except routine matters of filing annual statements.

2.13 The Societies Registration Act, 1860 provides for formation of a Society for any literary, scientific, or charitable purpose, or for any such purpose as is described under Section 20 of the Act. In terms of Section 20, the following Societies may be registered under this Act:

Legal Framework

*“Charitable societies, the military orphan funds or societies established at the several presidencies of India, societies established for the promotion of science, literature, or the fine arts for instruction, the diffusion of useful knowledge, *[the diffusion of political education], the foundation or maintenance of libraries or reading-rooms for general use among the members or open to the public, or public museums and galleries of paintings and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.”*

2.14 After Independence the subject came under the State list of Schedule 7. Most States made a number of amendments and states like, Andhra Pradesh, Rajasthan, Tamil Nadu, West Bengal, Uttar Pradesh, Gujarat and Maharashtra made major amendments in the original Act. The amendments mainly concern the following four issues:

- (i) Purpose for which Societies can be formed.
- (ii) Regulatory powers with regard to change in memorandum of association, bye-laws, alienation of property and investment, amalgamation and dissolution of the Body.
- (iii) Powers with regard to submission of annual returns.
- (iv) Powers of the State Government with regard to enquiry and investigation, supersession, dissolution or cancellation of registration.

2.15 The Act is not applicable in States (or parts thereof), which have independent legislations framed by their legislatures. They are:

- (i) Andhra Pradesh Societies Registration Act, 2001
- (ii) Jammu & Kashmir Societies Registration Act, 1998
- (iii) Madhya Pradesh Societies Registrickaran Adhinyam, 1973; amended by M.P. Society Registrickaran (Sansodhan) Adhinyam, 1976
- (iv) Meghalaya Societies Registration Act, 1983
- (v) Karnataka Societies Registration Act, 1960
- (vi) Rajasthan Societies Registration Act, 1958; amended as Rajasthan Societies Registration Act, 1967
- (vii) Tamil Nadu Societies Registration Act, 1975

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (viii) West Bengal Societies Registration Act, 1961; as amended by West Bengal Societies Registration Act, 1964.

Kerala has an act 'Travancore-Cochin Literary, Scientific & Charitable Societies Act, 1955' which provides for the registration of literary, scientific and charitable societies in the State of Kerala excluding the Malabar Districts. The Societies Registration Act, 1860 applies to all other societies.

Comparative Analysis between various State Legislations on Societies is given as Appendix 2.

Religious and Charitable Endowments

2.16 Endowments are the dedication or entrustment of property either for a religious purpose or for a charitable purpose or both: religious and charitable purposes. It may be called a religious endowment or a charitable endowment depending upon its objects. The ultimate decision on whether or not an endowment is religious or/and charitable rests not with the settler but with the legislature and the court.

2.17 Hindu society has always been, at least apparently, a religious society. Majority of donations in India occurs in the context of religious charity. Additionally, during the British rule reformist orthodox Hindu socio-religious organisations fostered and shaped religious norms, precepts and ritual practices through charitable gifting. They also attempted to revitalize the Hindu dharma to craft citizenship, nationalism and a modern civil society.* Thus, we see innumerable religious and charitable endowments all over the country. However, in comparison to their numbers there is very meagre legal literature. This can be attributed to the trust in character of the priests who managed the institutions and the binding nature of the customs which regulated such organisations. When the British ruled over India, they passed a number of regulations. Out of them, there are three all India enactments on the subject of endowment still in force. The Religious Endowments Act, 1863; The Charitable Endowments Act, 1890; and the Charitable and Religious Trusts Act, 1920. These Acts are not comprehensive: they legislate on only a fraction of the subject.

2.18 The Religious Endowments Act, 1863 was basically a law on private endowments which placed a property under the management of Trustee/Trustees under a will for religious and charitable purposes for a

* All gifting is sacred'- The Sanatana Dharma Sabha movement, the reform of dana and civil society in late colonial India by Malavika Kasturi.

predefined set of beneficiaries. It was a type of contract between the will maker and the Trustee. The objective of the Act was to enable the Government to divest itself of the management of religious endowments. Since it was a contract between the Will maker and the Trustees, the only intervention possible was through filing of a civil suit in a court of law. Following this many Zamindars started creating endowments which generated a lot of civil disputes.

2.19 The Government then came up with a new law - The Charitable Endowments Act, 1890 to provide for vesting and administration of property held in trust for charitable purposes. This enactment led to appointment of a Government officer as a treasurer to oversee the functioning of charitable endowments and State formulated schemes for administration of property vested in the treasurer. However, the Act is of permissive nature in the sense that framing of scheme and vesting of scheme can only be done by the Government if application for that purpose.

2.20 Towards the beginning of the 20th century, many religious institutions had acquired considerable landed property and funds; often comparable to the holdings of a zamindari. It led to incidents of social tension and civil disputes.* There were constant complaints especially in the Madras Presidency, as to the inefficacy of The Religious Endowment Act, 1863 to prevent squandering and misappropriation of funds.** To deal with this situation, the government enacted a new law in the form of the 'Charitable and Religious Trusts Act, 1920' which recognised the existence of such religious bodies as entities different from Endowment Trusts formed for social and charitable purposes. It was meant to serve the twin purpose of simplifying the legal processes for obtaining information about these institutions as well as exercising control over the action of trustees. Trustees of such bodies were made accountable for disclosure of the income, values, management and application of the subject matter of the trust. Civil courts were given proactive powers with regard to management of the property but there was no direct State intervention.

However, after independence many state governments enacted their own endowment acts. The state government has the control over management of temples in the states with exceptions being made for those owned by families and private boards. Some such acts are the Madras Hindu Religious and Charitable Endowments Act, 1951; the Travancore-Cochin Hindu Religious

* www.arc.gov.in/9threport/ARC_9thReport_Ch3.pdf.

** Statement of object and reasons- The Charitable and Religious Trusts Act, 1920.

Institutions Act 1950; the Bodh Gaya Temple Act, 1949, the Andhra Pradesh Charitable and Hindu Religious Institutions and Endowments Act, 1987; and the Karnataka Hindu Religious Institutions and Charitable Endowments Act, 1997. The government appoints officials to the Board. In such a scenario, being a Hindu place of worship, in the state of Kerala, as a law and convention all temple board members as well as officials need to have sworn allegiance to Hindu faith and sworn to prime deity of each temple Board.

Wakf

2.21 "Wakf" means the permanent dedication by a person professing Islam, of any movable or immovable property for any purpose recognized by the Muslim law as pious, religious or charitable and includes:

- (i) A Wakf by user but such Wakf shall not cease to be a Wakf by reason only of the user having ceased irrespective of the period of such cesser.
- (ii) "Grants", including mushrut-ul-khidmat for any purpose recognized by the Muslim law as pious, religious or charitable.
- (iii) A wakf-alal-aulad to the extent to which the property is dedicated for any purpose recognized by Muslim law as pious, religious or charitable. and "wakif" means any person making such dedication.*

2.22 The concept of Waqf is rooted to the Quranic injunctions, which deal with charity. The followers of Islam transformed this concept of charity into an institution known as Waqf. Literally, Waqf means endowment of moveable or immovable property dedicated to God by the Muslims for the welfare of needy. The Waqif (settler) in his deed appoints Mutawalli (Manager) for the administration of the Waqf. The Waqif is has authority to either appoint himself or any Muslim as Mutawalli. During Muslim rule, the rulers generously dedicated property such as land and its revenue rights to Waqf created with the purpose of maintaining mosques, tombs, orphanages (yatimkhanas), madrasas etc. In many cases, donations to a Waqf were made with the intent of promoting the tenets of Islam. During that period, Islamic courts overseen by Qazis kept a close eye on the Mutawallis. Any mismanagement of Waqf property was considered breach of the trust reposed in them for which they were duly punished. After the collapse of Muslim Empire, the British abolished the institution of Islamic courts headed by Kazis and deprived them of their supervisory control over Waqf. The Mutawallis

* Definition of wakf- <http://mahawakf.com/>

became more powerful as they had no fear from the harsh punishment under the provision of Islamic Law. This led to large-scale corruption in the administration of Waqf and they often indulged in favouritism, corruption and mal-administration. At that time, the British colonial administration did not interfere much in the religious matters of the natives. After 1857, when the British started expanding the Common law regime in the country, they began exercising control over Awaqf mostly where there were charges of corruption. The British Government confiscated several Waqf properties like Jama Masjid and the Fatehpuri Mosque in Delhi. These were restored to the Mutawallis only after the enactment of the Charitable and Religious Endowments Act by the government in 1863. Another practice which was started by some wealthy Muslims was to endow them to Waqf- al-Alaulad (Family Waqf) with the intention of saving their properties from irresponsible progeny. This kind of Waqf was opposed by a number of Muslim clerics as well as Amir Ali, the noted advocate of Calcutta and expert of Muslim Law. In 1894, the Privy Council maintained that it was "a concealed means for the aggrandizement of family" (Wakf Administration in India by S.Khalid Rasid, Vikas Publishing House, 1978, page127), which was contrary to the concept of charity the core spirit behind Waqf. It also said that in Waqf-al-Aulad "the provision for charity is so illusory that the poor are not entitled to receive a rupee till after total extinction of a family".* This decision led to a chain of events which finally led to the enactment of the Mussalman Waqf Validating Act in 1913. Thereafter, there were slew of acts passed on this matter. They are as follows:

- (i) Mussalman Waqf Act, 1923
- (ii) Bengal Waqf Act, 1934
- (iii) The Hyderabad Endowment Regulation, 1939
- (iv) U.P. Muslim Waqf Act, 1936
- (v) Delhi Muslim Waqf Act, 1943
- (vi) Bihar Waqf Act, 1947
- (vii) Bombay Public Trusts Act, 1950
- (viii) Dargah Khwaja Saheb Act, 1955

* Wakf background- <http://www.southasiaanalysis.org/%5Cpapers12%5Cpaper1136.html>

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (ix) Central Waqf Act, 1954
- (x) Waqf Amendment Act, 1959
- (xi) U.P. Muslim Act, 1960
- (xii) Dargah Kwaja Saheb Waqf Amendment Act, 1964
- (xiii) Waqf Amendment Act, 1969
- (xiv) Waqf Amendment Act, 1984 and
- (xv) The Waqf Act, 1995

2.23 The Central Government is responsible for the implementation of the Wakf Act. The Wakf Act, 1954 had provisions for survey of Wakfs, constitution of Central Wakf Council and State Wakf Boards etc. For better management and administration of Waqfs, the Wakf Act, 1954 was amended many times. Finally a comprehensive and land mark legislation, i.e., Wakf Act, 1995 was enacted by the Government of India which became effective from 01.01.1996. In contrast to the previous Act, this Act is applicable throughout the country except for Jammu & Kashmir and Dargah Khwaja Saheb, Ajmer. Currently, 300000 Waqfs in India are being administered under various provisions of the Waqf Act, 1995. The management structure under the Act consists of a Waqf Board as an apex body in each State. Every Waqf Board is a quasi-judicial body empowered to rule over Waqf-related disputes. At the national level, there is Central Waqf Council which acts in an advisory capacity. The Council consists of Chairperson, who is the Union Minister Incharge of Wakfs and such other members not exceeding 20 in numbers appointed by Government of India as stipulated in the Act. The Council derives its income from the contribution received by it from the various State Wakf Boards @ 1% (one per cent) of the net income of the Wakfs. All administrative and other expenses of the Council are met out of from this income. The Council advises the government pertaining to working of the State Wakf Boards and proper administration of the Wakfs in the country. The main functions of the State Wakf Boards can be described briefly as follows:

- (i) Registration of Wakf Properties on due process.
- (ii) Appointment & removal of Muttawalli.
- (iii) Removal of Encroachment & illegal occupation on Wakf property.
- (iv) Assessment of income, Issuance of Demand Notices of Wakf contribution & its collection.
- (v) Preparation of Budget and scrutiny of Annual Accounts submitted by Muttawalli.

- (vi) Maintenance of Wakf Fund & Fund of Wakf Estates.
- (vii) Audit of Wakf Estates with income ₹ 10000/- and more by Govt. approved panel of Audit Firm.
- (viii) Development of Wakf properties for Housing, marketing, educational institutions and other income generating purposes.
- (ix) Management of Wakf Estates under Direct Management.
- (x) Law matters and Court cases.
- (xi) Preservation of Wakf Records like Deeds and other relevant papers.
- (xii) Distribution of Stipend to poor and meritorious students.
- (xiii) Organization of –Urs / Melas/ fair under different Estates.
- (xiv) Liaison with the Central Wakf Council, Delhi.

The Sikh Gurdwaras Act, 1925

2.24 This Act was enacted to provide for the better administration of certain Sikh Gurdwaras and for inquiries into matters and settlement of disputes connected therewith, and whereas the previous sanction of the Governor-General has been obtained to the passing of this Act. The Gurdwara Reform Movement, which led to the passing of the Sikh Gurdwaras Act in 1925, started because the Mahants were not duly recognizing the status and role of Sri Guru Granth Sahib in the Gurdwaras by placing other objects of worship alongwith. This remarkable piece of legislation is considered an achievement of Sikhs in the twentieth century. The Sikhs got not only their Gurdwaras but also the full freedom to manage them.

2.25 Scope of the Act is as follows:

- (i) Petitions to State Government Relating to Gurdwaras - Chapter II (Section 3 To 11)
- (ii) Appointment of, And Proceedings Before, A Tribunal - Chapter III (Section 12 To 37)
- (iii) Application of Provisions of Part III to Gurdwaras Found to be Sikh Gurdwaras by Courts Other Than A Tribunal Under the Provisions of The Act - Chapter IV (Section 38)
- (iv) Control of Sikh Gurdwaras - Chapter V (Section 39 To 41)

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (v) The Board - Chapter VI (Section 42 To 69)
- (vi) The Judicial Commission - Chapter VII (Section 70 To 84)
- (vii) Committees of Gurdwaras - Chapter VIII (Section 85 To 105)
- (viii) Finances - Chapter IX (Section 106 To 124)
- (ix) Powers and Duties of The Board - Chapter X (Section 125 To 132)
- (x) Powers and Duties of Committees - Chapter XI (Section 133 To 140)
- (xi) Miscellaneous - Chapter XII (Section 141 To 148A)
- (xii) Temporary and Transitional Provisions - Chapter XII-A (Section 148B To 148F)
- (xiii) Electoral Offences - Chapter XIII (Section 149 To 161)

Section 25 of the Companies Act, 1956

2.26 Section 25 of the Companies Act, 1956 provides for a mechanism through which an Association can be registered as a Company with a limited liability, if such association is formed for promoting commerce, art, science, religion or any other useful object and intends to apply its profits/income in promoting its objects. The objective of this provision is to provide corporate personality to such Associations but at the same time exempting them from some of the cumbersome legal requirements.

This Section reads as:

"25(1) Where it is proved to the satisfaction of the Central Government that an association:

Is about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object,

Intends to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members,

The Central Government may, by license, direct that the association may be registered as a company with limited liability, without addition to its name of the word "Limited" or the words "Private Limited."

An Association registered under the above provision shall enjoy all the privileges and would be subject to all the obligations of limited companies.

Non-Trading Corporations

2.27 The list of State Non-trading Corporations Act is as follows:

- (i) Andhra Pradesh Non-trading Companies Act, 1962
- (ii) Bihar (Non-trading) Act, 1959
- (iii) Kerala Non-trading Companies Act, 1961
- (iv) Madhya Pradesh Non-trading Corporations Act, 1962
- (v) Orissa (Non-trading) Companies Act, 1959
- (vi) Punjab Non-trading Companies Act, 1960
- (vii) Rajasthan Non-trading Companies Act, 1960
- (viii) Tamil Nadu Non-trading Companies Act, 1972
- (ix) West Bengal Non-trading Corporations Act, 1965

National Policy on the Voluntary Sector, 2007

2.28 This Policy is a commitment to encourage, enable and empower an independent, creative and effective voluntary sector, with diversity in form and function, so that it can contribute to the social, cultural and economic advancement of the people of India.

This policy recognizes the important role that the voluntary sector has to play in various areas and affirms the growing need for collaboration with the voluntary sector by the Government, as well as by the private sector, at the local, provincial and national levels.

Scope of the Policy

2.29 In the Policy, Voluntary Organisations (VOs) mean to include organization engaged in public service, based on ethical, cultural, social, economic, political, religious, spiritual, philanthropic or scientific & technological considerations. VOs include formal as well as informal groups, such as:

Community-based organizations (CBOs); non-governmental development organizations (NGDOs); charitable organizations; support organizations; networks or federations of such organizations; as well as professional membership associations.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

To be covered under the Policy, VOs should broadly have the following characteristics:

- (i) They are private, i.e., separate from Government
- (ii) They do not return profits generated to their owners or directors
- (iii) They are self-governing, i.e., not controlled by Government
- (iv) They are registered organizations or informal groups, with defined aims and objectives.

Objectives of the Policy

2.30 The specific objectives of the policy are as follows:

- (i) To create an enabling environment for VOs that stimulates their enterprise and effectiveness, and safeguards their autonomy;
- (ii) To enable VOs to legitimately mobilize necessary financial resources from India and abroad;
- (iii) To identify systems by which the Government may work together with VOs, on the basis of the principles of mutual trust and respect, and with shared responsibility, and
- (iv) To encourage VOs to adopt transparent and accountable systems of governance and management.

Establishing an Enabling Environment for the Voluntary Sector

2.31 The independence of VOs allows them to explore alternative paradigms of development to challenge social, economic and political forces that may work against public interest and to find new ways to combat poverty, deprivation and other social problems. It is, therefore, crucial that all laws, policies, rules and regulations relating to VOs categorically safeguard their autonomy, while simultaneously ensuring their accountability.

Partnership in Development

2.32 The voluntary sector can play an important role in the development process, particularly through community participation. It is, therefore, essential that the Government and the Voluntary Sector work together.

This Policy recognizes three instruments of partnership, *viz.*, (i) consultation, through a formal process of interaction at the Centre, State and District level; (ii) strategic collaboration to tackle complex interventions where sustained social mobilization is critical over the long-term; and (iii) project funding through standard schemes.

Strengthening the Voluntary Sector

2.33 The Indian society has a well-established tradition of philanthropy. While a regime of tax concession facilitates donations to charitable organizations, there is considerable untapped potential to channelise private wealth for public service. The Government will support and encourage existing, as well new, independent philanthropic institutions and private foundations to provide financial assistance to deserving VOs. It will also promote a dialogue among public and private grant makers so that they may take advantage of the best practices in grant making and fund-raising strategies.

This National Policy on the Voluntary Sector, 2007 is the beginning of a process to evolve a new working relationship between the Government and the Voluntary Sector, without affecting the autonomy and identity of VOs.

Grants-in-aid from the Government of India

2.34 Government of India allocates the grants-in-aid for carrying out the specific programmes as well as for block general purposes. These grants are made out to voluntary organizations who are involved in implementing these programmes. Grants-in-aid have been defined as the sum which a superior authority assigns to an inferior authority. For allocation of the financial resources, the Government of India has framed General Financial Rules for deciding the right agency. The terms and conditions governing these specific schemes are from the grants-in-aid rules mentioned in these schemes of the various ministries and departments.

It should have been engaged in social welfare/ development activities for a minimum period of 3 years prior to seeking the grant.

Government Schemes

2.35 There are various schemes sponsored by the various Central Government ministries, such as, Ministry of Social Justice and Empowerment, Ministry of Health and Family Welfare, Ministry of Human Resources Development. The applicant voluntary organizations applying for such grants in

aid should file these through the relevant State level department. The recommendations made by these departments shall be considered while sanctioning these grants. Various schemes sponsored by the various Central Government ministries are given as **Appendix 3**.

Taxation

2.36 Though there exists a plethora of methods by which NPOs capable of being registered, as far as income tax is concerned, it makes no difference whether the organisation is formed by way of trust, a company or a society. The relative benefits would depend upon the way in which these organisations would be conducting its activities. The local laws of each state will also have relevance particularly in an area of compliances and state interferences in the activities.

2.37 The provisions regarding granting of exemption to a public charitable Trust, a company registered under Section 25 of the Companies Act, 1956 or a society registered under the Societies Registration Act, 1860, or any other institution is contained in one or more of the following sections of Act:

- (i) Section 2(15);
- (ii) Section 2(24) (ia);
- (iii) Section 10
- (iv) Sections 11, 12, 12A, 12AA and 13; and
- (v) Sections 35(i)(ii) , 35(i)(iii), 35AC

Charitable Purpose [Section 2(15)]

2.38 Section 2(15) defines the expression “*charitable purpose*” in an inclusive manner to include,

- (i) relief of the poor,
- (ii) education,
- (iii) medical relief,
- (iv) preservation of environment, (including watersheds, forests and wildlife)
- (v) preservation of monuments or places or objects of artistic or historic interest, and

- (vi) any other object of general public utility.

The definition is not exhaustive and, therefore, purposes similar to the purposes mentioned in the definition will also constitute charitable purposes. The clause "any other object of general public utility" was increasingly being misused or being the subject of disputes. Finance Act, 2008 sought to limit the definition of "charitable purpose" by stating that if the "advancement of any other object of general public utility" involves undertaking any trade, commerce, or business activities, or rendering any related service for a fee or any other condition (irrespective of use, application, or retention of income arising from such activities), it will not be considered a "charitable purpose." The Finance Act 2010, retroactively effective from April 1, 2009, provided some relief by exempting the aggregate value of receipts from such activities up to ten lakh rupees that was further raised to ₹ twenty five lakhs by the Finance Act, 2011.

2.39 Section 12A states that provisions of section 11 and section 12, regarding exemption of income, will not be applicable to an institution etc., unless an application for its registration is made to the CIT within a period of one year from the date of its creation. Section 12A(b) also requires that if the total income of a trust etc. in any previous year exceeds the maximum amount not chargeable to income tax without giving effect to the provisions of section 11 and section 12, then its accounts are required to be audited by an accountant and his report in Form no. 10B has to be filed along with the return of income.

Income [Section 2(24)(ia)]

2.40 This section defines what constitutes income for certain specified non profit organisations. Under section 2(24)(ii), voluntary contributions received by the following entities are considered as income:

- (i) trust or institution created wholly or partly for religious or charitable purposes
- (ii) scientific research association as specified in section 10(21) and Section 35(1)(ii) and (iii)
- (iii) fund or trust or institution established for charitable purposes having special importance as specified under section 10(23C)(iv)
- (iv) trust or institution established for wholly for public religious or

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

charitable purposes being administered in accordance with requirements of section 10 (23C)(v)

- (v) any university or other educational institution referred to in section 10 (23C)(vi) or
- (vi) any hospital or other institution referred to in section 10 (23C)(via).

2.41 Section 12 makes some changes in the aforesaid “income”. Firstly, it excludes corpus donations from the ambit of income. Thus, voluntary contributions received with a specific direction that they shall form part of the corpus are to be excluded from the definition of the term income. It may be noted here that these contributions have to be used in accordance with the directions of the donor. And secondly, the value of any medical or educational service, by a trust etc. running an educational institution or a hospital, to a person referred to in section 13(3) of the Income Tax Act (author, founder, trustee, relative etc) will be deemed to be the income of the trust or institution. If the beneficiary has made any payment for such service, then such payment shall be deducted from the value of the service in arriving at the income.

Business Income

2.42 With respect to trust or institutions created or established wholly for religious or charitable purposes, income from a business that it operates that is incidental to the attainment of the objects of the organization, is exempt from income tax, provided the entity maintains separate books and accounts with respect to the business.

Application of Income

2.43 Section 11 deals with income from property held for charitable or religious purposes. It specifies the conditions on satisfaction of which the entity gets tax exemptions.

- (i) The organization must spend 85% of its income in any financial year on the objects of the organization. The organization has until 12 months following the end of the financial year to comply with this requirement.
- (ii) Surplus income may be accumulated for specific projects for a period ranging from 1 to 5 years.
- (iii) The organization's income must be applied or accumulated in India. If for any reason income received falls short of 85% the entity has to

apply in writing to get exemption and the funds have to be deposited as specified in section 11(5);

- (iv) If due to circumstances beyond the control of the entity, the accumulated income cannot be applied for the purpose it was set up, the entity has to apply to the Assessing Officer and if permission is granted and other conditions set in the Act are met, entity can apply the income for other charitable or religious purposes which are similar to its objects.
- (v) If the organisation is dissolved, then Assessing officer may allow the income to be transferred to a trust or institution specified under section 11(3)(d).

Capital Gains

2.44 Treatment of capital gains is specified in Section 11(1A). Where the whole of the property is used for charitable and religious purposes and the whole of the net consideration (Consideration minus the expenditure incurred in connection with transfer) is applied towards acquiring a new capital asset, then, the capital gains is taken to have been applied for charitable or religious purpose. However, if only a part of the net consideration is applied for acquiring a new capital asset, then, the capital gains to the extent of differences between amount so applied and original cost of the asset is taken to be applied for religious or charitable purpose. The provision applies *mutatis-mutandis* where the capital asset is held partly for religious or charitable purpose.

Anonymous Donations

2.45 The organization must keep a basic record (name, address and other prescribed particulars) of voluntary contribution received. According to section 115BBC, introduced with the Finance Act, 2006, all anonymous donations to charitable organizations are taxable at the maximum marginal rate of 30%. Section 115BBC is applicable to following NPOs:

- (i) Any university or other educational institution referred to in section 10(23C) (*iiia*) or 10(23C) (*vi*)
- (ii) any hospital or other institution referred to in section 10(23C) (*iiia*) or 10(23C) (*via*)

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (iii) any fund or institution referred to in section 10(23C) (iv)
- (iv) any trust or institution referred to in section 10(23C) (v)
- (v) any trust or institution referred to in section 11

2.46 Anonymous donations were taxable at the maximum marginal rate of 30%. However, Finance (No.2) Act, 2009, gave some relief and, w.e.f. 1-4-2010 the income-tax payable shall be the aggregate of:

- (i) the amount of income-tax calculated at the rate of thirty per cent on the aggregate of anonymous donations received in excess of the higher of the following, namely:
 - (A) five per cent of the total donations received by the assessee; or
 - (B) one lakh rupees; and
- (ii) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of anonymous donations received.

2.47 Additionally, the following entities are exempt from the provisions of this section:

- (i) any trust or institution created or established wholly for religious purposes;
- (ii) any trust or institution created or established wholly for religious and charitable purposes other than any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.

Tax Deduction for Donors

Deductions under 80G

2.48 Though the internal auditor is auditing the NPO, the auditor should get acquainted with the tax impact to the donor as this can be useful in the audit. E.g. copies of receipts can serve as audit evidence for verifying donations received by the entity. More implications are discussed in chapter related to audit.

2.49 Section 80G of the Income Tax Act, 1961 sets forth the types of donations that are tax-deductible. Contributions to various funds, institutions,

charitable institutions are exempt. The percentage of exemption differs for various types of entities. Donor get a 100% deduction for donations to entities listed under section 80G (2) which comprises mainly of funds set up by Central or State Government or local authority .For entities not specifically enumerated in section 80G, donors may deduct 50% of their contributions to such organizations, provided the following conditions are met.[Section 80G(5)]:

- (i) The institution or fund was created for charitable purposes in India and provisions of section 11 and 12 apply to it ;
- (ii) The institution or fund is tax-exempt;
- (iii) The institution's governing documents do not permit the transfer or use of income or assets for any purpose other than a charitable purpose;
- (iv) The institution or fund is not expressed to be for the benefit of any particular religious community or caste; and
- (v) The institution or fund maintains regular accounts of its receipts and expenditures.
- (vi) The institution is either a public charitable trust or a society or section 25 company or a specified educational institution or is an institution financed wholly or partly by the government or a local authority.

2.50 It should be remembered that:

- (i) Total deductions available to a donor cannot exceed 10% of the donor's total gross income. Any amount in excess of 10% will not be exempt in the hands of donor.
- (ii) Donations to institutions or funds "for the benefit of any particular religious community or caste" are not tax-deductible. A not-for-profit organization created exclusively for the benefit of a particular religious community or caste may, however, create a separate fund for the benefit of "Scheduled castes, backward classes, Scheduled Tribes or women and children" and those will be exempted [Section 80G Explanation 1].
- (iii) For purpose of Section 80G, an association or institution related to sports or games and notified by the Central Government will be considered as charitable institution.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (iv) Tax deduction under section 80G are only allowed if the donation is a sum of money. Thus, in-kind donations are not recognised for exemption.
- (v) Receipts issued to donors by not-for-profit organizations must bear the number and date of the 80G certificate.

Deductions for Projects, Schemes, etc.

2.51 The Income Tax Act, 1961 contains a number of other provisions permitting donors to deduct contributions related to various projects, schemes and programmes related to welfare and scientific research:

- (i) Under section 35AC of the Act, donors may deduct 100% of contributions to various projects, carried out by approved funds or institutions including i) construction and maintenance of drinking water projects in rural areas and in urban slums; ii) construction of dwelling units for the economically disadvantaged; and iii) construction of school buildings, primarily for economically disadvantaged children.
- (ii) Section 35CCA of the Act allows donors to deduct 100% of their contributions to associations and institutions (approved by prescribed authority) carrying out rural development programs and,
- (iii) Under Section 35CCB of the Act, 100% of donations to associations and institutions (approved by prescribed authority) carrying out programs of conservation of natural resources is allowed as tax deduction.
- (iv) A weighted deduction of 175% is also allowed for contributions to organizations approved under section 35(1)(ii) (i.e., a research association or a university, college, or other institution) specifically for "research," and 125% for contributions made under section 35(1)(iii) specifically for "research in social science or statistical research".
- (v) Similar type of exemption is now available to donors of companies engaged in scientific research. Finance Act, 2008 introduced a weighted deduction of 125% for contributions made to a company registered in India, whose main objective is scientific research and development, when those contributions are approved by the prescribed authority and satisfy prescribed conditions. However, these companies will not be eligible for the weighted deduction of

200% available under section 35(2AB) to qualifying companies and manufacturers for expenditures incurred on scientific research or in-house research and development.

Foreign Contribution (Regulation) Act (FCRA), 2010

History of Foreign Contribution (Regulation) Act (FCRA), 1976

2.52 The Foreign Contribution (Regulation) Act was enacted by our Parliament in 1976 by virtue of Entry 36 of the Union list in schedule VII of the constitution dealing with currency, coinage and legal tender, foreign exchange. The FCRA bill, 1976 received the assent of the President on 31st March, 1976 and becomes an Act as published in the Gazette of India, Extraordinary, Part II, Section I, dated 31st March 1976 to serve as a component of the protective structure of our constitution and our cultural values. In order that funds from abroad do not subvert the integrity of the institutions that constitute the pillars of our secular democratic polity, the FCRA seeks to regulate the flow of funds into India from foreign sources by laying down a legal framework that enables the government to keep a vigil over undesirable foreign influence.

Object of Foreign Contribution (Regulation) Act (FCRA), 1976

2.53 The object and purpose of FCRA is to regulate the acceptance and utilization of foreign contribution or foreign hospitality by certain persons or associations and academic and other voluntary organizations as well as individual working in the important areas of national life may do so in a manner which is confident with the values of a sovereign democratic republic that India is.

As foreign money and hospitality at the material time was invading many institutions and organisations to destabilize the government in power, it was felt necessary to curb the receipts and usage of foreign contribution or foreign hospitality for nefarious or anti national purposes by all persons including Indian citizens or corporation operating within or outside India. The Ministry of Home Affairs has been made responsible for the implementation of the FCRA. The FCRA is a Framework for regulating and controlling the acceptance and utilization of foreign contribution and foreign hospitality.

History of Foreign Contribution (Regulation) Act (FCRA), 2010

2.54 Foreign Contribution Regulation Act and Rules 1976 is replaced by Foreign Contribution (Regulation) Act 2010 and Foreign Contribution (Regulation) Rules 2011.

2.55 Foreign Contribution (Regulation) Act (FCRA), 2010 received the assent of the President on the 26th September, 2010 and notification relating the Foreign Contribution (Regulation) Rules, 2011 published on 29th April, 2011. The FCRA, 2010 and Foreign Contribution (Regulation) Rules, 2011 is effective from 1st May 2011.

2.56 The FCRA, 2010 is an act to consolidate the law to regulate the acceptance and utilization of foreign contribution or foreign hospitality by certain individuals associations or companies and to prohibit acceptance and utilization of foreign contribution or foreign hospitality for any activities detrimental to the National interest and for matters connected therewith or incidental thereto.

2.57 The Act extends to whole of India and it shall also apply to:

- (a) Citizens of India outside India and,
- (b) Associate, branches or subsidiaries, outside India, of companies or bodies corporate registered or incorporated in India.

Expanded Scope of FCRA, 2010

2.58 The FCRA, 2010 has much broader applicability. It is applicable to individuals, HUF, association and a Section 25 company.

Similarly the object of act also changes from regulation to prohibiting. The object of FCRA, 1976 was to regulate the acceptance and utilization of foreign contribution or foreign hospitality by certain persons. Where as role of FCRA, 2010 is to regulate the acceptance and utilization of foreign contribution or foreign hospitality and to prohibit acceptance and utilization of foreign contribution or foreign hospitality for any activity detrimental to the national interest.

Provisions under FCRA, 2010

2.59 The new provisions introduced under FCRA, 2010 are as follows:

(a) *Restriction to Utilize Foreign Contribution for Administrative Purpose*

Every Person who is registered and granted a certificate or given prior permission under this act and received any foreign contribution shall not defray as far as possible such sum, not exceeding fifty percent of such contribution, received in a financial year, to meet administrative expenses.

Elements which shall be included in the administrative expenses and the manner in which the administrative expenses shall be calculated are prescribed in Rule 5 of FCRA Rules, 2011.

Administrative Expenses

The Following shall constitute administrative Expenses:

- (i) Salaries, Wages, travel expenses or any remuneration realized by the members of the Executive Committee or Governing Council of the person;
- (ii) All expenses towards hiring of personnel for management of the activities of the person and salaries, wages or any kind of remuneration paid, including cost of travel, to such personnel;
- (iii) All expenses related to consumables like electricity and water charges, telephone charges, postal charges, repairs to premise(s) from where the organization or Association is functioning, stationery and printing charges, transport and travel charges by the Members of the Executive Committee or Governing Council and expenditure on office equipment;
- (iv) Cost of accounting for and administering funds;
- (v) Expenses towards running and maintenance of vehicles;
- (vi) Cost of writing and filing reports;
- (vii) Legal and professional charges; and
- (viii) Rent of premises, repairs to premises and expenses on other utilities;

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Provided that the expenditure incurred on salaries or remuneration of personnel engaged in training or for collection or analysis of field data of an association primarily engaged in research or training shall not be counted towards administrative expenses:

Provided further that the expenses incurred directly in furtherance of the stated objectives of the welfare oriented organisation shall be excluded from the administrative expenses, such as, salaries to doctors of hospital, salaries to teachers of school, etc.

(b) *Foreign Contribution or Any Income Arising out of It Shall Not Be Used for Speculative Business*

Rule 4 is specifying the activities or business which shall be construed as speculative business:

Speculative Activities

1. The following activities shall be treated as Speculative activities:
 - (a) any activity or investment that has an element of risk of appreciation or depreciation of the original investment, linked to market forces, including investments in mutual funds or in shares;
 - (b) participation in any scheme that promises high returns like investments in chits or land or similar assets not directly linked to the declared aims and objectives of the organisation or association.
2. A debt-based secure investments shall not be treated as speculative investment.
3. every association shall maintain a separate register of investments.
4. every register of investment maintained under sub-rule (3) shall be submitted for audit.

(c) *Validity for Certificate of Registration*

The certificate granted to accept foreign contribution shall be valid for a period of five years & the prior permission shall be valid for the specific purpose or specific amount of foreign contribution proposed to received, as the case may be.

(d) *Renewal of Certificate*

Every person who has been granted a certificate under Section 12 shall have such certificate renewed within six months before the expiry of the period of the certificate.

(e) *Application for Obtaining 'Registration' or 'Prior Registration' to Receive Foreign Contribution*

- (i) An application for registration of a person for acceptance of foreign contribution shall be made electronically on line in form FC-3 and shall be followed by forwarding the hard copy of the on line application duly signed by the chief functionary of the association together with the required documents.
- (ii) The hard copy shall reach within thirty days of the submission of the on line application.
- (iii) An application for obtaining prior permission of the Central Government to receive foreign contribution shall be made electronically online in form FC-4 and shall be followed by forwarding the hard copy.
- (iv) An application made for the Grant of the registration shall be accompanied by a fee of ₹ 2000 and for the grant of prior permission shall be with a fee of ₹ 1000.
- (v) Every application made for registration or prior permission under the FCRA, 1976 but not disposed of before the date of commencements of the Foreign Contribution Regulation Rules 2011 shall be deemed to be an application for registration or prior permission, as the case may be under these rules, subject to condition that the applicant furnishes the prescribed fees for such registration or prior permission as the case may be.

(f) *Procedure for Renewal of Registration Certificate*

- (i) Every person shall apply to the central Government in form FC-5 six months before the date of expiry of the certificate of registration, for its renewal.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (ii) A person implementing an ongoing multi year project shall apply for renewal twelve month before the date of expiry of the certificate of registration.
- (iii) An application made for renewal of the certificate of registration shall be accompanied by a fee of ₹ 500.
- (iv) In case no application for renewal of registration is received or such application is not accompanied by the requisite fee, the validity of the certificate of registration of such person shall be deemed to have ceased from the date of completion of the period of five years from the date of the grant of registration.

(g) *Intimation of Foreign Contribution by the Recipient*

- (i) Every person who receives foreign contribution under the act shall submit a report in form Fc-6, accompanied by an income and expenditure statement, receipt and Payment account, and balance sheet for every financial year beginning on the 1st day of April within nine months of the closure of the financial year, to the Secretary to the Government of India, ministry of home Affairs, New Delhi.
- (ii) The annual return in form FC-6 shall reflect the foreign contribution received in the exclusive bank account and include the details in the respect of the funds transferred to other bank accounts for utilization.
- (iii) If the foreign contribution relates only to articles, the intimation shall be submitted in form FC-7.
- (iv) If the foreign contribution relates to foreign securities, the intimation shall be submitted in Form FC-8.
- (v) Every report submitted under sub-rules (2) to (4) shall be duly certified by a chartered accountant.
- (vi) Every such return in Form FC-6 shall also be accompanied by a copy of a statement of account from the bank where the exclusive foreign contribution account is maintained by the person, duly certified by an officer of such bank.
- (vii) The accounting statements referred to above in the preceding sub-rule shall be preserved by the person for a period of six years.

- (viii) A 'NIL' report shall be furnished even if no foreign contribution is received during a financial year.

(h) *Reporting by Banks of Receipt of Foreign Contribution*

The bank shall send a report to the Central Government within thirty days from the date of such last transaction in respect of receipt of any foreign contribution in excess of one crore rupees or equivalent thereto in a single transaction or in transactions within duration of thirty days, by any person, whether registered or not under the Act and such report shall include the following details:

- (i) Name and address of the donor.
- (ii) Name and address of the recipient.
- (iii) Account number.
- (iv) Name of the bank and branch.
- (v) Amount of foreign contribution (in foreign currency as well as Indian rupees.)
- (vi) Date of receipt.
- (vii) manner of receipt of foreign contribution (Cash/ cheque/ electronic transfer, etc)

(i) *Receipts of Foreign Contribution in Excess of One Crore Rupees in Financial Year*

In case a person who has been granted a certificate of registration or prior permission receives foreign contribution in excess of one crore rupees, or equivalent thereto, in a financial year, he/it shall place the summary data on receipts and utilization of the foreign contribution pertaining to the year of receipt as well as for one year thereafter in the public domain. Besides, the Central Government shall also display or upload the summary data of such persons on its website for information of the general public.

(j) *Intimation of Receiving Foreign Contribution From Relatives*

Any person receiving foreign contribution in excess of one lakh rupees or equivalent thereto in a financial year from any of his relatives shall inform the Central Government in Form FC-1 within thirty days from the date of receipts of such contribution.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

(k) *Guidelines For Declaration of An Organization to be of A Political Nature, Not Being A Political Party*

The Central Government may specify any organization as organization of political nature on one or more of the following grounds:

- (i) Organization having allowed political objectives in its Memorandum of Association
- (ii) or bylaws;
- (iii) Any Trade Union whose objectives include activities for promoting political goals;
- (iv) Any voluntary action group with objectives of a political nature or which participates in political activities;
- (v) Front or mass organization like students Unions, Worker' Union, Youth Forums and women's wing of a political party;
- (vi) Organization of farmers, workers, students, youth based on caste, community, religion, language or otherwise , which is not directly aligns to any political party but whose objectives, as stated in the Memorandum of Association, or activities gathered through other material evidence, include steps towards advancement of political interest of such groups;
- (vii) Any organization, by whatever name called, which habitually engages itself in or employs common methods of political action like 'bandh' or 'hartal', 'rasta roko', 'rail rook' or 'jail bharo' in support of public causes.

(l) *Bank Account*

Every person who has been granted a certificate or given prior permission shall receive foreign contribution in a single account only through such one of the branches of a bank as he may specify in his application for grant of certificate.

Provided that such person may open one or more accounts in one or more banks for utilizing the foreign contribution received by him. Provided further that no funds other than foreign contribution shall be received or deposited in such account or accounts.

(m) *Prohibition to Transfer Foreign Contribution to Other Person*

No Person Who:

- (a) is registered and granted a certificate or has obtained prior permission under this act; and
- (b) receives any foreign contribution.

Shall transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act.

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this act in accordance with rules made by the Central Government.

(n) *Cancellation of Registration Certificate*

Under Section 14, the Central government may cancel the registration certificate for various records. However, no certificate shall be cancelled unless reasonable opportunities of being heard certificate are:

- (i) Providing false information,
- (ii) Violating any of the terms and conditions of the certificate or renewal there of, or
- (iii) in the opinion of the central government, it is necessary in the public interest to cancel the certificate, or
- (iv) the holder of certificate has certificate has violated any of the provisions of this Act or rules, or
- (v) if the holder of the certificate has not been engaged in any reasonable activity in its chosen field for the benefit of the society for two consecutive years or has becomes defunct.

Any persons whose certificate has been cancelled under this section shall not be eligible for registration or grant of prior for a period of three years from the date of cancellation of such certificate.

(o) *Business/Consulting Income of an NGO*

The notable change in FCRA 201 is that foreign contribution does not include

commercial receipts. Any consulting or commercial receipt from foreign source by NGO will not be included as foreign contribution.

(p) *Foreign Company and Foreign Source*

As per provisions of section 2 (j) which defines the form foreign source includes an Indian company under the category of foreign source if more than 50% of its equity is held by foreigners.

(q) *Panchayat has been Defined as Legislature*

Panchayat has been included under the definition of Legislature under section 2 (1) (k). The implications of this charged is that a member of a panchayat cannot receive any foreign contribution.

Definitions under FCRA, 2010

2.60 Some of the definitions under FCRA, 2010 are as follows:

Foreign Contribution

“Foreign Contribution” Means the donation, delivery or transfer made by any Foreign Source:

- 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 is not more than such sum as may be specified from time to time, by the Central Government by the rules made by it in this behalf;
- of any currency, whether Indian or foreign;
- of any security as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and includes any foreign security as defined in clause (o) of section 2 of the Foreign Exchange Management Act, 1999.

Explanation 1 – A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more person, shall also be deemed to be foreign contribution within the meaning of this clause.

Explanation 2 – The interest accrued on the foreign contribution deposited in any bank refer to in sub-section (1) of section 17 or any other income derived from the foreign contribution or interest thereon shall also be deemed to be foreign contribution within the meaning of this clause.

Explanation 3 – Any amount received, by any person from any foreign source in India, by way of fee (Including fees charged by an educational institution in India from foreign student) or towards cost in lieu of goods or service rendered by such person in the ordinary course of his business, trade or commerce whether within India or outside India or any contribution received from an agent of a foreign source towards such fee or cost shall be excluded from the definition of foreign contribution within the meaning of this clause;

Foreign Source

“Foreign Source” Includes,

- (i) The Government of any foreign country or territory and any agency of such Government;
- (ii) Any international agency, not being the United nations or any of its specialized agencies, the World Bank, International monetary Fund or such other agency as the Central Government may, by notification, specify in this behalf;
- (iii) a foreign company;
- (iv) a corporation, not being a foreign company, incorporated in a foreign country or territory;
- (v) a multi-national corporation referred to in sub-clause (iv) of clause (g);
- (vi) a company within the meaning of the Companies Act, 1956, and more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:
 - (a) the Government of a foreign country or territory;
 - (b) the citizens of a foreign country or territory;
 - (c) corporations incorporated in a foreign country or territory;
 - (d) trust, societies or other associations of individual (Whether incorporated or not), formed or registered in a foreign country or territory;
 - (e) foreign company.
- (vii) a trade union in any foreign country or territory, whether or not registered in such foreign country or territory;
- (viii) a foreign trust or a foreign foundation, by whatever name called, or

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

such trust or foundation mainly financed by a foreign country or territory;

- (ix) a society, club or other association of individuals formed or registered outside India;
- (x) a citizen of a foreign country.

Person

Person includes:

- (i) an individual,
- (ii) a Hindu undivided family(HUF),
- (iii) an association,
- (iv) a company registered under section 25 of the Companies Act, 1956.

Account and Audit under FCRA, 2010

Rule 16 provide that annual return in prescribed form FC-6 accompanied by income & Expenditure Statement, Receipts & Payment accounts & Balance Sheet shall be submitted by 31st of December.

- Copy of bank statement certified by the bank has to be submitted.
- A nil return is required to be filed if there is no activity.

Method of Accounting

The FCRA 2010 and the rules there of do not specify any method of accounting. Section 19 of the FCRA 2010 provides that accounts with regard to FC receipt & utilization should be maintained. On a plain reading of section 19 of FCRA 2010, Rule 16 & form FC – 6, it seems that the requirement is to report FC Fund received and utilised during the year. In other words, the receipts of fund shall be on cash basis only. There is no specific direction regarding utilization on payment basis only.

FCRA 2010 does not prescribe any fixed method of accounting. Any method of accounting may be followed but the receipts of FC Funds should be reported on cash basis only.

Role of Chartered Accountants

2.61 Since the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) is national security legislation; associations are required to exercise extreme

care and caution in dealing with foreign contribution from the time of its receipt to its final utilization. As the Chartered Accountants audit the accounts of the associations and certify the accounts before submission to the Government, they are required to provide proper guidance to the associations who is either applying for grant of prior permission/ registration or who have been granted prior permission/registration under FCRA, 2010.

2.62 The Chartered Accountants are required to get themselves thoroughly acquainted with FCRA, 2010 and the Foreign Contribution (Regulation) Rules, 2011 (FCRR, 2011) so that they can help the associations:

- (i) To verify whether the associations are eligible to receive foreign contribution.
- (ii) To guide the applicant organization in submission of application for registration/ prior permission;
- (iii) To ensure that the association receives and utilizes the foreign contributions through its bank account exclusively opened for the purpose in accordance with the provisions of FCRA, 2010 and FCRR, 2011 and that foreign contribution is not deposited or utilized from the bank account being used for domestic funds.
- (iv) To assist in the proper maintenance of prescribed books of accounts in accordance with the provisions of FCRA, 2010 and FCRR, 2011;
- (v) To ensure that the annual returns of an association have been prepared in accordance with the provisions of FC(R) Act, 2010 and FCRR, 2011.

Chapter 3

Key Concepts

3.1 While a for-profit and a not for profit organisation have a lot in common, there are some areas which require a different approach in case of not-for-profit activities. They are either distinctive to the not –for- profit organisation (NPO) or demand special attention from the management.

A for-profit enterprise focuses on profitability and maximizing shareholder value. A not-for-profit organization's primary goal is to provide some socially desirable need on an ongoing basis. However, since both involve running an organisation and providing goods or services, most for-profit accounting and financial management principles apply to not-for-profit organisations as well. But there are some areas which require a different approach in case of not-for-profit activities. Before going into details of internal audit, it is necessary to have knowledge of these significant concepts relating to these enterprises. This Chapter presents some key concepts relating functioning of NPOs. Major areas of internal audit significance would include:

Revenue

3.2 Most NPOs derive their income from non business transactions like donations, contributions, grants, programs or events contributions, fees or investment income. Revenue is not received as a part of exchange between the NPO and a third party in most cases. There are usually statutory and tax prohibitions on carrying out commercial activities. If the NPO carries out such business activities, the express condition is that either the entire revenue has to go toward meeting their objectives and should be related to their mission. However, it would be wrong to assume that all NPOs survive on contributions from a vast multitude of general public. Publicly-supported charities, form just a small segment of the non-profit sector in terms of assets or revenue. There are essentially three ways by which NPOs get revenues:

Public Support

- (i) **No contribution from general public:** NPOs funded by private foundations like by wealthy individuals or corporate houses. E.g. Infosys Foundation, Bill and Melinda Gates Foundation.
- (ii) **Direct public support:** Charitable donations by individuals, private

foundations, and businesses each donation being limited to a small percentage of the total revenue. The amount comes from numerous individuals and businesses. Each contributing amounts forms small percentage of NPOs revenue. For e.g., CRY.

- (iii) **Indirect public support:** Two major indirect sources are governments and publicly-supported granting agencies (including other publicly-supported NPOs and public foundations). In the second case, the support is through a general public, but *via* an intermediary. This form of public support is particularly useful to large charitable or religious organisations as they do not have to put in effort to use the full amount statutorily required to get tax exemption. They can give the money to smaller grassroots level NPO who find difficult to raise funds. For e.g., GIVE Foundation, CRY (supports 300 organisations).

Revenue from Commercial Activities

In many countries, the governing statutes or tax laws provide a list of revenue-generating activities which may be carried out by the NPOs. The tax authorities may also decide exempt based on the details of the organization's mission statement and description, and their past treatment. In India, Income Tax Act, 1961 provides exemptions to certain NPOs if their activities are for "charitable purpose" [which includes relief of the poor, education, medical relief and the advancement of any other object of general public utility.] There is also not tax on income from a business that is incidental to the attainment of the objects of the not-for-profit organization, provided the entity maintains separate books and accounts with respect to such business (Section 11 of the Income Tax Act, 1961). Furthermore, certain activities resulting in profit, such as, renting out auditoriums, are not treated as income from business. Of course, certain conditions need to be met which would covered in detail in chapter related to tax.

Other Revenue

A NPO may earn revenue from various other activities. For instance fundraising events, membership fees, interest, investment income (other than those exempted), unused capital gains and other unrelated business income. Unrelated business income is income from business activities that aren't considered to directly advance the mission of the organisation. Unlike other sources of revenue, unrelated business income is taxed at normal corporate income tax rates. It is essential however, that the NPO should ensure that

the activities carried out are not prohibited by the statute under which the entity is formed. This may result in de-registration or loss of exemption.

Budgeting

3.3 A unique feature of NPO funding is that there is no exchange transaction with the resource providers. The resources provided are used for others. The organisation thus has to demonstrate its stewardship of donated resources — money donated for a specific purpose must be used for that purpose. That purpose is either specified by the donor or implied in the not-for-profit's stated mission or internal guidelines. The management and reporting activities should clearly demonstrate that the money was used as directed. Thus budgeting is a vital exercise for not-for-profit organizations.

3.4 Budget is an important tool to manage the financial health of an NPO. It serves as a benchmark for measuring current income and expense. A budget can also help in predicting tough financial times, and thus gives plenty of time for contingency planning if grants or other income sources fall through. Lastly, NPOs have to provide project and grant budgets to grant making agencies while applying for funds as well as progress reports.

3.5 New organizations may start the budgeting process by looking at potential income -- figuring out how much money they have to spend. Existing organizations can develop the budget as by reviewing its history of contributed income and stability of earned income. Ideally, the budgeting process should include those who are responsible for adhering to the budget and those who are responsible for achieving the organisation's objectives, i.e., both finance committee and senior staff.

3.6 The budgeting process should be documented, with tasks, responsibility and timelines clearly stated. A good budgeting process would incorporate strategic planning initiatives. With uncertain nature of income, the NPOs need to identify fixed costs and relate it to reliable revenue. They need to adopt policies that allow a balance between today's operating needs and maintaining the ability to provide for tomorrow's. Budgeting decisions are driven both by mission priorities and fiscal accountability.

3.7 Each organisation would have its own style of budgeting. The internal auditor can confirm whether good budgeting practices are being adhered to. Some good budgeting practices are as follows:

- (i) **Written:** It is always recommended that the budget is written down. This creates a measurement tool against which progress can be

Key Concepts

monitored and creates a checklist to ensure thoroughness in the process.

- (ii) **Timeline:** Many funding agencies require budget at the beginning of the fiscal year. Since NPO usually have a shortage of staff, the annual budget process should be integrated into the schedule such that the key persons have time to focus on it.
- (iii) **Headings and title:** Ensure that proper headings are present. This would include name of organisation, programme details, budget period. To avoid unnecessary confusion, many organisations mark the approved budget as final budget and date of approval .
- (iv) **Involvement:** While the executive directors and program directors play a significant role in the budget process, it is the departmental staff members who have responsibility for adhering to budgets. Hence, they should also have a role in creating those budgets. Staff members know more about operating details than board members, even the involved ones. With the limited manpower in most NPOs, it is probably more efficient for staff to create the early drafts of budgets and use the time of Finance Committee members to review and vet the proposed drafts.
- (v) **Assignment of responsibility:** The major reason for success of a budget is proper delegation. Tasks need to be listed specifically to be done within a given timeline. Ideally, there should be a person who has the leadership responsibility to ensure that the assigned task is completed within dead timeline. When a person knows he or she will be held personally accountable to have completed the assigned task by the dead timeline, it is more likely to get done.
- (vi) **Inflation:** The budget should take into account inflation. Many a time, there is time gap between the submission and approval of budget by the donor agency or funding agency. By implementation stage, the estimates may become useless. Items like salaries, audit fees, contractors' fees and taxes have a high probability of revision. For such items ensure whether there is provision for renegotiation. .
- (vii) **Basis of Calculation:** The basis of calculation of each and every line item is available. This is especially, required for responding to any query from outside agencies and external reporting requirements. Effective comparisons can be made between budget and actuals if

the budget line items are in sync with the financial statement line items. A mismatch would entail additional work to reconcile the two and may also lead to errors.

- (viii) Details: The budget presented to the Board is a summary. But staff, Finance Committee members and Internal auditors would need the complete details. The details of budget components should be readily available. This could be done with the help of spreadsheet which has linked worksheets or worksheet tabs. Each line item in the Budget summary could be linked to a worksheet which would provide the breakup, e.g., insurance line item would be linked to a worksheet containing details of types of insurance, like, general liability, vehicle insurance, asset insurance, officers' liability etc. Revenue would include details of events, projects, concerts, prices, discounts. Details of Contributed revenue would include name and amount of donations. In-kind contributions can be included on this worksheet or on a separate one, depending on the quantity and complexity of such contributions. In a similar manner, details of Personnel and external consultants, business expenses (interest, licenses, office expenses etc.), rent, transportation, capital expenditure should be available.

Management of Contributions

3.8 *Corpus* is a Latin word, which means *body*. The term "corpus" in corporate usage denotes the sum and substance of an entity. For a NPO, corpus fund are of paramount importance Just like the capital of a commercial organisation – the funds generated and kept aside for the existence and sustenance of the organisation. It is a permanent fund kept for the basic expenditures needed for the administration and survival of the organisation. It is generally not allowed to be utilised for attainment of organisational objectives but interest/ dividend accrued on the corpus funds can be utilised or accumulated.

In case of a trust, the corpus is started by the settler. For other types of NPO, a donation is treated as corpus donation only if it is accompanied by a specific written direction of the donor. In the absence of any written direction of the donor, a contribution or grant cannot be transferred to corpus fund. Corpus fund is an unrestricted permanent fund. i.e.. there is no bar on the purpose for which the funds are used but its use should be restricted to preserve the financial base of the NPO. A corpus fund may be used in

exceptional circumstances, when there is a serious financial emergency or the survival of the NPO is at stake.

However, a large corpus may also invite questions from donors and public as the creation of a corpus fund implies reduction of program activities to that extent. In the long run, an unprotected corpus may also attract undesirable people.

Creation of Corpus

3.9 As discussed above, corpus can be created in case of a trust by the settlor. In other types of NPOs corpus can be created only when a written consent is received from the donor. For instance, a NPO puts a donation box with the inscription “donations will be added to the corpus”, the donation accumulated in the box will still not be considered corpus as there is no specific direction in writing. Corpus can also be created by the NPO out of its internal accrual and surpluses. These could be out of the current year’s income or other available Unrestricted Funds. To create a corpus fund from the current year’s income the prevailing legal provisions and the bye-laws of the organisation have to be kept in mind. For instance, for charitable trusts, the Income Tax Act requires that 85% of voluntary contribution received have to be applied for charitable purposes. In other words, a maximum of 15% of the income can be transferred to the corpus fund each year.

Management of Endowment Funds

3.10 Legally, an Endowment Fund is similar to a Corpus. The difference is only with respect to use of income from the Endowment Fund. Such a Fund is created under specific direction from the Donor. A donor *cannot* specify that funds donated for corpus should be used for a specified project whereas it can be done so in case of income from the Endowment Fund. Endowments can be earmarked for specific activities

The management of endowment funds –both principal and income are vital to a NPO. Getting funds is only half the story, the NPO should have the capacity to steward its endowment funds and maximize their impact. The fund management has following two aspects:

- (i) Investment, oversight and reporting of Endowment fund.
- (ii) Restrictions on spending of endowment fund interest and dividends.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

3.11 The investment decisions would be based on allowable investments, investment performance reports, market practices etc. The statutory and tax prohibitions also have to be taken into account. The NPO should have specific guidelines and policies with regard to the above. Some restrictions imposed on the endowment funds are as follows:

- (i) **Donor Restrictions:** The decision on spending endowment income or principal may not be in the hands of the organization's leadership. Most of the time NPOs try to raise money from donors on an unrestricted basis. This provides flexibility to use the funds and income in an optimum way across various projects and programmes. But many a time, donors specify that the contribution should be used for a specified purpose within the facing organization's scope of activities. For instance, X donates ₹ 2 lakh to be spent towards providing cycles to each girl student in 5 villages in Madhya Pradesh. Sometimes, a donor may require that the contribution not be used until a project has reached a predetermined goal or threshold. Thus, the concept of "unrestricted" and "restricted" comes in.
- (ii) **Endowment for "Perpetuity" but the Program is not:** Many donors specify that the contribution is used for a specified project or program. In such a case, when the donor restriction expires, i.e., when a stipulated time restriction ends or purpose restriction is accomplished, the assets are reclassified as unrestricted net asset. In some cases, the donor stipulates that the contribution must be held by the non-profit in perpetuity (forever, not be used up), like, to provide a scholarship to the topper in the institution every year. The amount is to be recorded as a permanently restricted asset. The problem arises if the income is restricted to support a specific program or service of the organization—with an uncertain future. If there is any chance that such a "perpetually" endowed program or service could later be discontinued, there must be clear understanding and agreement with the donor at the time of the gift regarding an acceptable alternative application of such funds.
- (iii) **Utilisation of Endowment Funds and Income:** For most organisations, there are two aspects of funds management—revenue from its business and management of investments and funds ploughed back. Revenue for a NPO would be the collection from events, programmes etc. which in most cases are not sufficient to run

the organisation. The main source of funds is endowment funds. It has to pay special attention to proper utilization of its endowment income. .By establishing appropriate investment and endowment spending policies, institutions can judiciously place the spending fulcrum on the time continuum . An investment policy would state the appropriate asset mix based on the entity's needs and risk tolerance. It should include both a means of determining permissible current spending and a calculation of endowment principal.

The organization needs to decide how the income from endowment is handled, then attention must be given to the principal asset (the corpus).

Endowment Income

3.12 The NPO needs to make certain decisions regarding spending of endowment income. The first question is whether the organization will spend any of the income. If yes, what percentage of it? Then the question arises as to how it will spend it. If the organization decides to spend endowment income, it may direct this income toward annual operation expenses to provide some relief to Grant requests and/or because of a lack of sufficient other gifts and grants or it might rule that the income may be spent only to support specific ongoing, or new, programs, projects and services or, perhaps it might decide to pursue a combination of both these choices. To arrive at this decision, the organization needs to work out cost of current and imminent projects, programmes, etc., and prepared a budget for its short and long term expenses. However, if the donor restricts the use of income to a particular project these questions will not arise.

Endowment Principal

3.13 The Endowment Principal is supposed to be money required for working in perpetuity. Therefore, Not-for-Profit Organisations avoid depleting these assets which are intended to safeguard the future. It is inadvisable to dip into endowment principal for day to day activities. But there is so much uncertainty in NPOs that a situation may arise it has to choose between using the principal or going out of business. If the organization “today’ sets an ironclad prohibition regarding any depletion of endowment principal for “tomorrow”—there be little or no other choice at a future time of dire need. It is much more practical that the organization first takes all possible steps to avoid such a situation. As a backup plan, it can define the circumstances and

events under which the principal would spent. It can set a condition in the organization's financial policy that, should it be absolutely necessary to spend any endowment principal, those funds must be replaced by a designated date—the sooner the better.

Accounting Practices

3.14 The following paragraphs provide a brief overview of the accounting practices prevalent in the NPOs. It does not dwell on accounting and presentation of various items. For accounting practices prevalent in Not-for-Profit Organisations, please refer to ICAI's publication "*Technical Guide on Accounting for Not-for-Profit Organisations*".

3.15 The basic accounting principles which apply to commercial enterprises are applicable to NPOs also. There are certain differences in nomenclature, grouping and presentation on account of the non profit nature of their activities. The first element is profit. Though an NPO is not prohibited from making profits, if it generates a surplus, the surplus is referred as "Excess of Revenues over Expenses" and it should be used to further the goals of the entity to avoid being mischaracterized as a profit-making organization. A net loss is called "Excess Expenses over Revenues". Another difference is the presentation and nomenclature for owner's interest. A for-profit organisation uses the term Equity. Equity is the worth of the organization usually expressed as the sum of the assets (what the entity owns), less the sum of its liabilities (what it owes). In a for-profit organisation, basically the company owns all the equity so there is no need to divide it up. A not- for-profit organization needs to separate the funds as they represent various pots of money that are meant for specific purposes. For example a NPO has a hospital building fund which can only be used for building the hospital or pay off the building loans. That money cannot be used to pay for medical equipment or salary of the hospital staff. Those would come out of a general operations fund or other designated funds. This necessitates Fund Accounting.

Fund Accounting

3.16 Under Fund Accounting, resources are segregated into various categories (or funds) and the source of funds and the use of each fund are shown. This segregation helps in controlling and monitoring resources and also ensures and demonstrates that legal/ administrative requirements are complied with. Take an example of an NPO involved in educational activity. It

Key Concepts

has received a grant from the State Government to support a computer education initiative, another grant from the central government for a free meal program, and an endowment from a business family for undertaking research projects. The NPO has to report Government about the special education program, the central government agency about the school lunch program, and the business family about the research program. Each of these donors has diverse reporting requirements and need to be apprised about the related revenues and expenditures. This is achieved by establishing separate funds. The entity thus has to maintain a number of general ledgers (or funds), so that reports can be produced detailing the expenditures and revenues for each individual fund, and reports that summarize the organization's financial activities across all of its funds.

Example 1: A NPO Gram Seva Trust maintains the following funds;

- Building Fund – For construction of ICU ward, children ward, new general wards, delivery rooms and dining hall.
- New Equipment Fund
- Poor Patient Relief Fund
- General Fund
- Children Fund
- In Memorium
- Eye Camp Sponsorship

Example 2: Excerpt from Balance sheet of World Vision UK (year ending 30th September 2010) showing break up of funds:

World Vision UK

	Notes	2010 £000	2009 £000
The funds of the charity			
Restricted funds	16	5,454	5,693
Unrestricted funds			
Tangible fixed asset fund	16	3,260	3,830
Strategic initiative funds	16	500	—
Emergency relief funds	16	500	1,000
General funds	16	7,616	5,649
Total funds	16	17,330	16,172

Source: http://www.worldvision.org.uk/upload/pdf/WV_annual_report_2010_v2.pdf

Restrictions on Funds

3.17 Fund accounting may not convey all the required information to users. The users of financial statements should be able to figure out whether the funds are restricted or unrestricted, what are the restrictions and whether the entity was following the restrictions set. The entity must also be able to demonstrate that it still holds assets belonging to restricted and endowment funds and has not used these for unauthorised purposes. It is a breach of trust to spend restricted funds for purposes other than for which they were given.

Statutory authorities in many countries (UK, USA, and Canada) now insist on reporting on “net assets” classification, rather than tracking each fund. (Net assets means more or less the same as owner’s equity or net worth in a for-profit business.) Under this approach, the equity of the organization is presented with three classes of assets, i.e., Restricted Assets; Temporarily Restricted Assets; Unrestricted Assets.

- (i) **Unrestricted:** Funds which are free from any external restrictions and available for general use are classified under this head. Usually individual contributions are unrestricted, as are general operating and unrestricted grants. It important to remember here that restrictions can only legally be placed on funds by the donors. The shape and form of the restrictions are defined in the “gift instrument.”If the management designates some of the non profit's unrestricted assets for a specific purpose, those assets must continue to be reported as *unrestricted net assets*.
- (ii) **Temporarily Restricted:** Sometimes the donors impose restrictions which are not perpetual. Such restrictions expire either with passage of a defined period of time (time restriction) or by performing specified activities (purpose restriction). Grant for a specific program or project or individual contributions given with the intent of supporting a particular program or campaign would fall under this category. An example of a *time-restricted* gift is a contribution of a trust, annuity, or term endowment where the principal of the gift is restricted for a certain term of time.
- (iii) **Permanently Restricted:** These funds are gifts restricted by a donor for a designated purpose or time restriction that will never expire. An example is an endowment gift with the stipulation that the principal is

Key Concepts

permanently unavailable for spending, but the investment income from the principal may be used in current operations. The intent is that the principle balance of the contribution will remain as an investment forever, and the non-profit will utilize the interest and investment returns, such as with an endowment.

Excerpt from Balance sheet of Deepalaya (year ending 31st March 2010) showing break up of funds

Balance Sheet as on March 31,		2010	2009
Sources of Funds:	Sch.	Amount in Rupees	
Membership Funds		2,000	2,000
Corpus Fund		19,967,240	19,732,240
Unrestricted Project Funds	1	136,899,403	126,653,569
Restricted Project Funds	2	12,154,332	24,248,345
Total		169,022,975	170,636,354

3.18 Internal auditors need to pay special attention to the accounting practices of an NPO. The grant making entities, tax authorities and other watchdog agencies carefully analyze the accounting system of non-profit organizations. As tax-exempt entities, non-profit organisations must be extra careful to avoid incorrect accounting practices as this can prove to be very costly and endanger its existence, For detailed accounting methods, please refer to ICAI publication “ *Technical Guide on Accounting for Not-for - Profit Organisations*”.

Given below are some illustrations on accounting practices:

Illustration 1. If Mr. Patel gifts ₹ 10,00,000 to a non profit educational institution and stipulates only the interest on the ₹ 10,00,000 can be spent. There is a further condition that ₹ 15,000 is given to the person scoring highest in Physics every year. How is this be presented in annual accounts?

Solution: ₹ 10, 00,000 will be transferred to *permanently restricted net assets*. ₹ 15,000 has to be reported as *temporarily restricted net assets* until the restriction is released by the payment to the student.

Illustration 2: The board of directors of Akashdeep Services, a not-for-profit organization, approved the earmarking of ₹ 200,000 to upgrade facilities over the next four years. The ₹ 200, 000 of assets set aside for this purpose should be reported in which category of net assets?

Solution: Assets set aside by the board of directors are classified as *board-designated net assets*, which is still part of unrestricted net assets. Only donors can impose *restrictions* on how or when contributions will be used.

Illustration 3: A donor contributed ₹ 49,500 in 2010 but specified it to be for unrestricted use in 2011 . This amount was transferred from the temporarily restricted to the unrestricted net asset class in 2011.

Solution: The journal entry requires recording this transaction in 2011 is:

Net Assets Released—Expiration of Time Restrictions— Temporarily Restricted	49,500	
Net Assets Released—Expiration of Time Restrictions—Unrestricted		49,500

Illustration 4: The Manav Seva Prathisthan organised a charity fair to raise funds for an Employment Initiative for Disabled Persons. Direct costs of Rs 26,000, not incidental in nature, incurred for this event were paid in cash. The event yielded cash contributions of ₹ 1,50,000. What is (are) the required journal entry(ies)?

Cash	1,50,000	
Contributions—Temporarily Restricted—Program		1,50,000
Direct Costs— Employment Initiative	26,000	
Cash		26,000

Solution: It is recommended that all special event revenue and direct costs should be reported at their gross amounts. Cash could have been debited by 1,24,000 (1,50,000-26,000). However, it is likely that the costs and contributions are separate transactions occurring at different times. In fact, good internal controls suggest that contributions should be deposited when received and not held until all the costs are incurred.

Illustration 5: During the past year, 45 nurses volunteered numerous hours at the Institute of Mother and Baby, a nongovernmental NPO,

providing immunizations to infants, children and pre natal and post natal care to women from disadvantaged families, as well as other health-related services. Otherwise, the entity would have to hire nurses to perform these tasks. The NPO records in kind contributions. What will be the journal entry to record these volunteer services?

Solution: The services "require specialized skills, are provided by individuals possessing those skills, and typically would need to be purchased if not provided by donation." The journal entry would debit to the appropriate program expense account and credit to contributed services revenue.

Classification of Expenses

3.19 Classification of expenses assumes a great deal of importance in not-for-profit entities. Many not-for-profit organisation cannot provide satisfactory information about their relative effectiveness in fulfilling their mission. In such a scenario, donors, funders, and watchdog of the organizations have to fall back on financial indicators. The principal financial indicators of effective utilisation of funds are the program-spending ratio (total program expenses ÷ total expenses) and the fund raising-efficiency ratio (fund raising costs ÷ total contributions). Many donors use these ratios as their primary basis for evaluating and ranking NPOs.

3.20 Classification by natural categories would not provide the information needed to arrive at these ratios. Natural categories, such as, salaries, rent, or electricity etc. shows what the money was spent for, but provide no indication of the purpose for which it was spent. Except in cases where the expenses clearly pertain to only one functional category like, the cost of printing a fundraising brochure is clearly a fundraising cost. However, the complexity arises when expenses benefit more than one function. In these cases, functional classification, which involves breaking down expenses based on the organization's major types of activities, becomes necessary. An NPO's major activities are usually program or mission based services, supporting services like, management/ general expenses and fundraising. Functional accounting helps in understanding who (provides the income /pays for the expense, what (type of income/expense) and why (program or purpose) of every rupee coming in and going out of the organization. Ideally, the functional areas are based on the mission. The tracking of 'why' is by the purpose of the organisation and not by the funder or contract. With proper functional accounting each rupee can be tracked through its journey through

the organisation. Through functional accounting, the entity can know the real costs of program and supporting activities, making it an invaluable tool for decision-making. This helps the entity in understanding whether the fundraising for a program is enough to achieve its objectives or whether the entity should build, maintain or scale back a program and so forth.

3.21 The expenses are usually bifurcated as:

- a. Program expenses
- b. Supporting services expenses

a. Program Expenses

Program expenses (or program services expenses) are the amounts directly incurred by the not-for-profit organisations in carrying out its programs. Programs are the activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill objective or mission of the entity. A NPO may have several major programs. For example, an educational institution may have programs for student instruction, research, literacy programs for deprived, social welfare (providing basic infrastructure in rural areas)

b. Supporting Services Expenses

Supporting services are all activities of a not-for-profit organization other than program services. Supporting services expenses are reported in three subgroups:

- Management and general.
- Fundraising.
- membership-development activities.

3.22 Management and general activities include business management, general record keeping, budgeting, financing, and other administrative activities, except those directly incurred for program services or fund raising activities. Fund-raising activities include publicity and conducting fundraising campaigns; conducting fund-raising events; preparing and distributing fundraising manuals and other materials; and conducting other activities involved with soliciting contributions from individuals, foundations, government agencies, and others. Membership development activities include soliciting for prospective members and membership dues, membership relations, and similar activities.

Key Concepts

3.23 In order to accurately report the amount in each of these subgroups, it may be necessary to allocate some management and general salaries to fundraising based on the time spent by employees performing fundraising activities. For example, a management employee might be spending 30% of her time in fundraising activities but her entire salary has been recorded as management and general expenses.

Excerpt from Income and Expenditure Account 2010 of African Children's Mission

	2010	2009
Expenses and Losses:		
Program Services	330,339.58	223,357.26
Supporting Activities:		
Management and General	52,426.38	40,860.26
Fund Raising	0.00	14,032.05
Total Expenses and Losses	382,825.96	278,249.46

Source : http://africanchildrensmision.org/uploads/2010_Profit_Loss_Statement.pdf

3.24 Under the accrual method of accounting, expenses are reported in the accounting period in which they best match the related revenues. If that is not clear, then the expenses should be reported in the period in which they are used up. If there is uncertainty as to when an expense is matched or is used up, the amount spent should be reported as an expense in the current period.

In-Kind Contributions

3.25 Many NPOs, including funding agencies, receive a large amount of donations or support in the form of goods or services. Common examples of in-kind contributions include donated rent, utility payments, materials, and services, such as, advertising. They also receive assets as donations like vans or equipment which are also gifts in-kind. In some situations, NPOs are granted discounts for the purchase of certain items. There are certain tricky cases where it is difficult to estimate the value. For instance, an NPO decides to provide certain infrastructure facilities for the welfare of the local

community .The local people might contribute in the following manner:

- (i) They agree to provide labour at a lower cost or work without wages;
- (ii) Allow free use of tractor-trolley for carrying stone, mud ,cement etc.;
- (iii) Providing free saplings during tree plantation;
- (iv) Allowing free use of personal shed for school / meetings.

Accounting for in-kind Contribution

3.26 Recognizing in-kind contributions paints a more complete picture of the activities of the NPO and the resources used to accomplish its mission. Additionally , In-kind contributions whose details need to be filed under Form FC 7 of Foreign Contribution (Regulation) Rules, 2011, have to be accounted for. However, these are not accounted by many NPOs. Some field level NPOs try to resolve this by showing them as receipt of money when actually they have received items or services. These go against sound accounting principles and raises questions and doubt.

3.27 The following issues need to be resolved for accounting for in-Kind contributions

- (i) Estimating the money value of the material or services received;
- (ii) Issue of supporting documents- vouchers/ receipts;
- (iii) Making accounting entries;
- (iv) Disclosure in Final Accounts.

3.28 Since the in-kind contribution received by many NPOs is substantial not accounting for them would mean:

- (i) The assets constructed are shown at lower value in accounts - which is not the real value;
- (ii) The community's economic participation is not reflected in the Income and Expenditure Account or ledger books.
- (iii) It becomes difficult to have proper internal control over goods received from the community. This may lead to pilferage or wastage

3.29 In-kind contributions have been discussed in greater detail in later chapters.

Chapter 4

Accounting Standards and Standards on Internal Audit Relevant to NPOs

4.1 The basic accounting principles which apply to commercial enterprises apply to NPOs also. However, there are certain peculiar features which are discussed in brief. The accounting aspects and applicability of Accounting Standards are covered in detail in ICAI's publication "*Technical Guide on Accounting for Not-for-Profit Organisations.*"

Key Aspects

- (i) Receipt of contributions and grants from resource providers restricted for specific purposes (temporarily and permanently).
- (ii) Allocation of costs across functional areas (programs, management and general, and fundraising), across grantors, and identification by natural classification (i.e., line-item).
- (iii) Reports to stakeholders (e.g., contributors, grantors, oversight bodies) according to needs, formats, and accounting periods.
- (iv) Applicability of Standards on Internal Audit.
- (v) Applicability of Accounting Standards.

Standards on Internal Audit (SIAs)

4.2 The Institute of Chartered Accountants of India has till date issued seventeen Standards on Internal Audit (SIAs), which aim to codify the best practices in the area of internal audit and also serve to provide a benchmark of the performance of the internal audit services. While formulating SIAs, the Board takes into consideration the applicable laws, customs, usages, business environment and generally accepted internal auditing practices in India. The list of Standards on Internal Audit (SIAs) is given below:

- (i) Standard on Internal Audit (SIA) 1, Planning an Internal Audit
- (ii) Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit
- (iii) Standard on Internal Audit (SIA) 3, Documentation

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (iv) Standard on Internal Audit (SIA) 4, Reporting
- (v) Standard on Internal Audit (SIA) 5, Sampling
- (vi) Standard on Internal Audit (SIA) 6, Analytical Procedures
- (vii) Standard on Internal Audit (SIA) 7, Quality Assurance in Internal Audit
- (viii) Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement
- (ix) Standard on Internal Audit (SIA) 9, Communication with Management
- (x) Standard on Internal Audit (SIA) 10, Internal Audit Evidence
- (xi) Standard on Internal Audit (SIA) 11, Consideration of Fraud in an Internal Audit
- (xii) Standard on Internal Audit (SIA) 12, Internal Control Evaluation
- (xiii) Standard on Internal Audit (SIA) 13, Enterprise Risk Management
- (xiv) Standard on Internal Audit (SIA) 14, Internal Audit in an Information Technology Environment
- (xv) Standard on Internal Audit (SIA) 15, Knowledge of the Entity and its Environment
- (xvi) Standard on Internal Audit (SIA) 16, Using the Work of an Expert
- (xvii) Standard on Internal Audit (SIA) 17, Consideration of Laws and Regulations in an Internal Audit

The application of standards on Internal Audit has been discussed in the chapter related to internal audit procedures.

Accounting Standards

4.3 The ICAI's publication "*Technical Guide on Accounting for Not-for-Profit Organisations*" states the following:

"37. The '*Preface to the Statements of Accounting Standards*', issued by the Institute of Chartered Accountants of India, states the following:

"3.3 Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting, which are

Accounting Standards and Standards on Internal Audit Relevant to NPOs

subject to the attest function of the members of the ICAI. Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, 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 of an enterprise is considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature.”

38. From paragraph 37, It is apparent that the Accounting Standards formulated by the ICAI do not apply to an NPO *if no part of the activity of such entity is commercial, industrial or business in nature*. The Standards would apply even if a very small proportion of activities is considered to be commercial, industrial or business in nature. For example, where an NPO is engaged in the commercial activity of granting loans/credit to small entrepreneurs at nominal rates of interest or in the industrial activity of manufacturing clothes for the rural poor, Accounting Standards formulated by the ICAI would apply to such an NPO. It may be mentioned that since the Accounting Standards contain wholesome principles of accounting, these principles provide the most appropriate guidance even in case of those organisations to which Accounting Standards do not apply. It is, therefore, recommended that all NPOs, irrespective of the fact that no part of the activities is commercial, industrial or business in nature, should follow Accounting Standards. This is because following the Accounting Standards laid down by the ICAI would help NPOs to maintain uniformity in presentations of financial statements. However, while applying the Accounting Standards certain terms used in the Accounting Standards may need to be modified in the context of the corresponding appropriate terms

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

for NPOs. For instance, where an Accounting Standard refers to the term 'statement of profit and loss', in the context of NPOs, this Technical Guide uses the term 'income and expenditure account'.

39. NPOs incorporated under section 25 of the Companies Act, 1956, are required to comply with the Accounting Standards by virtue of sub-section (3A) of section 211 of the said Act. Sub-section (3B) of section 211 requires that where the profit and loss account (income and expenditure account) and balance sheet of a company do not comply with the Accounting Standards, the company shall disclose in its profit and loss statement (income and expenditure account) and balance sheet the fact of such deviation, the reason therefore and the financial effect, if any, arising due to such deviation. Further, section 227(3)(d) requires the auditor to state whether profit and loss account (income and expenditure account) and balance sheet comply with Accounting Standards referred to in sub-section (3C) of section 211. Sub-section (3C) of section 211 provides that for the purposes of this section, the expression 'accounting standards' means the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under The Chartered Accountants Act, 1949 (38 of 1949), as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards (NACAS) established under sub-section (1) of section 210A. Proviso to sub-section (3C) of the section provides that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the Accounting Standards are prescribed by the Central Government under this sub-section. It may be noted that Accounting Standards 1 to 7 and 9 to 29 as formulated and recommended by the Institute of Chartered Accountants of India have been notified by the Central Government under Companies (Accounting Standards) Rules, 2006, in consultation with the NACAS, vide Notification dated December 7, 2006 in the Official Gazette.

40. As far as non-company NPOs (including trusts, societies registered under the Societies Registration Act, 1860) carrying on even a very small proportion of commercial, industrial or business activities are concerned, Accounting Standards, formulated by the Institute of Chartered Accountants of India, are mandatory for the members of the Institute in the performance of their attest functions

Accounting Standards and Standards on Internal Audit Relevant to NPOs

as per the relevant announcements made by the Institute of Chartered Accountants of India from time to time.”

4.4 Keeping in view the nature of activities carried on by NPOs, some Accounting Standards may not be relevant to NPOs unless events or transactions of the nature covered by the Standard take place. Accounting Standards, normally, not relevant to NPOs and accordingly not covered under the abovementioned Technical Guide are as follows:

- (a) Accounting Standard (AS) 7, *Construction Contracts*
- (b) Accounting Standard (AS) 14, *Accounting for Amalgamations*
- (c) Accounting Standard (AS) 16, *Borrowing Costs*
- (d) Accounting Standard (AS) 20, *Earnings Per Share*
- (e) Accounting Standard (AS) 21, *Consolidated Financial Statements*
- (f) Accounting Standard (AS) 22, *Accounting for Taxes on Income*
- (g) Accounting Standard (AS) 23, *Accounting for Investments in Associates in Consolidated Financial Statements*
- (h) Accounting Standard (AS) 24, *Discontinuing Operations*
- (i) Accounting Standard (AS) 25, *Interim Financial Reporting*
- (j) Accounting Standard (AS) 27, *Financial Reporting of Interests in Joint Ventures*

However, it may be mentioned that NPOs should follow these Accounting Standards as and when and to the extent these are applicable to them.

Report to Stakeholders

4.5 How to judge whether a non-profit organization is doing a good job? This is an important issue both for NPOs themselves and for donors. If the NPO is to retain donors it must convince them that their contributions are having a substantial and beneficial effect. The donor is not the only stakeholder with an interest in how NPOs do their job general public, revenue authorities, government and most importantly the people and communities who benefit from the services provided by an NPO need to be convinced. Few donors would be satisfied that the charity to which they've entrusted funds is honest, i.e., and will not misappropriate the money. Most donors

want to be sure that the people or cause which motivated their gift in the first place does benefit from their generosity. Honesty, organizational efficiency and effectiveness (impact) are the three dimensions of NPOs in which they are interested.

Assessment

4.6 From an international perspective, donors often have to satisfy their own internal revenue authorities that the proposed recipient of their gift would be deemed 'charitable' if it were located in the donor's country. While there are usually some common requirements (official registration, board of trustees, governing document, etc), different countries have specific requirements too -- a winding up clause, exclusion of political activity, and so on. Also, some activities deemed charitable in one country may not be so classed in another.

4.7 To ensure this, most grantors undertake some form of organizational assessment prior to considering funding applications and these assessments can be extremely rigorous. Also, donors would like that as much of their contributions as possible goes into the actual charitable activity. Though individual donors may not have a say, grantors often state a maximum level of administration support within their grants. If the NPO has received foreign contribution, the Foreign Contribution (Regulation) Act, 2010 defines what consist administrative expenses and what does not. Also, the Act prohibits administrative expenses beyond 50%.

4.8 For assessing impact, grantors expect evaluations and reports, and most donors receive some type of communication illustrating effectiveness. They want to know how their investments made a difference – not just numbers to how many were helped but how lives were improved, how things have changed. This will need in-depth record keeping, research and interpretation, but need to become part of the process to secure funding from international agencies and large corporate donors. "No numbers without stories; no stories without numbers."

4.9 On its part, the NPO needs to provide information which is as far as possible be verifiable: references to grants received, reports produced, statistics in the public domain, registration documents. The information must also be sufficient to satisfy an international donor that further checks would verify that the NPO was eligible for a grant. The NPO can present additional information to demonstrate its effectiveness as an organization.

Types of Reports

4.10 The types of reports that may be useful to various financial information users/decision makers are as follows:

Financial Information Users/Decision Makers	Reports
Oversight bodies; external funding sources, and national organizations	Audited Annual Financial Statement (Audit Opinion letter, Balance Sheet, Statement of Cash Flow, Income & Expenditure Account , and accompanying Notes)
Central Government (CG)	All foreign contributions received within 30 days of the receipt of the contribution reported to CG File annual reports with the Home Ministry reporting the amount of the foreign contribution, its source, the manner in which it was received, the purpose for which it was intended, and the manner in which it was used.
Income Tax Authorities	NPOs claiming exemption under Section 11 and 12 to file audit report and annual return of income
Government and other Foundation funding sources	Grant Report (specific to the agency or foundation)
Management and Program Directors	Budget <i>vs.</i> Actual Statement of Activities (by month, quarter, year)
Service recipients/ clients	Performance measures
Public at large, and watchdog agencies	Performance measures

Chapter 5

Internal Audit - Concept and Objectives

5.1 From providing an independent assurance function, internal audit has become one of the core organizational governance elements. Many organisations which are not statutorily required to have internal audit functions have also established. The internal audit activity has become a key resource to the management in performing risk assessment and recommending improvements to an entity's governance, risk management, internal controls, Management Information System (MIS) and operations. An effective internal audit function helps the management in effectively discharging their duties towards the accomplishment of organisation's objectives by assessing the effectiveness of an organization's risk management processes, as well as using specialized data analysis in the audit, fraud detection and compliance arena.

Need for Internal Audit in NPO

5.2 In many ways not-for-profit organisations are no different from for-profit or commercial organisations. Their objectives and activities may be different but the day to day operations would more or less involve common activities like receipt and processing cash, tracking revenue and expenses, managing personnel, and financial reporting to stakeholders. Errors, misappropriations, frauds can happen in any organisation and the extent of its impact is more if it affects those key processes that contribute to the accomplishment of the organisational objectives. The uniqueness of not-for-profit organisations (at least those that are supported by donations) is that even a whiff of a scam can ruin it. An overwhelming majority of public still holds not-for-profit organisations to a high standard of integrity that the organization will use donations as promised. Thus, the greatest threat to the not-for-profit sector is the betrayal of public trust and the disappointment of public confidence. Additionally, they have to meet unique compliance requirements, especially, regarding tax exemptions and foreign contributions.

5.3 The most reliable method of meeting all these requirements is to have sound internal control. When controls are effective, there is high probability that key processes will function as designed and the organisation will achieve its objectives. Here, the internal auditor's objectivity, knowledge of the organization, and understanding and application of sound consulting and audit principles would be useful.

Methodology for Internal Audit

Terms of Internal Audit Engagement

5.4 The design and direction of the internal audit depends on the terms of engagement. These are usually finalized jointly by the client and the internal auditor. The internal auditor needs to take into account what kinds of issues are important to the management. It is also important to remember that the client may not have a deep understanding of the role and advantages of internal audit. Therefore, there is a need to assess what additional issues should be covered. The orientation of an internal audit may be more towards transactions verification, or system assurance. A third possible approach could be donor assurance, this would focus on whether justifiable expenses have been charged to correct budget heads.

(i) Transaction Testing and Verification

Transaction testing involves vouching and review of transactions to ensure that transactions are properly recorded and their data content with respect to internal application system is accurate. This would include

- a) Reviews of the detail Transactions posted.
- b) The transactions are accurate, valid and appropriate.
- c) Corrective actions and closures of purchase orders have been initiated.
- d) Payroll reports represent time worked by valid employees.
- e) Amount shown in rupees and hours are correct and charged to the proper account.

Verification involves valuation and existence of assets like fixed assets, cash, equipment, etc. This orientation is, especially, useful for smaller organizations, where the accounts department is not fully developed and stable and there are a very few transactions but is not desirable or possible to do it in any other organisation. It is not internal audit's role to test every transaction and verify that it was handled properly (and function as a detective control). They should focus on the adequacy of processes and controls. Also, confirming that transactions are correct does not provide assurance that the controls are in place and effective.

(ii) System Assurance

Systems assurance is the planned and systematic set of activities that assure systems, processes and products conform with systems requirements for safety, reliability, availability, maintainability, standards, procedures, and regulations.

It involves system control and internal control. Whether it takes the form of system audit would depend upon the terms of engagement decided by the management and the internal auditor.

(iii) Donor Assurance

This approach is designed to reassure the donors that their funds are being spent properly. An internal audit could provide reasonable assurance that good stewardship is being used in handling and accounting for donor's money and other assets of the not-for-profit organization. It can be performed by external Accounting firms (or by an outside CA) or done internally-in which case the books are reviewed by selected non-related officers, or by prominent people in the not-for-profit organization who understand financial management. Under this approach, the focus is on looking at budgeting, budget monitoring, cost-effectiveness, distribution of assistance, internal transparency, governance, quality and timeliness of donor reporting, etc. Such audits encourages good habits of fiscal responsibility to among employees and will assure that contributions made to the organization with stipulations as to how the funds should be used, are consistently used in accordance with the donor's instructions, providing donors the assurance that their contributions are being used as intended.

Engagement Letter

5.5 Before commencement of the internal audit, the internal auditor has to obtain an engagement letter from the auditee. The engagement letter mainly outlines the terms and conditions of the engagement, scope of the work, assistance required from the management and the compensation terms. In case of a new assignment, the internal auditor visits the auditee and obtains information to determine the audit scope, audit objective, time schedules, audit dates and in a continuing assignment the earlier letter has to be modified depending on the changed circumstances. The engagement letter is prepared by the internal auditor and has to be approved by the appropriate authority of the auditee which could be Board of Directors or Board of Trustees or Audit Committee. Briefly, the engagement letter would

Internal Audit - Concept and Objectives

include:

- (i) Scope of internal audit: this could include internal audit of financial statements, Supplemental information, Compliance reports, Tax filings, FCRA filings etc.
- (ii) Provide for an agreed-upon process for changes in the scope of work.
- (iii) A timetable for the internal audit work including dates for fieldwork, number of staff, date of delivery of draft reports, Delivery of management letter, if applicable, meetings with audit committee, if any.
- (iv) Information that is expected to be provided during the internal audit by the organization's personnel: this typically include various information to be provided by the organization, such as permanent file documents and schedules prepared by the organization's staff in connection with the internal audit engagement.
- (v) Discuss how adjustments below the internal auditor's materiality threshold will be handled. (For example, does it address how they will be communicated to management for possible recording in the subsequent year's financial statements?)
- (vi) Identify the persons or entities that will use the internal audit report and for what purpose. Usually, the report states that report is intended for the information and use of the audit committee, management, specific legislative or regulatory bodies, grant making agencies and is not intended to be and should not be used by anyone other than these specified parties without the internal auditor's permission.
- (vii) Address the internal auditor's record retention policy stating the minimum period for which internal audit documentation is retained and conditions (dispute, disagreement) under which the timeframe may be increased.
- (viii) Internal Auditor's privacy policy regarding the organization's financial information.
- (ix) Include basis of compilation of the professional fees to be charged for the engagement and make provision for the handling of out-of-pocket expenses.

5.6 It is recommended that the letter clarifies that the internal audit engagement ends on delivery of the internal audit report and state that the any follow-up (such as representing the client before taxation authorities) will be deemed to be a separate engagement and will be governed by the terms and conditions of a subsequent engagement letter. The Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement provides detailed guidance related to terms of engagement.

Planning an Internal Audit

5.7 The internal auditor needs to develop an audit plan for each internal audit engagement so that the internal audit can be completed in an efficient and effective manner. Adequate planning ensures that appropriate attention is given to every significant area so that weaknesses can be identified and errors can be rectified. Once deficiencies are found the entity can take preventives steps by enhancing policies, procedures, and operations. NPOs usually have budgetary constraints, so the internal auditor has to also plan that frequency and depth of the audit is based on the entity's needs and budgetary constraints and focuses on the most important areas. The Standard on Internal Audit (SIA) 1, *Planning an Internal Audit* provides indepth guidance on planning an internal audit.

5.8 A significant characteristic of not-for-profit organisations which affects internal control is the presence of volunteers across various levels of the organisation. The nature and degree of influence of volunteers varies across NPOs depending on size, purpose, nature of NPO's activities and its corporate culture. Volunteer presence the following forms:

- (i) Volunteer presence on the governing board
- (ii) Inadequate amount of staff for administrative purposes affecting segregation of duties.
- (iii) Both Volunteers and paid staff are involved in day-to-day operations including finance function.

5.9 This could affect the management and internal control of these organisations significantly. The altruistic nature of their activities and absence of an owner group could mean lesser understanding and interest in having a strong corporate culture. The focus is on allocating resources to further the mission of the entity than on segregation of duties. Deep involvement of volunteers in operations and management performing

accounting functions, control or supervisory positions may affect the control system, especially, in areas, like, personnel management, authorisation procedures, establishment of priorities, accountability and control over data. Again, some NPOs may not have resource constraints or may have a strong corporate culture.

The internal auditor must take these into consideration and take additional safeguards while conducting internal audit of NPOs.

Knowledge of the Business

5.10 The internal auditor should have knowledge of client business to obtain an understanding of the events, transactions and practices. At the planning level, this knowledge will enable them to determine materiality level, identify components of internal audit risk, identify areas which need special attention and draw conclusions. The internal auditor needs to have specific knowledge of the following:

- (i) Legal form
- (ii) NPO's mission and objectives
- (iii) Organisational structure
- (iv) Nature and mix of its main activities
- (v) Major sources of funding, donors, etc.
- (vi) Chart of accounts and accounting methods
- (vii) Policy and procedures
- (viii) Major risks
- (ix) Tax status
- (x) Main characteristics of recipients of its services
- (xi) Related parties

5.11 If the entity has a well documented service provision and outcomes it would help in understanding the type of work undertaken by NPO. This usually contains:

- (i) The mission statement and details of all the services the organization provides to the community.
- (ii) Scope of those services; this answers questions like, how large is the

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

service area? Is the organization state, county or citywide? The population the organization serves; is it a specific population, such as individuals with disabilities, homeless or battered women, or children with criminal backgrounds

- (iii) Documentation on outcomes, or how the NPO's services affect the population it serves, numbers of people affected and length of time individuals utilize the services of the NPO.

5.12 For internal audit, it is vital that the internal auditor gain knowledge about the field of activity, economic, tax and legal environment. For an NPO audit, it becomes all the more vital to gain an understanding of the working of the entity from diverse resources as there might be inadequate availability of information. The internal auditor can obtain sufficient knowledge through:

- (i) Financial information, like, previous annual reports and budgets. Prior year comparative reports and narrative explanations of significant changes or unusual balances would reveal critical information about cash balances, investments, receivables, payables, and the overall financial health of the organization.
- (ii) Reports of statutory auditors required under Section 10 and 12 of the Income Tax Act.
- (iii) Monthly or quarterly report generated for the management, like, the Statement of Financial Position, the Statement of Financial Activities (sometimes called the profit and loss report, income and expense report, or budget report). If possible, go through specific detail reports, like, income and expense (profit and loss) line items by activity, cash flow projection, fundraising progress, and program or project reports.
- (iv) Enquire about the accounting policies for various items, like, capital assets, fund accounting, contribution in kind.
- (v) Study the documents, like, periodicals, survey results and financial statements of similar entities.
- (vi) Visit various offices and meet management.

Standard on Internal Audit (SIA) 15, Knowledge of the Entity and its Environment provides detailed guidance in this regard.

Audit Planning, Materiality and Sampling

5.13 During the initial stages, the internal auditor needs to formulate the internal audit program and thereafter modifications may be made as necessary. The opening conference with the client would aim at discussing the overall plans of the audit before the fieldwork starts. During the opening conference the internal auditor would:

- (i) Explain the scope of the planned audit, the internal audit objectives, and the general approach to the internal audit;
- (ii) Clarify that the auditee understands the commitment needed from the auditee to support the internal audit and respond to internal audit requests;
- (iii) Review organizational charts and job descriptions and the nature of the auditee's activities and functions;
- (iv) Inquire about current developments relating to the entity function, activity, department, or unit under audit;
- (v) Inquire about problem areas that would be reviewed;
- (vi) Make arrangements with the auditee for the preparation of the data which will be needed during the internal audit, like, management plans, objectives, or other documents that may have a material impact on the audit outcome;
- (vii) Develop a list of key personnel in the auditee department to be contacted for meetings or information;
- (viii) Develop preliminary estimates of materiality levels and acceptable error rates.

Standard on Internal Audit (SIA) 1, Planning an Internal Audit provides detailed guidance in this regard.

5.14 The magnitude of a misstatement in quantitative terms is but the first step in evaluating materiality and there is a need for full analysis of all relevant considerations. Materiality needs to be considered when there is "substantial likelihood" that a reasonable person would consider it important. Materiality must be judged within the "total mix" of information.

The assessment of materiality in planning and completing an internal audit of a not-for-profit organization is inherently difficult. The for-profit world's rules of thumb for materiality thresholds, such as, calculating a percentage of net income, do not easily apply to charitable organizations. Instead, auditors apply various percentages to total assets, total revenues, or some other measure of an organization's size. The assessments of materiality involve both quantitative and qualitative judgments. Auditors can consider "other measures" for assessing planning materiality, such as unrestricted contributions, total program expenses, the ratio of program expenses to total expenses, and the ratio of fund-raising expenses to contributions.

5.15 Audit sampling is used when the internal auditor has to obtain evidence on a selective basis, i.e. to audit less than 100% of the items within an account balance or class of transactions to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population. Audit sampling can be used as part of a test of control or as part of a substantive procedure. They have to follow the procedure in Standard on Internal Audit (SIA) 5, "Sampling". When using either statistical or non-statistical sampling methods, internal auditors should design and select an audit sample, perform audit procedures thereon and evaluate sample results so as to provide sufficient appropriate audit evidence.

Risk Assessment

5.16 Every organization faces a variety of business risks from external and internal sources that must be assessed. Risk assessment involves the identification and analysis of relevant risks that may prevent the achievement of established objectives. Internal auditors typically conduct an overall risk assessment of the organization to understand overall strategy and objectives, and then within the framework of strategy, understand the key processes that drive and support accomplishment of strategy and the inherent risks to the accomplishment of objectives. Once the areas of high risk (areas susceptible to error or fraud) have been identified, different types of procedures (agreed upon procedures, reviews, audits) are performed to identify the strength of controls in the high risk areas. Risk Assessment aids the auditor in deciding audit timing, audit intensity and audit frequency

5.17 Risk analysis usually takes the following form

- (i) Define the audit universe and identify the auditable units within the entity for which these analyses will be carried out.

Internal Audit - Concept and Objectives

- (ii) Identify appropriate risk factors designed to reflect management's concerns.
- (iii) Select an appropriate format for evaluating risk factors.
- (iv) Develop a combination rule for each audit unit which will properly reflect its riskiness over several risk factors that have been identified and a method of setting audit priorities for the audit units.
- (v) Once audit units have been rated according to their risk, assign them various audit frequency categories; that is, to identify frequency of audit and, a mechanism for applying variable audit scope or intensity of auditing commensurate with the importance of the audit unit.
- (vi) Have an audit coverage plan which indicates which audits will be conducted at what times throughout the planning horizon and the expected costs associated with those audits. This will help in staff and other resource scheduling.

Risk Types

5.18 The internal auditor should try to limit audit risk, which is the product of inherent risk, control risk and detection risk.

Inherent Risk

Inherent risk is the risk that a financial assertion is susceptible to a material misstatement. The assertion could be about a class of transactions, account balances or disclosures about significant company events. Examples include double counting funds received, incorrectly valuing inventory and failing to disclose significant accounting changes.

The internal auditor has to assess inherent risk for each account head or class of transaction. One high risk area is cash donations. The restrictions on use of certain funds will impact the risks as wrong use of those assets could mean that the donor might refuse to provide further funding.

Control Risk

Control risk is the risk that one or more material misstatements might not be prevented or detected on a timely basis by the organization's internal control systems. For example, if the revenue is misstated on an organisation's income statement, control risk means that the organisation's internal auditing processes may not be able to catch it. As stated earlier, the use of volunteers

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

for accounting and day to day management might be a major factor to consider.

Detection Risk

Detection risk is the risk that an audit might not be able to detect a material misstatement. For example, if there are revenue or cost misstatements on a company's income statement, detection risk refers to the possibility that an audit fails to detect these misstatements and, consequently, expresses an inappropriate favourable opinion.

Assessment

The Internal auditors are required to assess inherent risk and control risk on three levels: maximum or high risk, moderate or medium risk and low risk. If the inherent and control risks are high, the detection risk must be low in order to have a low overall audit risk. Therefore, the internal auditor has to carry out more detection procedures to be reasonably assured that the financial statements are free of material misstatements.

Significance

A low audit risk is important because it is not possible for internal auditors to verify all transactions. Auditors tend to focus on key risk areas -- for example, overstated revenues or understated costs, where it is more likely that errors will lead to material misstatements on the financial statements. Standards on Internal Audit require internal auditors to plan and perform audits with professional skepticism because there is always the possibility that the financial statements are materially misstated. Professional skepticism involves a questioning mind and a critical evaluation.

Understanding and Evaluation of Internal Control

5.19 At the planning stage, the internal auditor has to analyse the internal controls in the organisation. The issue with NPOs is that there are limited number of staff personnel, there is a mix of paid staff and volunteers .The internal audit team should be look into the following aspects:

- (i) The adequacy of internal control.
- (ii) The accuracy of the records and the reports to the governing body (usually. the board of directors).
- (iii) The proper authorization of activities and expenditures.
- (iv) The determination of the physical existence of assets.

Internal Audit - Concept and Objectives

- (v) A review of the tax-exempt status and identification of any activities that may endanger it.
- (vi) Ascertaining that TDS, licenses, sales taxes, other taxes and corporate reports are properly filed in a timely manner.

In developing the audit program, the adequacy of the internal accounting controls is an influencing factor. The internal audit team should satisfy itself that the internal control procedures outlined above actually were being followed.

5.20 The involvement of volunteers and limited staff may affect the segregation of duties. The responsibility and authority delegation varies from one NPO to another. This involvement of volunteers influence the management and internal controls these organisations greatly:

5.21 The internal auditor needs to pay special attention to:

- (i) Nature and extent of volunteer involvement.
- (ii) Attitude of management, staff and volunteers with regard to internal control, budgets, etc.
- (iii) Assignment of authority and responsibility.
- (iv) Nature of external influences which may affect the internal control environment.
- (v) Personnel policies.

5.22 A system of internal control can be evaluated by assessing its ability to achieve seven commonly accepted control objectives:

Authorization: All transactions are pre-approved by responsible personnel.

Completeness: All valid transactions are included in the accounting records.

Accuracy: All valid transactions are accurate, consistent with the originating transaction data, and information is recorded in a timely manner.

Validity: All recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's authorization.

Physical Safeguards and Security: Access to physical assets and information systems are controlled and properly restricted to authorized personnel.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Error Handling: Errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.

Segregation of Duties: Duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing a transaction.

Standard on Internal Audit (SIA) 12, Internal Control Evaluation provides detail guidance in this regard.

Chapter 6

Major Areas of Internal Audit Significance

6.1 Just as with accounting, internal auditing considerations for a not-for-profit organization are similar to those of a profit-making entity. However, there are a number of special challenges that are faced by the internal auditors of not-for-profit organizations. Donation receipts, grant management, limited resources, use of volunteers, and expenditure control give rise to unique internal control and risk management issues. Completeness of contributions — particularly as related to donations and other fundraising activities — is also an area of exposure. There is also a question of whether or not to value non-cash contributions and services and how to value them. Key focus areas for internal audit would include:

- (i) Revenue completeness assertion.
- (ii) Internal controls over receipts and revenues.
- (iii) Accounting of restricted fund transactions.
- (iv) Valuation of non-monetary transactions.
- (v) Dealing with variations of budgets to actual results.
- (vi) Risks caused by absence of detailed chart of accounts.
- (vii) Problems associated with accounting for multiple programs, grants or contracts that have year-ends different from the fiscal year-end of the not-for-profit organization.
- (viii) Internal Audit restrictions imposed by funding sources.
- (ix) Risks associated with the use of volunteer personnel and volunteer board of trustees.
- (x) Tax considerations resulting from unrelated business income.

6.2 Once internal audit strategy is formed, it should be reevaluated every year as resource outflow, inflow, funding sources may change drastically from one year to another. This could mean changes in restrictions or requirements imposed by donors which has to be taken into account to design internal audit procedures to detect non-compliances, if any. All items of noncompliance (no matter how small) should be summarized by the auditors, evaluated, and brought to the attention of management.

Receipts

6.3 Revenues are recognized by a NPO for resources received in reciprocal or *exchange* transactions; i.e., those in which the other party receives benefits in exchange for the resources provided.

6.4 During any given accounting period, Revenues and Expenses are the two primary sections where summarized transaction amounts will be reported.

6.5 Revenues that may be listed in the statement of activities include:

- (i) Contribution, gifts and legacies
- (ii) Membership fees
- (iii) Program fees
- (iv) Fundraising events
- (v) Institutional grants
- (vi) Donated goods and services
- (vii) Investment income from endowments
- (viii) Gain on sale of investments
- (ix) Interest from other investments
- (x) Interest from earmarked funds
- (xi) Transfer from project funds - reclassifications when net assets are released from restrictions (a negative amount in the temporarily restricted column and a positive amount in the unrestricted column)
- (xii) income derived from economic undertakings specified in the charter/mission

6.6 There are various direct and indirect ways to determine amount of receipts in such cases. Complications arise in ascertaining income from non-business transactions, like, donations, contributions and grants.

6.7 It is recommended that the entity should document all private, individual donations, regardless of how small or large the monetary amount. Donations that are specified for a particular purpose should be accounted separately. Pre-numbered receipts should be given for contributions, gifts, etc. "Anonymous" donations should be to a minimum. If a donor wishes to be

anonymous, the NPO can issue a receipt to the individual with the details and agree to keep the information confidential and list the donations as anonymous in public documents such as brochures and financial information.

6.8 Anonymous donations may also result in disallowance under Income Tax. Under Section 115BBC, all anonymous donations to charitable organizations are taxable. Finance (No.2) Act, 2009, has provided some relief by stating anonymous donations aggregating up to 5% of the total income of the organization or a sum of ₹ 100,000, whichever is higher, will not be taxed. Additionally, religious organizations (e.g., temples, churches, mosques, etc) are exempt from the provisions of this section.

Donation or Exchange

6.9 Income received could be contribution or exchange. Contribution is an *unconditional* and *non-reciprocal* transfer of cash or other assets from one entity to another. Assets could be land, buildings, use of facilities or utilities, materials and supplies, intangible assets, services. In other words, someone is making a donation to an organization without the expectation of receiving anything in return besides a possible tax deduction. Mr. A's cheque of ₹ 600 to Wellness Foundation in response to its fundraising appeal would be called a contribution as he expects nothing in return.

In contrast, an exchange transaction is a *reciprocal* transfer between two entities where each party receives something of approximately equal value. So, using the same example Mr. A gives ₹ 600 and in exchange the foundation gives him a medical check-up package (worth ₹ 600). In most cases, there is a partial donation and a partial exchange. Using the example, when Mr. A gives ₹ 600, he is given a t-shirt valued at ₹ 150. In this instance, of the ₹ 600 of value, part of it (₹ 450) would be a contribution and the other half (₹ 150) would be an exchange transaction.

Internal Control over Donations

6.10 The inherent risk with respect to cash donations is quite high. It is quite difficult sometimes impossible to verify that all amounts given by donors were effectively recorded. NPOs use a wide variety of methods to raise funds. Not only that, several methods are used concurrently. These include door to door solicitation, corporate fundraising strategies, organisation of fundraising events, TV campaigns endorsed by stars, etc. The internal auditor has to gather at the planning stage, information about the various

methods used during the year to devise an audit strategy. The most important are gathering information about the internal control over cash and cheque receipts.

Cash Receipts

NPOs usually have shortage of staff. This may result in a single person having multiple responsibilities. This may be acceptable for some areas but certain duties need to be segregated. The following simple techniques would go a long way in having effective internal control:

- (i) Cash receipts should be recorded immediately and deposited in the bank daily.
- (ii) A person with no access to cash should compare cash receipts records and authenticate deposit slips.
- (iii) Individuals handling cash should not make entries to the general ledger or subsidiary ledgers.
- (iv) A petty cash fund should be entrusted to a single custodian and used for all payments other than those made by cheque.
- (v) Individuals handling cash should be bonded.

Cheque Receipts and Issued

- (i) Incoming mail should be opened and recorded by persons other than those with access to cash receipts journals and accounts receivable records. If there is no donation form with the Cheque, one should be prepared. All information on the Cheque should be captured on the donation form.
- (ii) A person with no access to cash should compare cheque receipts records and authenticate deposit slips with mail listing.
- (iii) Cheques should be pre-numbered, used in sequence with adequate controls over supplies of blank Cheques. All Cheque numbers, even destroyed Cheques, should be entered into the accounting program.
- (iv) Cheques should be prepared by persons other than those who approve invoices. The supporting organizational invoices should be signed by the responsible committee chair for that type of funding.
- (v) Cheques should be entered in the disbursement journal exactly as they have been prepared.

Major Areas of Internal Audit Significance

- (vi) Cheques to vendors should be issued only in payment of approved invoices, and the supporting documents should then be cancelled.
- (vii) Cheques should be prepared from original organizational invoices with attached copies of purchase orders, vendor invoices and receiving reports and presented for signature with these attached. The organizational invoices should be numbered (by the treasurer after receipt), include the originals of all receipts, and be retained in numerical order.
- (viii) Bank accounts should be reconciled periodically by someone other than the person who signs the cheques.
- (ix) The person who is responsible for the physical custody of an asset should not also have responsibility for keeping the records related to that asset.
- (x) The best bank accounts will link each evening with the organization's accounting system, and update the accounts with that day's bank transactions.
- (xi) The governing board should authorize all Cheque signers. All Cheques more than a certain amount should be signed by two persons.
- (xii) Signing of blank Cheques should not be permitted.
- (xiii) An officer or executive director should receive the unopened bank statement before turning it over to a person, other than one who handles the receipt and disbursement of cash, for reconciliation. This officer should review the bank reconciliation, then date and initial it. The reconciliation should be retained for the internal audit team.
- (xiv) The person who has authority for placing employees on the payroll and establishing wage rates should not be the same person who signs the checks.

Internal Audit of Donations

6.11 Similar to other areas, the internal audit objectives would be to ascertain completeness, measurement and presentation, ownership and existence of the receipts which would be achieved by ensuring:

- (i) Value of donations received during the year is appropriate (measurement).

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (ii) Donation recorded during the year were in fact received by and belong to the organisation (occurrence, ownership and existence).
- (iii) Value of donations received in kind, where value could be reasonably estimated were recorded (completeness).
- (iv) Cash donations during the year were recorded (completeness).
- (v) Donations during the year were adequately disclosed in the Financial Statements (presentation).

6.12 The internal auditor needs to understand the process of issuing of donation receipts by the entity. They assume importance as these are the only official documents issued to third parties attesting to donations received. The internal audit of the receipt issuing process is an integral part of the internal control examination performed by the auditor with respect to donations. In case of a registered entity, the auditor can rely on receipts to donors for claiming income tax exemptions. Where the donation is motivated by allowance of tax deductions, donors would insist on receipts thus ensuring records are available. Difficulty arises where:

- (i) The donation is not tax deductible.
- (ii) Donors do not insist on a receipt
- (iii) The amount contribute is below the minimum limit for which the entity issues receipts.
- (iv) Donation is anonymous.

6.13 It has been estimated that most organisations receipts are not issued for upto to 20% of donations. Thus, the internal auditor may not be able to express an opinion on completeness, measurement and existence of all donations. The internal audit process would mainly help the internal auditor to determine to what extent policies and procedures of the entity can be relied upon. An internal audit strategy for donations will be based on the auditor's understanding of the receipt issuing process and of internal control on donation receipts.

6.14 The internal auditor should enquire about the following policies and procedures to ensure reliability of receipts:

- (i) Control over numerical sequence.
- (ii) Procedures to ensure amount mentioned in receipts is correct.

Major Areas of Internal Audit Significance

- (iii) Control over date of issuance of receipt and date of donation.
- (iv) Details of entity name, address and registration number.
- (v) Presence of name and address of donor.
- (vi) In case of property, description of property is correct, consistent use of appraisal method competence of persons.
- (vii) Authorised signatories.
- (viii) Controls over issuing of duplicates.

6.15 Given the importance of donation receipts and unavailability of proper records, the internal audit would not be complete without some substantive testing. Procedures selected could include:

- (i) Review of receipts issued during the year to detect unusual or substantial donations which need to be audited in detail.
- (ii) Internal Audit of cash donations – Donation receipts can be used as internal audit evidence. One way is to compare records of donations in accounting system with the bank deposit slips for the day. This can be done where the internal control ensures that cash received is deposited daily as it is. Alternatively match the total receipts issued with total donation revenues recorded and with total revenues deposited in bank. This would ensure that donations received were actually recorded. But it does not provide reasonable assurance that all donations were recorded so should be used in conjunction with other procedures.

When there are differences in total amount of receipts and donation revenue shown in the books, the internal auditor should get a satisfactory explanation from the organisation. Many a time the difference is due to the different cut off dates for accounting and tax purposes or due to the fact that the donors did not ask for receipt. For donations in kind, no corresponding receipts may have been issued.

The internal auditor should analyse differences and if no satisfactory explanation would necessitate increase in internal audit procedures for donations. It would mean looking into the receipt issuing process to find, if there are any weaknesses in the internal control system, paying special attention to receipts issued late, duplicate receipts, etc.

Internal Audit of Funds

- 6.16 The internal auditor should ensure the following:
- (i) The organization's financial policy addresses the circumstances and restrictions attached to funds.
 - (ii) Though fair and reasonable requirements connected to restricted, or designated, endowment funds from donors are acceptable, the internal auditor should verify that organization carefully reviews with donors, limits, conditions, and expectations of such gift—taking special care to avoid conditions set forth by any donor which could cause the organization to stray from its basic mission.
 - (iii) In case of donor restrictions, whether the not-for-profit organisations to segregate these contributions as temporarily restricted assets until the specified conditions have been met.
 - (iv) When a donor restriction expires, whether the temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. If material, the components of temporarily restricted net assets and the amounts released are disclosed in the footnotes of the financial statements.
 - (v) When the contribution must be held by the not-for-profit organisations in perpetuity whether the amount is recorded as an asset and as permanently restricted contribution revenues. Permanently restricted contribution revenues (reported on the statement of activities) also cause the amount of permanently restricted net assets to increase.

Utilization of Endowment Funds

The internal auditor can ensure these policies, which usually are set by Board or their investment committees and, have been reviewed in conjunction with state laws.

Restricted Funds

For restricted funds following should be kept in mind by the internal auditor:

- (i) The principal amount of the permanently restricted assets is invested to generate income. Unless otherwise stated, the income earned belongs to the fund and has the same restrictions and must be accounted for as part of the fund to which it belongs.

Major Areas of Internal Audit Significance

- (ii) For investment purposes, based on conditions of the donation assets are not pooled with others, but instead, are held in separate accounts. Activity and investment performance are reported periodically. Where the assets can be pooled for investment purpose, the income is attributed to each fund, based on the amounts invested and the time for which they were invested. The amount of interest credited at the end of the investment period will be determined by the average rate of return received by the entity on investments during that period
- (iii) If a restricted fund consists of assets (e.g. a property or investments) and any are sold, the proceeds of sale must be held within the same restricted fund.
- (iv) The only exceptions to the above are: (i) where the donor has expressly provided for some other use for the income; (ii) where the asset is part of a permanent endowment held for general purposes. In this case, the capital is restricted in an endowment fund (because it cannot be spent) but the income is unrestricted and can be spent for general purposes. E.g., Millionaire Foundation awards ₹ 5,00,000 for use over twenty years for general operating support.

Donated Property, Plant and Equipment

6.17 One of the primary issues in accounting for donated goods is their valuation in the NPO's financial statements. Since in kind contributions are recognised by the Income tax authorities in Canada and USA, the internal auditors can review the receipts issued for tax purposes with accounting records but in India since Section 80 G provides exemption only for monetary donations auditors cannot use that method.

6.18 Though the transactions is non-monetary in nature the inherent risk in determining their value remains high, particularly for used assets not recently involved in a business transaction. Donated property, plant and equipment may be recorded by the organisation when an estimate of fair value can be reasonably made. Both the Canadian standards and US SFAS 157 talk of fair value. Fair value would be "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date". During internal audit , the internal auditor should review the documents, invoice or appraisal reports in supporting the market value attributed to these assets.

6.19 In many circumstances, the organisation is likely to receive bulk quantities of the donated items (for example, manufacturers and/or retailers donating packaged foods, new toys, new blankets, stationery etc.). In such cases, the entity can use wholesale values for the items received.

Internal Audit of Small or Used Items

6.20 The completeness of donations often presets a high inherent risk, especially in case of small furniture or equipment belonging to organisations that do not capitalise their assets.

The reasons could range from NPO not valuing its low value assets at all due to difficulty involved or it might estimate their value. If the NPO is using estimates, the internal auditors should ensure that if, the methods are being applied consistently and the results obtained are reasonably expected not to be materially different from detailed measurements. The internal auditors should obtain sufficient appropriate evidence to enable them to evaluate whether management accounting estimates are reasonable within the context of the financial statements as a whole.

6.21 Valuation of used items also needs to be considered. For example, if the NPO received donated office furniture from a business, how would it value it? Here the concept of “exit price” comes into the picture. The recipient charity should consider the market that would be most advantageous for the asset. It would need to identify the market where it would get the best price for the items. In case of used furniture, because of the volume and condition of the items the organization could not sell them to users directly, the best market could be the price that a used furniture outlet store would pay an office for such items.

Donated Services

6.22 Contributed services are a significant activity for many non profit organizations. However, most of the time it is difficult to place a monetary value on donated services, and the NPO may also not have control over the time and effort put in, so such services are generally not recorded as contributions and expense. Then again, there are some services which if not recorded would not show a correct picture of the entity position on the financial statements. Some such services would include:

- (i) Legal, accounting, and other professional services,
- (ii) Donation of office space,
- (iii) Providing free use of equipment such as computers, printing equipment.

Major Areas of Internal Audit Significance

6.23 The thumb rule for recognition would be to recognise services, only if they:

- (i) can be easily measured,
- (ii) create or enhance non-financial assets (e.g., constructing a building), or
- (iii) require specialized skills, are provided by individuals possessing those skills (e.g., carpenters, doctors, and accountants), and
- (iv) would typically need to be purchased if not provided by donation.

Illustrations

What constitutes donated service?

- a. A lawyer on the NPO board reviews the organization's contracts and receives the handicrafts made at the NPO in appreciation of her services.

The lawyer's services are within the scope of her voluntary service on the board which is not compensated and not recognized.

- b. A local accountant volunteers 10 hours of service a week to set up the information system and helps in recording transactions. His professional services are valued at ₹ 350 an hour.

The accountant's services should be recognized as donated service because he is providing specialized services that would otherwise have had to be purchased.

- c. The executive director is a salaried employee.

The director is compensated so it does not constitute donation.

- d. Several local citizens were at the counter at the fun fair organised by the NPO and were noting the name of the participants at the contest.

There was no specialised services provided.

Grant Management

6.24 Funders expect not-for-profit organisations to justify the request for funding and its capability to use it in an effective fashion. The grant proposal should be able to bring out how the applicant's research has determined, and

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

demonstrate, that the project being presented is central to the funder's agenda. Strong proposals offer compelling solutions to be carried out by competent, solvent applicants. Grant management thus involves researching grant sources, planning projects, preparing proposals and budgets and managing funded programs and evaluating them. In short, the entity has to be able to develop funders' interest in the organization's mission/services, developing in them a passion for the mission and a commitment to the organization's future, getting them to make-the-gift, and maintaining the relationship so that they will continue to support the mission and continue to give.

6.25 It has been found that a high number of funding requests, estimated at 90 percent, are declined as they fall outside a funder's stated interest areas or because they are inadequately prepared and do not reflect an organisation's strengths and its ability to carry out a proposal's objectives. Also , if grants are not utilized as per decided terms or periodic reports are not sent, the funder will not make any further disbursements. It thus becomes essential for the internal auditor to review the proposals and management of grant and contribution programs.

6.26 The internal auditor has to first gain an understanding of the process and then go into details of management of project under grant:

First Step: Details of Grants

The Internal auditor should obtain:

- (i) A list of all grants procured by the organization, including the amount of grant, time frame for fund usage, and the specific program, service or project the money has been designated for. get copies of any specific financial arrangements or contracts required by the grant-making organization.
- (ii) Documentation on entity's goals and its strategy to achieve them. The entity would have a plan on amount of money required and use of the money along with detailed procedures for executing the plan.

Second Step: Service Provision and Outcomes

A well documented service provision and outcomes should have the following details:

- (i) the mission statement and listing of all the services the organization provides to the community under the umbrella of the mission.

Major Areas of Internal Audit Significance

- (ii) Documentation of the scope of those services; how large is the service area? Is the organization state, county or citywide? List the population the organization serves; is it a specific population, such as individuals with disabilities, homeless or battered women, or children?
- (iii) Documentation of outcomes, or how the NPO's services positively affect the population it serves, numbers of people affected and length of time individuals utilize the services of the NPO.

Third Step: Information on Project

Obtain knowledge of the policy history, the program results desired, critical success factors, risks, known weaknesses, as well as matters specific to the program under review. At the core of internal auditing, grants and contributions is the determination of whether financial management and control is adequate. There should be clear evidence for the following:

- (i) Support for appropriate decision-making at all levels;
- (ii) Availability of timely, relevant and reliable management information, both financial and non-financial;
- (iii) Management of risk;
- (iv) Efficient, effective and economical use of resources;
- (v) Accountability for the use of resources;
- (vi) A compliance with authorities and safeguarding of assets; and
- (vii) Monitoring and reporting of actual results.

In short, auditing grants and contributions programs amounts to the determination of an appropriate level of due diligence in the management of funds.

Fourth Step: Project Management, Implementation

- (i) Has the management reviewed the program design to ensure that it provided for effective control?
- (ii) Are the results expected from the program clear, measurable, directly related to objectives?
- (iii) Do the eligibility and assessment criteria, and any associated direction, directly address and contribute to these expected results?

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (iv) Does the program design address relevant risks?
- (v) Is there a centre of expertise/central review group for grants and contributions in the organization to assist program management?
- (vi) Are responsibilities well defined – in particular, those of people who are not program staff but are involved in funding decisions?
- (vii) Do available resources (human, physical, financial and other) match the workload for the program?
- (viii) Are responsibilities among staff supportive and clear?
- (ix) Does staff have the time and means to enforce the rules and carry out their responsibilities?
- (x) Does staff have information, tools and essential resources to do their jobs well?
- (xi) Does staff know how to assess an application under the program, and how to monitor a project with due diligence?

Fifth Step: Project Reporting

- (i) Are actual project results measured and rolled-up?
- (ii) Is there on-going program information on achievement of expected results?
- (iii) Are there compliance audits/reviews of projects?

Chapter 7

Illustrative Internal Audit Checklist

This chapter contains detailed internal audit checklist on various aspects of non-for-profit organisations. The checklist is general in nature, which can be customized according to nature and size of the organisation:

A. Knowledge of Business

S. No.	Particulars	Y/N N/A	Notes
1.	<p>What are the documents available about the NPO's activities:</p> <ul style="list-style-type: none"> • Articles of incorporation • Regulations • Major contracts • Minutes of meetings • Brochures, newsletters or reports distributed to members or donors. 		
2.	<p>What information is available about the NPO's external environment:</p> <ul style="list-style-type: none"> • Tax, legal, regulatory and contractual obligations • Manuals, periodicals, financial information about similar organisations. 		
3.	<p>Which of the following sources for financial information are available:</p> <ul style="list-style-type: none"> • Working papers of previous engagements • Annual reports • Budgets 		
4.	<p>What accounting policies are adopted by the organisation for:</p> <ul style="list-style-type: none"> • Capital assets • Donated materials • Donated services • Fund accounting • restricted assets and funds 		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

S. No.	Particulars	Y/N N/A	Notes
5.	<p>What are the NPO's main sources of income?</p> <ul style="list-style-type: none"> • Obtain information on major sources of funding and names of main contributors. • Methods to collect donations. 		
6.	<p>What are the characteristics of the recipients of NPO's services:</p> <ul style="list-style-type: none"> • Physically challenged • Economically deprived • Homeless children, etc. 		
7.	<p>Who are the related parties?</p> <p><i>The income tax exemption available to NPO would not be available on the portion of income or property if it is used for the benefit of certain specified persons (Section 13). These include:</i></p> <ul style="list-style-type: none"> • <i>Author of the trust or founder of the institution</i> • <i>Trustee or manager of the trust</i> • <i>Person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds [fifty thousand] rupees.</i> • <i>Any relative of any such author, founder, trustee, manager, or member as aforesaid.</i> • <i>Where such author, founder or person is a Hindu undivided family, a member of the family.</i> • <i>Any concern in which any of the person, mentioned above, has substantial interest.</i> 		

B. Budgeting

S. No.	Particulars	Y/N N/A	Notes
1.	<p>Which of the following budgets does the organisation have:</p> <ul style="list-style-type: none"> • project /program budgets. (e.g. those relating to one activity or donor-funded project) • core costs (administration/overheads) budget. • comprehensive operating budget (organisation-wide budgets consolidating all activities like cost of programs ,management and fundraising). • Others.[specify] <p><i>Try to get copies or go through the most recent budgets available, noting the period they refer to.</i></p>		
2.	<p>Whether the organization prepares cash flow projections.</p>		
3.	<p>What process is used to produce the organisation's budgets.</p> <ul style="list-style-type: none"> • <i>Find out who is involved(executive staff / finance committee)</i> • <i>When they are produced (year end or quarterly)</i> • <i>Is there a link to the organisation's mission and objectives?</i> 		
4.	<p>What method is used to produce the organisation's budgets:</p> <ul style="list-style-type: none"> • Based on historical figures and projections made? • Periodically year -end revenue is forecast and budget adjusted 		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

S. No.	Particulars	Y/N N/A	Notes
5.	<p>Is there provision for contingencies to deal with emergency or unexpected expenses:</p> <ul style="list-style-type: none"> • unexpected repairs and maintenance. • Personnel expenses due to retirement or maternity leave. • changes in tax rates, fringe benefits, allocations of rents, auditing fees, etc. 		
6.	<p>Is the organisation's annual budget formally approved by the Board and entered in the minutes: Are significant changes to the budget approved by the Board.</p>		
7.	<p>Whether the organisation prepares budget report comparing the actual to budgeted amounts: <i>For actual the organization needs to monitor unit costs of programs and services through the documentation of staff time and direct expenses and allocate the management , general and fundraising expenses.</i></p>		
8.	<p>Whether the organization has established a plan identifying actions to take in the event of a reduction or loss in funding.</p>		
9.	<p>Whether The organization has established, or is actively trying to develop, a reserve of funds to cover at least three months of operating expenses.</p>		

C. Internal Control

S. No.	Particulars	Y/N N/A	Notes
1.	<p>Does the organisation have an up-to-date Organisation Chart?</p> <p><i>If not, enquire about admin structure and management responsibilities.</i></p>		
2.	<p>What are the roles of various levels of management?</p> <p><i>Note the job profiles and hours spent in various activities like fundraising, program management, admin etc.</i></p>		
3.	<p>Does the organisation have approved policies outlining its expectations in:</p> <ul style="list-style-type: none"> • Financial management practices • Personnel management practices • Conflict of interest • Fundraising practices • Quality of services to users, clients, consumers, or the public • Safety of staff, volunteers, and clients <p><i>Find out about the nature and extent of entity's reliance on volunteers and its impact.</i></p> <p><i>Training provided to staff</i></p>		
4.	<p>What are the policies and procedures in various activities? Are they written down? Are they communicated to executive staff?</p> <ul style="list-style-type: none"> • Delegation of authority • Cash handling • Procurement • Payment 		
5.	<p>Are the above policies and procedures implemented ?</p>		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

S. No.	Particulars	Y/N N/A	Notes
6.	<p>Is there proper segregation of duties in critical activities:</p> <ul style="list-style-type: none"> • Finance and book-keeping ? • Procurement and payment • Invoice approval and cheque signing 		
7.	<p>What controls are in place for handling cash.</p> <ul style="list-style-type: none"> • Cash receipts recorded immediately and deposited in the bank? • A person with no access to cash compares cash receipts records and authenticate deposit slips? • All incoming money banked and no amounts held over for petty cash "feeding"? • Numbered duplicate receipts issued for all incoming cash and cheques? • Segregation of duties between Individuals handling cash and person recording in the ledgers? <p><i>Variations should be explained</i></p>		
8.	<p>What controls are in place for cheques received and issued.</p> <ul style="list-style-type: none"> • Rules for authorisation of payment? • Cheques never signed in blank? • Cheques are issued in sequence, blank cheques safeguarded and all Cheque numbers, even destroyed Cheques are entered into the accounting program. • Segregation of duty- cheque signing and invoice approval; person deciding salary amount and signatory • Cheques issued only for approved invoices and never signed without proper documentary evidence of the nature of the payment? 		

Illustrative Internal Audit Checklist

S. No.	Particulars	Y/N N/A	Notes
	<ul style="list-style-type: none"> • Authorised signatories approved by the governing board 		
9.	<ul style="list-style-type: none"> • What controls are in place for bank accounts. • All bank accounts held in the name of the NPO, not individuals. • Authorisations for bank operations and cheque signatories done yearly. • Bank notified of the amounts beyond which counter-signatures are required. • Instructions to open or close accounts properly authorised and / or reported to Trustees/Board. • Secure records held for all bank accounts. • Regular bank reconciliations carried out by someone other than the person who signs the cheques. • Bank statements regularly inspected by the Board. 		
10.	<ul style="list-style-type: none"> • Which of the following controls over purchases are followed: • Competitive quotations are considered wherever applicable. • Supporting documentation held for all items of expenditure (i.e. invoices, vouchers, receipts). • All expenditure properly authorised. • Invoices checked against orders made. • The quality and quantity of goods supplied checked against orders made. • Payments only made against original invoices (i.e. not on monthly statements or photocopies). 		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

S. No.	Particulars	Y/N N/A	Notes
11.	<p>Whether Organizations take periodic inventories?</p> <ul style="list-style-type: none"> • monitors the inventory against theft. • reconciles general ledger inventory information. • maintains an adequate inventory level. 		
12.	<p>Whether Organizations has an effective contracting or tendering system:</p> <ul style="list-style-type: none"> • Complies with the requirements of procurement legislation; • is open and fair; • meets all the requirements of each contract or tender. 		

D. Finance

S.No.	Particulars	Y/N N/A	Notes
1.	Whether the organisation has set up appropriate financial systems.		
2.	Whether the organisation has employed qualified persons, either full-time part-time or voluntarily to administer and manage the systems.		
3.	<p>Whether the organisation has financial policies and procedures manual which includes:</p> <ul style="list-style-type: none"> • Financial statement presentation • distribution of financial statements • system of accounting codes • investment policies • cheque signing procedures • bank statement reconciliation procedures 		

Illustrative Internal Audit Checklist

S.No.	Particulars	Y/N N/A	Notes
	<ul style="list-style-type: none"> • travel expense and other policies • revenue collection and recording • payroll policy, • insurance policies, • controls over fixed assets, • controls over inventories (if applicable), budgeting procedures • tax procedures (if applicable) and • conflicts of interest 		
4.	Whether capital needs are at least reviewed annually.		
5.	Whether the organization has insurance coverage. <ul style="list-style-type: none"> • insurance coverage is adequate. • which is periodically reviewed to ensure the appropriate levels and types of coverages are in place. 		
6.	Whether the organization has clear policies on loans and staff advances.		
7.	Whether the organization has a policy regarding the receipt of outside honoraria and/or remuneration in order to avoid 'duplicate' or inappropriate payment.		
8.	Whether employees, board members and volunteers who handle cash and investments are bonded to help assure the safeguarding of assets.		
9.	Whether the organization has a written policy related to investments.		
10.	Whether Training is made available for board and appropriate staff on relevant accounting topics.		

E. Donation and Grants Received

S.No.	Particulars	Y/N N/A	Notes
1.	<p>What controls are in place for donation receipts:</p> <ul style="list-style-type: none"> • control over numerical sequence • Procedures to ensure amount on receipts ins correct • Control over date of issuance of receipt and date of donation • Details of entity name , address and registration number present • Presence of name and address of donor. • In case of property, description of property is correct , consistent use of appraisal method competence of persons • Authorised signatories <p>Controls over issuing of duplicates</p>		
2.	<p>What are the different methods to collect donations:</p>		
3.	<p>Review receipts to detect substantial or unusual donations.</p>		
4.	<p>Whether total receipts issued match donation revenues and amount deposited in bank.</p> <p><i>Variations to be explained</i></p>		
5.	<p>Whether relevant details of grants received maintained:</p> <ul style="list-style-type: none"> • list of all grants procured by the organization with details of amount of grant, time frame for fund usage, and the specific program, service or project the money has been designated for. • any specific financial arrangements or contracts required by the grant-making organization 		
6.	<p>What is the effect of non compliance with restrictions</p> <ul style="list-style-type: none"> • Penalties and sanctions 		

Illustrative Internal Audit Checklist

S.No.	Particulars	Y/N N/A	Notes
	<ul style="list-style-type: none">Financial impact		
7.	Enquire on the reasons for non compliance with conditions or restrictions.		
8.	Whether the organisation has designated ratios and standards to keep control of fundraising and administration costs.		
9.	Whether the organisation has developed a diversified funding base to reduce the risk of financial dependency.		

F. In-kind Contribution

S. no.	Particulars	Y/N N/A	Notes
1.	How is the valuation of Donated property carried out: <ul style="list-style-type: none">Method usedSupporting documents which are evidence of the value attributedPresentation in financial statements		
2.	What is the policy of the organisation for valuation of donated material and services. <ul style="list-style-type: none">Method usedMethod used consistentlyAudit the estimated valuePresentation in financial statementsCompare with earlier years data		

G. Compliances- FCRA 2010

Sr.No.	Particular	Y/N N.A.	Note
1.	<p>Whether any foreign contribution is received by the organization during the period: If yes,</p> <ul style="list-style-type: none"> • organisation has obtained the certificate of registration from the central govt. or • has taken the prior permission from the CG. 		
2.	<p>Whether receipt of contribution has been reported to the Central Government within 30 days of receipt with the following details:</p> <ul style="list-style-type: none"> • amount of the foreign contribution • its source • the manner in which it was received • the purpose for which it was intended, and • the manner in which it was used. 		
3.	<p>Verification of registration documents as per FCRA</p> <ul style="list-style-type: none"> • to verify registration certified issued by Ministry of Home Affairs • to verify the designated bank account mentioned in certificate • to verify the nature of organization in certificate. 		
4.	<p>Documents in support of receipts of foreign contribution:</p> <ul style="list-style-type: none"> • to verify the donor letter & purpose there of. • whether the purpose mentioned in donor letter is in accordance with the object & registration certificate. 		

Illustrative Internal Audit Checklist

	<ul style="list-style-type: none"> • whether the source is a foreign source • whether interest & other incidental income generated out of foreign contribution is accounted properly in FC books. • whether such foreign contribution deposited in designated bank account mentioned in registration certificate. • To counter check total foreign contributions with total cr in designated bank account. 		
5.	<p>Document in support of utilization of foreign contribution:</p> <ul style="list-style-type: none"> • to verify the purpose of utilization. • to verify whether such utilization is in accordance to donor instruction • to verify whether the utilization reached to end user. • To verify supporting for such utilization 		
6.	<p>Utilisation of foreign contribution by way of donation to other trust:</p> <ul style="list-style-type: none"> • to verify the registration status of donee organisation under FCRA. • to verify the purpose for which such donation made. • to verify supporting for such transaction. • to verify application/ proposal from donee. 		
7.	<p>Whether organisations is complying with donor restrictions, if any:</p> <ul style="list-style-type: none"> • Financial managers have copies of relevant documentation to know the restrictions set forth. • Are the funds being utilised in accordance with the donor's wishes. 		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

8.	<p>Whether utilisation of foreign contribution as per the FCRA Act:</p> <ul style="list-style-type: none"> • Verify whether FC is used for speculative business. If it has been so used, this should be included in the report. • Administration expenses amount to not more than 50% of the total amount of foreign contribution. 		
9.	<p>In case, there is transfer of foreign contribution to another entity, it complies with provisions of FCRA, 2010.</p> <ul style="list-style-type: none"> • other person is also granted certificate of registration. • If transfer to unregistered entity should get prior permission and total amount of transfer to unregistered organisations should not exceed 10% of the total foreign contribution received. 		
10.	<p><u>Administrative Expenditure.</u></p> <p>(i) Section 8 of the FCRA 2010 provides that the administrative expenditure shall not exceed 50% of the total utilization of funds out of FCRA receipts. Further, it states that any expenditure of administrative nature in excess of 50% shall be defrayed with prior approval of the central government.</p> <p>(ii) The rule further provides that any type of expenditure expended directly on programme activities shall not be considered as administrative in nature.</p> <ul style="list-style-type: none"> • to verify for the overall expenditure of organization towards administrative expenditure. • to verify direct cost for projects and other administrative expenditure. • to verify overall budget of the organization. 		

11.	<p><u>Change in member of executive committee/Governing council</u></p> <p>(i) FCR Rules through its Forms require prior permission for change of more than 50% of members of Executive Committee of an NGO.</p> <p>(ii) Form FC-3 pursuant to FCR rule 9(1)(a) of 1976 and Form FC-4 pursuant to FCR rule 9(2)(a) of 2010 includes 'Declaration and undertaking' by the Chief Functionary of the applicant organization which in point (ii) specifies obtaining of prior permission for the changes causing replacement of 50% or more members of the Executive committee/Governing Council.</p> <p>(iii) There is no corresponding provision in FCR Act 1976 or 2010 which provides for the above and so forms in rules takes the effect of superseding the Act. The rules are made under the power conferred by the Act itself and cannot have any provision which stretches beyond the Act.</p> <ul style="list-style-type: none"> • to verify the present status of governing body and to ensure there is no substantial change in the overall composition. • In case of change in excess of prescribed limit to ensure for necessary approval has been obtained from ministry of home affairs. 		
12.	<p><u>Consultancy income of an NPO</u></p> <p>(i) FCRA, 2010 excludes 'the professional/ consultancy fees paid to NGOs from Foreign Source' from the definition of</p>		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

	<p>Foreign Contribution.</p> <p>(ii) Explanation 3 to Section 2(1)(h) of FCRA 2010 states that any amount received, by any person from any foreign source in India by way of fee or cost against business, trade or commerce shall not be considered as foreign contribution. In other words, such receipts shall be kept outside the FCRA account.</p> <ul style="list-style-type: none"> • to verify whether any of such transaction is recorded in FC accounts. • to verify such similar type of contract with donor agency. 		
13.	<p><u>Information on Public domain</u></p> <p>(i) Rule 13 provides for requirement of keeping the information regarding receipt and utilization in public Domain.</p> <p>(ii) The Rule provides that if the contribution received during the year exceed ₹ 10 million, then the organisation has to keep in the public domain all data of receipts and utilization during the year and also in the subsequent year. The rule also states that the Central Government will also upload such summary data through its website.</p> <p>(iii) The manner of disclosure or meaning of 'public domain' has not been explained. It seems that all such organizations are required to have their own website where such data should be uploaded.</p> <ul style="list-style-type: none"> • to ask for web site and to verify that the information as required by the rule is kept on it and is accessible to all. 		

Illustrative Internal Audit Checklist

14.	<p><u>Speculative investment</u></p> <p>(i) The new law does not permit investment of surplus funds in risky or speculative assets. Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund.</p> <p>(ii) Rule 4(1)(b) prohibits investment in high return schemes or in land if it is not directly linked to the declared aims and objectives of organisation. Basically the idea is to prevent investment of short term funds into risk bearing instruments or assets.</p> <ul style="list-style-type: none"> • to verify the details of investments to ensue no investment is made in such speculative investment. 		
15.	<p><u>Prohibited Sources.</u></p> <p>The Act provides power to the Central Government under section 11(3) (iv) to notify such source(s) from which foreign contribution shall be accepted with prior permission only. It implies that the Central Govt. may notify specific donors or countries from which foreign funds could not be received or shall be received with prior permission only.</p> <ul style="list-style-type: none"> • To verify sources of all foreign contribution and to ensue that no fund is received from such prohibited sources. 		
16.	<p><u>Contribution received in kind.</u></p> <p>(i) The new FCRA Rules under form FC-7 requires a certificate from a Chartered Accountant with regard to the foreign contribution received in kind there was no such requirement in the earlier Act and Rules. A Chartered Accountant normally certifies only objective valuations. In case of contribution</p>		

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

	<p>received in kind from foreign sources the authentic valuation in India is not normally available which may cause problems for the Chartered Accountant in certifying such valuations. In this regard, it is important that the FCRA department issues guidelines on the valuation of contributions received in kind and thereafter the Chartered Accountant can certify whether such processes were followed or not. Further, when FC assets are given by one FC registered organization to another FC registered organization. The written down value of the donor organization may be considered as a basis for valuations.</p>		
17.	<p>Make sure that the foreign contribution has been received only in single bank account.</p>		

Appendix 1

Laws for Societies, Trusts, Wakfs and other Endowments*

S. No.	Legislation	Purpose of the Act	Organisations Covered	Coverage	Measures for Purpose Compliance	Strength	Limitations
1.	<p>Societies Registration Act, 1860</p> <p>Modelled on the English Literary and Scientific Institutions Act, 1854</p> <p>Basic aim was (i) to maintain a register of such Associations functioning in the State</p>	<p>Regulation, incorporation, improving the legal condition of Societies</p>	<p>Societies registered for the promotion of literature, science, fine arts, diffusion of knowledge, education, charity, political education, libraries.</p> <p>-Non-profit Bodies</p>	<p>-requirements for registrations.</p> <p>-annual returns about Governing Body.</p> <p>-legal personality of</p>	<p>-purpose should be lawful.</p> <p>-alteration of purpose or dissolution only by General Body by special vote.</p>	<p>Least intervention by the State.</p> <p>-facilitative role of law recognized.</p>	<p>-loosely refers to democratic framework.</p> <p>-purpose compliance mechanism and financial discipline scheme ineffective.</p>

* Source: www.asianphilanthropy.org.

	<p>and (ii) to make them a legal entity; (iii) element of any control / regulation was absent in the original Act. After Independence the subject came under the State list of Schedule 7. Under Indian Adaptations Order this legislation became virtually a Model Act which could be amended only by the State Government. In subsequent years many of the governments went on adding different degrees of teeth to this Act in form of (a) palcing annual audit and other reports before the General</p>			<p>Society.</p>			
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	Body as well as to the government; (b) Registrar's power of enquiry and investigation; (c) power of supersation; (d) take over of management.						
	<p>Andhra Pradesh Societies Registration (SR)Act,1959</p> <p>Karnataka SR Act, 1960</p> <p>-M.P. SR Act,1973</p> <p>-Meghalaya SR Act,1983</p> <p>-Rajasthan SR Act,1958</p> <p>-Tamil Nadu SR Act, 1975</p>	<p>Regulation, incorporation, improving the legal condition of Societies within the State.</p>	<p>Societies established for promotion of charity, education, science, literature, fine arts, sports, foundation or maintenance of libraries, reading room, collection of natural history.</p> <p>-Non-profit Bodies</p>	<p>-requirement for registration.</p> <p>-democratic framework of Managing Committee.</p> <p>-Authority vested with General Body.</p> <p>-control over transfer of property or</p>	<p>-General Bodies control and Committees accountability.</p> <p>-annual audit and other reports to be placed before General Body.</p> <p>-Registrar's power of enquiry, investigation, surcharge and actions like superseding</p>	<p>-systematic democratic organisation.</p> <p>-well conceived financial discipline.</p> <p>-effective scheme for purpose compliance.</p> <p>-laws role both facilitative and regulative</p>	<p>-excessive governmental intervention amounting to regimentation.</p> <p>-freedom to disassociate is difficult to exercise.</p>

	<p>-Travancore-Cochin Literary, Scientific & Charitable Societies Act, 1955</p> <p>-U.P. SR Act,1976</p> <p>-W.B.SR Act,1963</p>			<p>use of funds.</p> <p>-extensive power of Registrar - financial discipline.</p>	<p>appointment of administrator.</p> <p>-Court's or Registrar's power of dissolution and cancellation of registration.</p>		
2.	<p>Religious Endowments Act,1863</p> <p>Basically a Private Endowment Act which placed the property under the management of Trustee/Trustees under a Will for religious and charitable purposes.</p> <p>It was some sort of a contract between the Will maker and the</p>	<p>Management was solely in the hands of the Trustees.</p>	<p>Endowments of Mosques, Temples and other religious establishments.</p>	<p>Rights of Trustees;</p> <p>appointment of Regional Committees;</p> <p>members of Regional Committees;</p> <p>Duties of the Trustees.</p>	<p>-Trustees to give accounts.</p> <p>-committee to supervise.</p> <p>Since it was a contract between the Will maker and the Trustees, the only intervention possible was through filing of a civil suit in a court</p>	<p>-autonomy to Endowment.</p> <p>-concept of elected Body of the Committee.</p> <p>-control over Trustee.</p>	<p>-life tenure of Committee Member.</p>

	Trustee.				of law. -suits for breach of trust.		
3.	Charitable and Religious Trusts Act, 1920 Concept of Public Trust came to be established firmly. Trustees were made accountable for disclosure of the income and the value of the Trust. Civil courts given sue-motto powers to pass orders relating to proper management of Trust. But direct intervention of the government was not at all intended. After Independence, the	Effective control over charitable and religious Trusts.	Charitable and Religious Trusts.	-Trustee under an obligation to disclose object, income and value of Trust. -court to pass orders relating to proper management.	-Court's interference for proper administration. -Remedies under civil procedure code for breach of trust.	-Transparency is ensured by disclosure of particulars. -Courts regulative role.	-Extensive institutional or administrative control is absent. -preventive mechanism is not adequate.

	<p>situation changed drastically. Many of the State Government enacted their own Religious and Charitable Endowments Act in the areas of temple management. State Government officials (State Government appointed Trustees and functionaries) given widespread administrative and supervisory powers.</p>						
	<p>a) Madras Hindu Religious and Charitable Endowments Act,1951 b) Travancore-Cochin Hindu Religious</p>	<p>Administration and governance of all Hindu public religious institutions and endowments in the concerned State.</p>	<p>Hindu public religious institutions and endowments including Matths.</p>	<p>Formation, rights and duties of Trustees, powers of Authorities</p>	<p>-supervising powers of authorities. -religious qualifications and duties of Trustee</p>	<p>-systematization in temple administration. -wide-ranging powers of State Authorities to ensure</p>	<p>-lack of democratic framework for devotees participation.</p>

	Institutions Act, 1950			such as - Commissioner , Deputy Commissioner , Assistant Commissioner , Accounts Committee etc.	and servants. -financial accountability for proper use.	purpose compliance.	
	c) Andhra Pradesh Charitable and Hindu Religious Institutions and Endowments Act,1966	Administration and governance of all Hindu Public Religious Institution and Endowments in the State.	Hindu public religious institutions and endowments including Matths.	-registration. -vesting of property in the institution. -appointment of Board of Trustees, rights, powers, duties,	-requirement of giving accounts, audit, budget. -regulation on investment of funds and use of surplus funds.	-Chairman of the Board of Trustee is elected by the Board of Trustees. -elaborate measures about Tirupati Temple.	-lack of democratic framework for devotees'participation

				disqualifications of Trustees. -Powers of Authorities.			
	d) Karnataka Hindu Religious Institutions and Charitable Endowments Act, 1997	Administration and governance of Hindu public religious institutions and endowments in Karnataka other than Matths and Institutions of religious denominations.	Hindu religious institutions and Charitable Endowments other than Matths and denomination institutions.	-formation of Committee of Management for each notified institution. -Advisory Committee at State level. -Powers of Authorities.	-requirement of giving accounts, audit, budget. -regulation on investment of funds and use of surplus funds. -power to suspend improperly Working Committee. -proper administration of common pool fund.	Extensive measures for financial discipline.	-exclusion of Matths and religious denominations. -lack of democratic participation of devotees.

4.	<p>Wakf Act,1995 Special kind of Charitable and Religious Endowments Act.</p> <p>To manage Muslim Trust properties (Wakf). This again guided by a Will.</p> <p>Little regulatory powers of the government. In case of any dispute, it could be settled only by a Civil Court.</p>	<p>Better administration of Wakfs, superintendence and control of Wakfs.</p>	<p>Wakfs or permanent dedication by a Muslim, of any property for any purpose recognized by the Muslim law as pious, religious or charitable.</p>	<p>-formation of Wakf Board.</p> <p>-distribution of power between Wakf Board and Wakf Commissioner</p> <p>-appointment of Executive Officer.</p> <p>-strengthening finance of Wakf Board.</p> <p>-restrictions on powers of Muttawalli</p> <p>-Wakf Tribunal.</p> <p>-prevention of</p>	<p>-restraints on powers of muttawalli.</p> <p>-restriction on misuse of property</p> <p>-Executive Officer's role.</p> <p>-Wakf Tribunal's interference</p>	<p>Semi-democratic composition of Wakf Board.</p> <p>-protection against misuse of mechanism for purpose compliance is effective.</p>	<p>Beneficiaries are not given any opportunity in decision making.</p>
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				misuse of improper transfer of property			
5.	Charitable Endowments Act, 1890 The government introduced some elements of regulation by instituting a post of treasurer in each State to oversee the functioning of such charitable endowments. It was the first step towards State intervention in the field of charity.	Vesting administration of property held in Trust for charitable purpose	Public Trusts for charitable purpose.	-defines charitable purpose. -constitutes treasurer for charitable purpose. -vesting and administration of property.	Treasurer has the responsibility of using Trust's property for the purpose mentioned in the Trust Deed.	State's involvement in ensuring proper use of Trust property.	Skeleton like legislation without elaboration for peoples' participation.
6.	Indian Trusts Act, 1882 beginning of charity	Registration/ incorporation. Rights	Private Trusts either for charitable or	Creation of Trust, duties,	Beneficiaries can compel Trustee	facilitates creation of	Lack of remedies outside the

	laws in the country. Basically for management of a Private Trust created by a person through a Will, in the form of a contract between the Will-maker and the Trustees. The intended benefit was only for the family members as mentioned in the Will. The intervention could only be through Civil Court.	and duties of Trustees and beneficiaries.	other lawful purposes.	liabilities, rights and powers of Trustees. Rights and liabilities of beneficiaries.	through legal proceeding to execute the trust and avoid breach of trust.	Trusts. -codifies rights and duties of Trusts and beneficiaries -does not involve extensive State control	courts. -lack of State supervision.
	a) Bombay Public Trusts Act, 1950: The first Act for Public Endowments; Firmly established strong regulatory presence of the State Government (Charity	Detailed measures for governance of Public Trusts in the State of Maharashtra.	Public Trusts	- superintendence of Public Trusts by Charity Commissioner. -quasi-judicial	-suspension or dismissal of Trustee by Charity Commissioner for injurious acts. -prevention of waste, damage or	-transparency. -in-built checks by Charity Commissioner. -purpose compliance is effective. -economically more	-not much insistence on democratic governance. -over work on Charity Commissioner. -over dependence on Charity Commissioner.

	Commissioner). Provision for suspension and dismissal of Trustees, special audit of accounts.			adjudication by Charity Commissioner .	improper transfer of Trust property. -special audit of accounts and inquiry about laws.	effective.	
7.	Trade Unions Act, 1926	Registration, rights and liabilities of Trade Unions.	Trade Unions	-arrangements and requirements about registration of Trade Unions. -immunity from civil suits and from criminal liability. -funds, amalgamation dissolution.	-Registrar's power to cancel registration - annual returns. -access to Registrar.	-scope for election of office bearers. and democratic framework. -competence to involve in collective bargaining.	-no check against outside /political interferences - purpose clause usually vague

8.	Indian Companies Act, 1956, Section 25	Registration of Nonprofit Companies/ Institutions	Not-for profit Companies	-arrangement and requirement about registration. -corporate entity - privileges of a Limited Company.	Acts done in violation of Memorandum of Associations are invalid, Directors are answerable	-enables a corporate personality. -General Body meetings controls, policies and leadership.	
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Appendix 2

Comparative Analysis between Various State Legislations on Societies

1. Purpose for Formation of Societies
 - (a) Societies Registration Act, 1860 provides for formation of a Society for any literary, scientific, or charitable purpose, or for any such purpose as is described under Section 20 of the Act. In terms of Section 20, the following Societies may be registered under this Act:

“Charitable Societies, the military orphan funds or Societies established at the several presidencies of India, Societies established for the promotion of science, literature, or the fine arts for instruction, the diffusion of useful knowledge, [the diffusion of political education], the foundation or maintenance of libraries or reading-rooms for general use among the members or open to the public, or public museums and galleries of paintings and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.”
 - (b) State Amendments –
 - (i) Andhra Pradesh - A Society can be registered for promotion of art, fine art, charity, crafts, religion, sports, literature, culture, science, political education, philosophy or diffusion of any knowledge, or any public purpose.
 - (ii) Karnataka – Societies can be established for promotion of charity, education, science, literature, fine arts, or sports, diffusion of knowledge relating to commerce or industry or of any other useful knowledge, diffusion of political education, foundation or maintenance of libraries, reading rooms, public museums and galleries, the promotion of conservation and proper use of natural resources and scarce infrastructural facilities like – land, power, water, forest, etc. and the collection of natural history, mechanical and philosophical inventions, instruments or designs. This is subject to the provision that such Societies would intend to

apply their profits or other income in promoting their objects and prohibit the payment of any dividend or distribution of any income or profits among their members.

- (iii) Madhya Pradesh – Societies may be formed for promotion of science, education, literature or fine arts, diffusion of useful knowledge or political education, foundation or maintenance of libraries, galleries of paintings and arts, public museums, collection of natural history, mechanical and philosophical inventions, instruments or designs, promotion or social welfare, promotion or religious or charitable purpose including establishment of funds for welfare of military orphans, political sufferers and welfare of the like, promotion of gymnastics, promotion and implementation of the different schemes sponsored by the State Government or the Union Government and promotion of commerce, industries and khadi.
- (iv) Rajasthan – For any literary, scientific or charitable purpose, military orphan funds, promotion of literary, science or fine arts, diffusion of knowledge or political education, foundation or maintenance, libraries, reading rooms, museums, galleries, collections of natural history and for mechanical and philosophical inventions, instruments or designs.
- (v) Tamil Nadu – The objects for formation of a Society are interests of consumers in the supply and distribution of essential articles, interests of passengers using buses, taxis and similar public conveyance, welfare of the physical handicap, working women and the unemployed, interests of residents in the matter of provision of civic amenities, interest of pilgrims and tourists, welfare of animals, birds and similar living beings, welfare of displaced persons and downtrodden economically and socially backward classes.
- (vi) West Bengal – Promotion of literature, arts, science or religion; any charitable purpose, including the care or relief of orphans, or of aged, sick, helpless or indigent persons; the alleviation of the sufferings of the animals; the diffusion of knowledge; the dissemination of social, political or

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

economic education; establishment and maintenance of libraries or reading-rooms for the members or for the public; the collection and preservation of manuscripts, paintings, sculptures, works of art, antiquities, natural history specimens, mechanical and scientific instruments and designs; any other object as may be notified by the State Government as being beneficial to the public or to a section of the public.

- (vii) Uttar Pradesh – In addition to the objectives listed in the Societies Registration Act, Societies can also be formed for Khadi and Village Industry and Rural Development.

1. Registration

- (a) In terms of the Societies Registration Act, 1860, the Registrar will register a Society after the Memorandum of Association and certified copy of Rules and Regulations are filed with him.
- (b) State Amendments:
 - (i) Andhra Pradesh – A Society can be registered after the Memorandum of Association and Bye-laws are filed with the Registrar. If an application for registration complying with all the provisions of the Act is not disposed of within 60 days, the Society is deemed to have been registered and the Registrar shall issue a certificate to that effect. In case of refusal of registration, an appeal shall lie to the Registrar General.
 - (ii) Karnataka – Registration to be given on the basis of MOU and the Rules and Regulations filed with the Registrar. In case of refusal, an appeal shall lie to the Karnataka Appellate Tribunal.
 - (iii) Madhya Pradesh – Registration certificate to be issued on the basis of a copy of MOU and the Rules and Regulations.
 - (iv) Rajasthan – Registration is done on the basis of the certified copy of MOU.
 - (v) Tamil Nadu – Registration certificate to be issued on the basis of a copy of MOU and the Rules and Regulations.
 - (vi) West Bengal – Registration certificate to be issued on the basis of a copy of MOU and the Rules and Regulation. An

appeal shall lie to the State Government against an order of the Registrar refusing to certify the registration and the decision on such appeal shall be final.

- (vii) Uttar Pradesh – The certificate of registration shall remain enforce for a period of two years from the date of issue and will have to be renewed thereafter. If any question arises regarding entitlement of the Society for registration, the matter shall be referred to the State Government and the decision of the State Government shall be final.

2. Changes in the Memorandum of Association and Bye-laws

- (i) Gujarat – The MOU can be altered by special resolution passed by a majority of not less than 3/5th of the total membership of the Society and such alteration is sanctioned by the Registrar.
- (ii) Andhra Pradesh – By a “Special Resolution”, a Society may alter the provisions of the memorandum with respect to –
 - (a) Change of objectives of the Society;
 - (b) To amalgamate itself with any other Society; or
 - (c) To divide itself into two or more Society.

“Special resolution” means a resolution passed by a majority of the total members of the Society and not less than 3/5th of the members present and voting in a meeting.

The Bye-laws can be altered by an ordinary resolution passed by not less than half of the members present and voting.

- (iii) Karnataka – The MOU can be altered by a proposal agreed to by the votes caste in favour of the proposal and such votes are not less than three times the number of the votes, if any, caste against the resolution. The resolution will need to be confirmed by a simple majority of votes at a second special general meeting convened after an interval of thirty days after the former meeting.
- (iv) Madhya Pradesh – Any amendment to the MOU or Regulations of a registered Society will have to be registered with the Registrar.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Alternately, if the Registrar considers that any such amendment is necessary, he will direct the Society to make the amendments within such time as may be specified in such order. If a Society fails to make such amendment within the specified time, the Registrar will himself register such amendment and these amendments shall be binding on the Society and its members.

- (v) Tamil Nadu – The MOU and Bye-laws can be amended by a special resolution by the Society and such amendments will have to be registered by the Registrar.
- (vi) West Bengal – A Society shall not alter its Memorandum except with the previous permission of the Registrar in writing and the votes of 3/4th of its members. The regulation of a Society can be altered by the votes of 3/4th of the members subject to the provisions of the Act and its Memorandum.

3. Filing of Annual Return

- (a) In terms of the Societies Registration Act, 1860, an annual list is supposed to be filed with the Registrar containing the names, addresses and occupations of the Governors, Councils, Directors, Committee or other Governing Body entrusted with the management affairs of the Society.
- (b) State Amendments:
 - (i) Karnataka – Along with the list indicated above, a society has to file a copy of the Balance Sheet and Income & Expenditure Account audited by a person authorized under Section 226 of the Companies Act to act as an auditor of companies registered in Karnataka.
 - (ii) Madhya Pradesh – In addition to the annual list of the Governing Body, every society shall send to the Registrar a statement of Income and Expenditure with full particulars duly audited by its auditor, audit report and balance sheet of the previous year along with details of all financial activities. Accounts of such Society having annual transaction exceeding ₹ 1 lakh shall be submitted to the Registrar duly audited by Chartered Accountant. The Registrar is empowered to undertake a special audit of the account of a Society either himself or by a person authorized by him.

- (iii) West Bengal – In addition to the list of the Governing Body, every Society shall file an annual report by the Governing Body on the working of the Society for the previous year and a copy of the balance sheet and the auditors report certified by a duly qualified auditor which means a Chartered Accountant or a person approved by the Registrar in this behalf.
- (iv) In almost all the States the Registrar has been empowered to call for any information from the Society, if he so desires.

4. Property of the Society

- (a) In terms of Section 5 of the Societies Registration Act, 1860, the property belonging to a Society, if not vested in Trustees, shall be deemed to be vested in the Governing Body of such Society.
- (b) State Amendments:
 - (i) Uttar Pradesh – It shall not be lawful for the Governing Body of a Society or any of its members to transfer without the previous approval of the Court, any immoveable property belonging to such Society.
 - (ii) Madhya Pradesh – No immoveable property shall be acquired or transferred by the Society without the prior permission of the Registrar and such property will not be used for any object other than the object of the Society without prior permission from the Registrar and in case of gift, written consent of the donor.

5. Amalgamation and Dissolution of Society

- (a) Under the Societies Registration Act, the dissolution of a Society shall be decided by not less than 3/5th of the members and the subsequent settlement of the property would be done according to the rules of the Society applicable thereto. In case no such rules are in existence, it may be done as per the decision of the Governing Body. In case of any dispute between the Governing Body and the members, the matter shall be referred to the Civil Court. Subsequent assent will be required by vote of 3/5th of the members present in the general meeting convened for this purpose. Also, if the Government is a member or a contributor or otherwise interested in other Society, such Society shall not be dissolved without the consent of the government.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

Upon dissolution, any property left after discharging debts and liabilities of the Society, the same shall not be paid or distributed among the members of the Society but shall be given to some other Society to be determined by the votes of not less than 3/5th of the members. However, this shall not apply to any Society which has been founded or established by the contribution of share holders in the nature of a Joint-Stock Company.

(b) State Amendments:

- (i) Uttar Pradesh – Apart from proposing the dissolution of a Society by its Governing Body, the Registrar or not less than 1/10th of the members may also move the Court seeking an order for dissolution on the grounds of contravention of the provisions of the Act, number of the members is reduced below seven, the Society has ceased to function for more than three years, the Society is unable to pay its debts or liability and the registration of the Society has been cancelled on the grounds that the activities of the Society constitute a public nuisance or are otherwise opposed to public policy.
- (ii) Karnataka – The proposal for amalgamation of Societies needs to be approved by votes of the members which are not less than three times the number of votes cast against the resolution. The proposal needs to be reconfirmed at a second special general meeting convened by Governing Body after an interval of thirty days. The dissolution requires approval of 3/4th of the members of a Society. However, if the State Government is a member or a contributor or otherwise interested in any Society, such Society shall not be dissolved without the consent of the State Government.

The property which remains with the Society after the satisfaction of its debts and liabilities, shall be given to some other Society to be determined by the votes of not less than 3/5th of the members. The majority of the members may also decide to give such property to the State Government to be utilized for the purpose of formation of other Society.

- (iii) Madhya Pradesh – The dissolution to be decided by 3/5th of the members and to be confirmed by voting of equal number of members at a general meeting convened for the purpose. The provisions regarding property are the same as applicable in Karnataka, discussed above. However, the Registrar has also been given powers to cancel the registration on being satisfied that no useful purpose is likely to be served by continuing the Society and consequently the Society been deemed to have been dissolved. In such situation, the moveable and immoveable assets of the society shall vest in the State Governments to the extent of assistance/grant that the Society may have received from the Union or State Government or any of the statutory Bodies. It shall be the duty of the Collector of a District where the property is situated to take charge of the same on intimation of cancellation by the Registrar.
- (iv) Tamil Nadu – The amalgamation, division and dissolution of the registered Societies can be done by special dissolution and as per the Bye-laws. However, for amalgamation and division, prior approval of the registrar is required.
- (v) West Bengal – Two or more Societies can be amalgamated if so decided by the Governing Body of each such Society, if the proposal is approved by the votes of 3/4th of the Members of each of the Societies concerned and confirmed by like votes at a subsequent general meeting. However, prior approval of the Registrar would be required who can also order for modifications to be carried out in the proposal. An appeal against such orders of the Registrar lies with the State Government.

A Society may be dissolved by the votes of the 3/4th of the members at a general meeting convened for this purpose. No member to receive any profit upon dissolution and 3/4th of the members or in default thereof, by the Registrar, with the approval of the State Government can decide giving the surplus property to some other Society. The dissolution may also be ordered by the court on application of the Registrar or by not less than 1/10th of the members in case the Society contravenes any of the provisions of the Act, if the

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

number of members is less than seven, if the society has ceased to function for more than three years, if the Society is unable to pay its debt or meet its liabilities and if it is proper that the Society should be dissolved.

Also, where in the opinion of the Registrar, there are reasonable grounds to believe that a Society is not managing its affairs properly or is not functioning the Registrar may move the court for making an order for the dissolution of the Society.

6. Other Powers of the State Government and the Registrar

(i) Karnataka – (a) The Registrar may on his own motion and shall on the application of the majority of the members of the Governing Body or of not less than 1/3rd of the members of the Society, hold an inquiry or direct some persons authorized by him to hold an inquiry into the constitution, working and financial condition of a registered Society. While doing so, he will have all the powers regarding inspection of the documents, issuing summons to any person, calling general meeting, etc. During the course of such enquiry if any person related to Society has been found guilty of misfeasance or breach of trust, the Registrar can make an order requiring him to repay or property along with the interest or to contribute such sum to the assets of the Society by way of compensation. This will be in addition to the criminal liability incurred under the Act.

(b) The Registrar can also order for cancellation of registration and dissolution of certain societies if he satisfied that such society has been carrying on any unlawful activity or has allowed any unlawful activities within their premises.

(c) The State Government is empowered to appoint an Administrator for such period not exceeding six months at a time (the aggregate period shall not extend beyond four years) in case a Society is unable to hold the General Meeting, the Governing Body has not been constituted and whether it is in the public interest to do so. The Administrator shall perform all duties and functions of the

Society. He shall take necessary action to hold elections for the constitution of the Governing Body and convene the General Body meeting but for the reason beyond his control if is not able to do so, the State Government may order dissolution on his recommendations.

(ii) Madhya Pradesh – (a) The Registrar has been given the powers to seize records, documents of the Society in case he is satisfied that these are likely to be tampered with or destroyed.

(b) The Registrar may his own motion or an application made by a majority of the members of the Governing Body of the society or not less than 1/3rd of the total number members of the Society, either by himself or by a person authorized by him hold an enquiry into the constitution, working an financial condition of a Society.

(c) The State Government may make order for supersession of Governing Body of any State aided society if it is not functioning properly or commits acts which are prejudicial to the interest of Society and appoint a person or persons to manage the affairs of the Society for a specified period not exceeding two years in the first instance. The period however can be extended from time to time at the discretion of the State level.

(iii) Tamil Nadu – (a) The State Government has the power to order supersession of committee of any Society and appoint a person as the special officer to manage the affairs of the Society for a specified period not exceeding one year. The time period is extendable upto three years at the discretion of the State Government.

(b) As is the case with the other States, the Registrar has the power to enquire into the constitution, working and financial conditions of a registered Society. Such enquiry can also be ordered on the basis an application moved by the District Collector. The Registrar has authority to cancel the registration on the basis of outcome of such enquiry.

(c) The Registrar can also order cancellation of registration if any society is carrying on any unlawful activity or allow

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

unlawful activity within its premises. After cancellation of registration, the society will be dissolved by special resolution and in case of failure to do so, the Registrar can appoint a liquidator to wind up the Society.

(d) The Registrar also has the power to remove the names of the defunct Societies from the register.

7. Offences and Penalties

Unlike the Societies Registration Act, almost all the State Acts contain provisions regarding offences and penalty on the office bearers and members of the society for contravention of the provisions of these Acts.

8. Appeal

Few State Acts such as Tamil Nadu and Madhya Pradesh contain the provisions regarding appeal against the order of the Registrar. In Madhya Pradesh, the appeal against the order of the Registrar lies with the State Government and appeal against the order of the subordinate officers lies with the Registrar. In case of Tamil Nadu, the appeal against the order of the Inspector General of Registration can be filed before the State Government. In case of the orders of any other person, the appeal would lie with the Inspector General of Registration and any person aggrieved by any order made by liquidator may appeal to the Court.

Appendix 3

Various Schemes as Sponsored by Various Central Government Ministries

Various Schemes as sponsored by various Central Government Ministries are as follows:

I. Schemes Sponsored by the Ministry of Social Justice and Empowerment, Shastri Bhawan, New Delhi

S.No.	Name of the Scheme	Purposes and the eligibility
1.	Scheme for Welfare of Children in need of care and Protection	The main purpose of the scheme is to rehabilitate destitute children as normal citizens of the country. The scheme seeks to provide individualized and personal care to destitute children with the help of institutional and non-institutional care. The scheme is implemented through registered voluntary (national level) organisation.
2.	Scheme for Foster Care Services.	The objective of the scheme is welfare of the destitute children by providing the homely atmosphere to those who become destitute at an early age. It is made available to reputed V.O. working in the field of promoting foster care services in India.
3.	Organizational Assistance to Voluntary Social Welfare Organisations.	The objective is to provide assistance to voluntary organizations with a view of developing their organizational efficiency.
4.	Scheme for Assistance to disabled persons for purchases/ fittings of aids/ appliances.	The main objective is to assist needy physically handicapped persons in procuring quality and modern aids and appliances that can promote their physical rehabilitation.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

		The eligible are the individuals who are physically handicapped.
5.	Grants-in-aid for sponsoring research on rehabilitation of the handicapped.	The projects are intended to help in finding the solutions to the problems of the handicapped and facilitate their effective rehabilitation. The projects under this sponsoring shall be of an applied nature and result and action oriented.
6.	Scheme of Assistance to organizations for disabled persons.	The scheme seeks to provide financial assistance mainly for developing services in the area of prevention of disabilities, early detection and intervention; education, training and rehabilitation.
7.	Assistance to Voluntary agencies for prevention, detection and management of childhood disabilities	This scheme is jointly promoted by the Government of India and UNICEF. It seeks projects of Non-Governmental Organisations having a focus on preventive and early detection of disability among children. Projects eligible for this assistance would include community and family based rehabilitation programmes for disabled children; efforts aimed at creating awareness among families and community leaders; innovative programmes of training in early detection/ intervention methods for families etc.
8.	Grants-in-aid rules for sponsoring research.	The scheme provides assistance for conducting research in the field of social welfare, social policy and social development. Priorities within these broad areas will be given to projects of an applied nature keeping in view plan policies and programmes.
9.	Grants-in-aid rules for sponsoring publications	Grants for provided for publication of studies and documentation in the field of social welfare and policy development.
10.	Grants-in-aid for Workshops/	The Ministry also provides financial assistance for organising workshops/

	seminars.	seminars which will help disseminate research findings, identify problem areas, discuss problems and identify research needs etc. in the broad field of social welfare, social policy and social development.
11.	Grants-in-aid rules for supporting projects (Tribal Development) of all India or Inter-State nature	The scheme aims at supporting action oriented studies on problems of scheduled tribes particularly in the field of economic development for generation of necessary data to improve formulations and implementations of tribal developmental programmes.

II. Schemes Sponsored by the Ministry of Human Resource and Development, Shastri Bhawan, New Delhi

S.No.	Name of the Scheme	Purposes and the eligibility
1.	Scheme of Assistance for construction/ extension of Hostel buildings for working women with a day care centre.	The scheme seeks to provide suitable accommodation in healthy environment for the working women and day-care centres.
2.	Scheme for short stay homes for women and girls.	
3.	Scheme for setting up women's training centres/ institutes for rehabilitation of women in distress	The main objective is to rehabilitate destitute women through vocational trainings and residential care.
4.	Scheme for organizational assistance to voluntary organizations for women and child development.	The scheme seeks to support and help the V.O. for women and children to maintain their central offices, a vital input in the running of their activities.

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

5.	Scheme of Nutrition programmes through Bal-wadis and Day-care centres for pre-school children in the age group of 3 to 5 years.	The programme seeks to provide supplementary for children in the age of 3-5 years and envisage that it would form a basis for the development of other services like health, education and welfare.
6.	Scheme for Assistance to V.O. working in the field of adult education	Promotion of adult education and eradication of mass illiteracy.
7.	Scheme of Assistance to V.O. for early childhood education. (Universalisation of education)	Early Childhood education programmes.

III. Schemes Sponsored by the Ministry of Health and Family Welfare, New Delhi

1.	Scheme for improvement of health services	The scheme seeks to provide the medical care to rural and high density urban slums for expansion and improvement of existing nursing facilities.
2.	Schemes for sanctioning grants-in-aid for promoting the voluntary blood donation camps.	The scheme seeks to promote intensive and extensive education of the public and motivate them to donate the blood
3.	Grants to Under-graduate college of Indian Systems of Medicines and Homeopathy run by the V.O.	The scheme seeks to provide the financial assistance with a view to improve the standard of education in the under-graduate ISM and Homeopathy colleges for the purchase of lab equipment and setting up of the book banks.
4.	Grants-in-aid to the V.O. engaged in the Family welfare programmes.	The scheme seeks to encourage V.O. to take up the family welfare programmes by running the family welfare centres.

IV. Other Schemes Sponsored by Various Ministries

Concerned Department/ Board	Scheme	Purposes
National Wasteland Development Board Lok Nayak Bhawan, New Delhi	Scheme for Grant of Financial Assistance to V.O.	<p>The objective under the scheme is to bring under productive uses the wastelands in the country through a massive programme of afforestation and tree planting. The major steps include identification of lands, motivation of villagers, assisting the villagers either as a group in obtaining trees, rights on lands etc.</p> <p>The Board shall emphasise on the issues relating to laying of nurseries, forestry and Pasture development activities and development of culturable wasteland including improvement of land.</p>
National Fund for Rural Development (Department for Rural Development), Krishi Bhawan, New Delhi	Scheme for Rural Development	<p>The Govt. accords highest priority to programmes of rural development for attaining the objectives of increasing agricultural production, creating employment, eradicating poverty and bringing overall improvement in the rural economy.</p> <p>Projects qualifying for these assistance:</p> <ul style="list-style-type: none"> • Construction and maintenance of rural link road • Construction and maintenance of drinking water projects • Construction and maintenance of hospitals and dispensaries

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

		<ul style="list-style-type: none">• Establishment of rural industries and animal product units for generating employment in rural areas.
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V. Ministry of Home Affairs

Provides grants-in-aid to voluntary organizations to undertake activities for the cause of national integration and communal harmony, such as, inter-community celebration of National Days and festivals, cultural shows, essays and painting competitions, inter-regional camps, exchange of visits, public meetings, exhibitions

Appendix 4

Frequently Asked Questions (FAQs) Related to FCRA, 2010

Following are the Frequently Asked Questions (FAQs) related to FCRA, 2010:

1. What will be the status of existing registered trust under FCRA, 1976?

Any Association registered with the Central Government under Section 6 of the FCRA, 1976, as it stood immediately before the commencement of this Act, shall be deemed to have been registered under this act and such registration shall be valid for a period of five years from the date from which this section comes into force.

2. Whether organization can invest foreign contribution in M.F and what will be the status of existing investment?

No organization can invest foreign contribution in mutual funds. It is advisable to withdraw the existing investment in mutual funds.

3. Can Association have multiple bank accounts?

Yes, association can have multiple bank accounts for utilizing the foreign contribution. It is important to note here that it is obligatory for all associations to receive the foreign contribution in one bank account designated for the purpose and in no other bank account.

4. What is the last date for submission of annual accounts?

Every person who receives foreign contribution under the act shall submit a report in form Fc-6, accompanied by an income and expenditure statement, receipt and Payment account, and balance sheet for every financial year beginning on the 1st day of April within nine months of the closure of the financial year i.e. before 31st of December every year.

5. What are the documents required to be submitted with annual accounts?

Form FC 6/ FC 7/ FC8 as the case may be to be accompanied with statement of receipt and payment of foreign contribution, income and expenditure accounts and balance sheet. Every such return in Form FC-6 shall also be accompanied by a copy of a statement of account from the bank

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

where the exclusive foreign contribution account is maintained by person, duly certified by an officer of such bank.

6. What are the differences in from FC 3 (FCRA, 1976,) and FC – 6 (FCRA 2010)?

Bifurcation of cash and in kind is required for opening and closing balance. In form FC 6. New column is introduced to include details of places with addresses of specific activities carried out during year.

7. Whether donation given by a NRI (Non Resident Indian) is treated as Foreign Contribution?

It is important to note here that any donation received from foreign source will constitute to be a foreign contribution. In case of NRI if he/she posses the Indian Passport (i.e. holding Indian Nationality) than such donation will not be treated as foreign contribution.

8. Can foreign contribution be received in Rupees?

Yes, donation from foreign source in any currency will constitute to be foreign contribution.

9. Who can receive foreign contribution?

Person having definite cultural, economic, educational, religious or social programmed shall accept foreign contribution subject to condition that such person obtains a certificate of registration from central government.

10. Who cannot receive foreign contribution?

No foreign contribution shall be accepted by any:

- (a) candidate for election;
- (b) correspondent, columnist, cartoonist, editor. Owner, printer or publisher of a registered newspaper;
- (c) Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;
- (d) Member of any Legislature;
- (e) Political party or office-bearer thereof;
- (f) Organization of a political nature as may be specified under sub-section (1) of section 5 by the Central Government;

Frequently Asked Questions (FAQs) Related to FCRA, 2010

- (g) Association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any electronic mode, or any other electronic form as defined in clause (r) of sub-section (1) of section 2 of the information Technology Act, 2000 or any other mode of mass communication;
- (h) Correspondent or columnist, cartoonist, editor, owner of the association or company referred to in clause (g).

Explanation - In clause (c) and section 6, the expression “corporation” means a corporation owned or controlled by the Government and includes a Government company as defined in section 617 of the Companies Act, 1956.

11. Which are the purposes where provisions of Section 3 will not apply?

Nothing contained in section 3 shall apply to the acceptance, by any person specified in that section, of any foreign contribution where such contribution is accepted by him subject to the provisions of section 10:

- (a) by way of salary, wages or other remuneration due to him or to any group of persons working under him, from any foreign source or by way of payment in the ordinary course of business transacted in India by such foreign source; or
- (b) by way payment, in the course of international trade or commerce, or in the ordinary course of business transacted by him outside India; or
- (c) as an agent of a foreign source in relation to any transaction made by such foreign source with the Central Government or state Government; or
- (d) by way of a gift or presentation made to him as a member of any Indian delegation, provided that such gift or present was accepted in accordance with the rules made by the Central Government with regard to the acceptance or retention of such gift or presentation; or
- (e) from his relative; or
- (f) by way of remittance received, in the ordinary course of business through any official channel, post office, or any authorized person in foreign exchange under the foreign Exchange management Act, 1999; or
- (g) by way of any scholarship, stipend or any payment of like nature.

Provided that in case any foreign contribution received by any person specified under section 3, for any of the purposes other than those specified

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

under this section, such contribution shall be deemed to have been accepted in contravention of the provisions of section 3.

12. Is it necessary to submit form FC 6 in case no foreign contribution is received during year?

Yes, even NIL FC6 is required to submit every year.

13. What will be the status of application made for registration or prior permission under FCRA 1976 but not disposed of before the date of commencement of Foreign Contribution (Regulation) Rules, 2011?

It shall be deemed to be an application for registration or prior permission, as the case may be, under FCR Rules 2011, subject to condition that the applicant furnishes the prescribed fees for such registration or prior permission, as the case may be.

14. Whether a Company incorporated in India under the Companies Act, 1956 having its operations in two or more countries is to be treated as an MNC under FCRA, 2010?

No. However, the definition of 'foreign source' under section 2(j) (vi) may be seen.

15. Whether foreigners can be appointed as Executive Committee members?

Organizations having foreign nationals as members of their executive committees or governing bodies are generally not permitted to receive foreign contribution. However, foreign nationals, fulfilling the following conditions, may be appointed as Executive Committee members, after obtaining prior permission of the Central Government:

- (i) the foreigner is married to an Indian citizen;
- (ii) the foreigner has been living and working in India for at least five years;
- (iii) the foreigner has made available his/her specialized knowledge, especially in the medical and health related fields on a voluntary basis in India, in the past;
- (iv) the foreigner is part of the Board of Trustees/Executive Committee in terms of the provisions in an inter- governmental agreement;
- (v) the foreigner is part of the Board of Trustee/Executive Committee, in an ex-officio capacity representing a multilateral body which is exempted from the definition of

Frequently Asked Questions (FAQs) Related to FCRA, 2010

(vi) Foreign source. The need for such an appointment should, however, be adequately justified.

16. Whether Government servants, Judges and employees of a Government owned/controlled company/body can be on the executive committees/boards of an association?

Yes. The legal entity of a 'person' under FCRA, 2010 is distinct from an individual person. Therefore, individuals who cannot receive foreign contribution may happen to be on the executive committees/boards of such an association.

17. Whether foreign remittances received from a relative are to be treated as foreign contribution as per FCRA, 2010?

The position in this regard as given in Section 4(e) of FCRA, 2010 and Rule 6 of FCRR, 2011 are as under:

Subject to the provisions of section 10 of the FCRA, 2010, nothing contained in section 3 of the Act shall apply to the acceptance, by any person specified in that section, of any foreign contribution where such contribution is accepted by him from his relative. However, in terms of Rule 6 of FCRR, 2011, any person receiving foreign contribution in excess of one lakh rupees or equivalent thereto in a financial year from any of his relatives shall inform the Central Government in Form FC-1 within thirty days from the date of receipt of such contribution. Available on the website <http://mha.nic.in/fcra/forms/fc-1.pdf>.

18. What is the procedure for change of designated Bank Account?

For change of the bank account, an application in prescribed form mentioning the details of the old bank account and the proposed new bank account along with justification for change of designated bank, name/address of the society, copy of registration under FCRA, copy of fresh resolution of the executive committee (in English or Hindi) for change of designated bank account, certificate from the proposed bank (copy of Bank Pass Book is not acceptable) that the account is being opened exclusively for FCRA, may be submitted to MHA. This form is available on website http://mha.nic.in/fcra/forms/chng_name_addr.pdf.

19. What are the eligibility criteria for registration?

For grant of registration, the association should:

(i) be registered under the Societies Registration Act, 186 or the Indian Trusts Act, 1882 or section 25 of the Companies Act, 1956;

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

- (ii) normally be in existence for at least three years and has undertaken reasonable activity in its chosen field for the benefit of the society for which the foreign contribution is proposed to be utilized. For this purpose, the association should have spent at least ₹ 6,00,000 over last three years on its activities, excluding administrative expenditure. Statement of Income & Expenditure duly audited by Chartered Accountant for last three years may be enclosed to substantiate that it meets the financial parameter.
- (iii) meet the following conditions:
 - (a) The person making an application for registration or grant of prior permission under sub-section
 1. Sec.12 (4) (a) (1) is not fictitious or benami;
 2. has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another;
 3. has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country;
 4. has not been found guilty of diversion or mis-utilisation of its funds;
 5. is not engaged or likely to engage in propagation of sedition or advocate violent methods to achieve its ends;
 6. is not likely to use the foreign contribution for personal gains or divert it for undesirable purposes;
 7. has not contravened any of the provisions of this Act;
 8. has not been prohibited from accepting foreign contribution;
 9. the person and/or any of its directors or office bearers has neither been convicted under any law for the time being in neither force nor any prosecution for any offence is pending against him.

Frequently Asked Questions (FAQs) Related to FCRA, 2010

- (iv) the acceptance of foreign contribution by the association/ person is not likely to affect prejudicially:
 - (i) the sovereignty and integrity of India; or
 - (ii) the security, strategic, scientific or economic interest of the State; or
 - (iii) the public interest; or
 - (iv) freedom or fairness of election to any Legislature; or
 - (v) friendly relation with any foreign State; or
 - (vi) harmony between religious, racial, social, linguistic, regional groups, castes or communities.
- (v) the acceptance of foreign contribution:
 - (i) shall not lead to incitement of an offence;
 - (ii) shall not endanger the life or physical safety of any person.

20. What are the eligibility criteria for grant of prior permission?

An organisation in formative stage is not eligible for registration. Such organisation may apply for grant of prior permission under the law.

Prior permission is granted for receipt of specific amount from specific donor for carrying out specific activities/projects. For this purpose, the association should:

- (i) be registered under the Societies Registration Act, 1860 or the Indian Trusts Act, 1882 or section 25 of the Companies Act, 1956;
- (ii) submit a specific commitment letter from the donor; and
- (iii) submit copy of a reasonable project for the benefit of the society for which the foreign contribution is proposed to be utilized.
- (iv) should meet all the conditions for the grant of registration.

21. Is recommendation of District Collector or District Commissioner or District Magistrate mandatory?

No. Submission of verification certificate from the District Collector or District Commissioner or District Magistrate is not mandatory. However, in certain cases, if the amount applied for prior permission is less than ₹ 50 lakh, submission of such a certificate assists in speedy clearance of the application.

22. If an application for registration or prior permission is submitted online by an association, does it need to submit that application in physical form also?

Yes. When an application is filed online, a printout of the same may be taken after submission and thereafter, it should be submitted, duly signed, along with the requisite documents to the Ministry of Home Affairs. The prescribed forms for submission of application for grant of Registration and Prior Permission are FC-3 and FC-4 respectively. Available at MHA website <http://mha.nic.in/fcra/forms/fc-3.pdf> and <http://mha.nic.in/fcra/forms/fc-4.pdf>, respectively.

23. What are the documents to be enclosed with the application?

- (a) Following documents should be enclosed with the application for grant of Registration:
- (i) Hard-copy of the online application, duly signed by the Chief Functionary of the association;
 - (ii) Certified copy of registration certificate or Trust deed, as the case may be;
 - (iii) Details of activities during the last three years;
 - (iv) Copies of audited statement of accounts for the past three years (Asset and Liabilities, Receipt and Payment, Income and Expenditure);
 - (v) If functioning as editor, owner, printer or publisher of a publication registered under the Press and Registration of Books Act, 1867, a certificate from the Registrar of Newspaper for India that the publication is not a newspaper in terms of section 1(1) of the said Act.
 - (vi) Fee of by means of demand draft or banker's cheque of ₹ 2000/- in favor of the "Pay and Accounts Officer, Ministry of Home Affairs", payable at New Delhi.
- (b) Following documents should be enclosed with the application for grant of Prior Permission:
- (i) Hard-copy of the online application, duly signed by the Chief Functionary of the association;
 - (ii) Certified copy of registration certificate or Trust deed, as the case may be;

Frequently Asked Questions (FAQs) Related to FCRA, 2010

- (iii) Commitment letter from foreign donor specifying the amount of foreign contribution;
- (iv) Copy of the project report for which foreign contribution is solicited/being offered;
- (v) If functioning as editor, owner, printer or publisher of a publication registered under the Press and Registration of Books Act, 1867, a certificate from the Registrar of Newspaper for India that the publication is not a newspaper in terms of section 1(1) of the said Act.
- (vi) Fee of by means of demand draft or banker's cheque of ₹ 1000/- in favor of the "Pay and Accounts Officer, Ministry of Home Affairs", payable at New Delhi.

Note: The hard copy of the on-line application along with all the documents mentioned above must reach the Ministry of Home Affairs, Foreigners Division (FCRA Wing) within thirty days of the submission of the on-line application, failing which the request of the person for grant of registration or prior permission, as the case may be, shall be deemed to have ceased.

24. How to find the status of pending application for registration/prior permission?

Status of pending applications for grant of registration or prior permission may be checked on-line from the Ministry of Home Affairs web-site <http://mha.nic.in/fcra.htm>. One needs to fill in the numbers on acknowledgement letter or any correspondence from MHA (Foreigners Division) in the blank format which pops up on the screen after selection of status enquiry icon (registration/prior permission, as the case may be)

25. Is there any restrictions on transfer of funds to other organisations?

Yes. Section 7 of FCRA, 2010 states:-

"No person who :

- (a) is registered and granted a certificate or has obtained prior permission under this Act; and
- (b) receives any foreign contribution, shall transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government."

Technical Guide on Internal Audit of Not-for-Profit Organisations (NPOs)

It may further be noted that Rule 24 of FCRR, 2011 prescribes the procedure for transferring foreign contribution as under:

"Rule 24: "Procedure for transferring foreign contribution to other registered or unregistered persons:

(1) Any person intending to transfer the foreign contribution may make an application to the Central Government in Form FC-10.

<http://mha.nic.in/fcra/forms/fc-10.pdf>

(2) The Central Government may permit the transfer in respect of a person who has been granted the certificate of registration or prior permission under section 11 of the Act, in case the recipient person has not been proceeded against under any provision of the Act.

(3) Any transfer of foreign contribution shall be reflected in the returns in Form FC-6 <http://mha.nic.in/fcra/forms/fc-6.pdf> as well as in Form FC 10 <http://mha.nic.in/fcra/forms/fc-4.pdf> by the transferor and the recipient.

(4) In case the foreign contribution is proposed to be transferred to a person who has not been granted a certificate of registration or prior permission by the Central Government, the person concerned may apply for permission to the Central Government to transfer a part of the foreign contribution, not exceeding ten per cent, of the total value of the foreign contribution received. The application shall be countersigned by the District Magistrate having jurisdiction in the place where the transferred funds are sought to be utilized. The District Magistrate concerned shall take an appropriate decision in the matter within sixty days of the receipt of such request from the person. The donor shall not transfer any foreign contribution until the Central Government has approved the transfer."

26. How would an organisation that is registered or has obtained prior permission under FCRA and intends to transfer a part of the foreign contribution received by it to another organisation registered under FCRA would know whether the recipient organisation has been proceeded against under FCRA?

Where any organisation is proceeded against under FCRA, it is done with due intimation to the organisation concerned. Therefore, the donor organisation is advised to insist on a written undertaking from the intending recipient organisation.

27. What is the procedure for filing Annual Returns?

An association permitted to accept foreign contribution is required under law to

Frequently Asked Questions (FAQs) Related to FCRA, 2010

maintain separate set of accounts and records exclusively for the foreign contribution received and utilized and submit an annual return, duly certified by a Chartered Accountant, giving details of the receipt and purpose-wise utilization of the foreign contribution. The return is to be filed for every financial year (1st April to 31st March) within a period of nine months from the closure of the year i.e. by 31st December each year. Submission of a 'Nil' return, even if there is no receipt/utilization of foreign contribution during the year, is mandatory. The return is to be submitted, in prescribed Form FC -6, duly accompanied with the balance sheet and statement of receipt and payment, which is certified by a Chartered Accountant. The form is available on MHA's web-site - <http://mha.nic.in/fcra/forms/fc-6.pdf> For further details, please refer to Sections 17, 18 and 19 of FCRA, 2010 and Rule 17 of FCRR, 2011.

Note: It may be noted that the annual return for the financial year 2010 - 2011 is to be filed by the 31st December, 2011 in Form FC-3, i.e., as per FCRA, 1976.

28. What is foreign hospitality?

Foreign Hospitality means any offer, not being a purely casual one, made in cash or kind by a foreign source for providing a person with the costs of travel to any foreign country or territory or with free board, lodging, transport or medical treatment.

29. Who cannot accept foreign hospitality without prior approval of the Ministry of Home Affairs?

No member of a Legislature or office bearer of a political party or Judge or Government servant or employee of any corporation or any other body owned or controlled by the Government shall, while visiting any country or territory outside India, accept, except with the prior permission of the Central Government any foreign hospitality.

Provided that it shall not be necessary to obtain any such permission for an emergent medical aide needed on account of sudden illness contracted during a visit outside India, but, where such foreign hospitality has been received, the person receiving such hospitality shall give, within one month from the date of receipt of such hospitality an intimation to the Central Government as to the receipt of such hospitality, and the source from which, and the manner in which, such hospitality was received by him.

30. How one can seek permission of the Government for receiving foreign hospitality?

Application form (Form FC-2) for this purpose is available on MHA's web-site - <http://mha.nic.in/fcra/forms/fc-2.pdf>. In terms of Rule 7 of FCRR, 2011:

- (i) Every application for acceptance of foreign hospitality shall be accompanied by an invitation letter from the host or the host country, as the case may be, and administrative clearance of the Ministry or department concerned in case of visits sponsored by a Ministry or department of the Government.
- (ii) The application for grant of permission to accept foreign hospitality must reach the appropriate authority ordinarily two weeks before the proposed date of onward journey.
- (iii) In case of emergent medical aid needed on account of sudden illness during a visit abroad, the acceptance of foreign hospitality shall be required to be intimated to the Central Government within sixty days of such receipt giving full details including the source, approximate value in Indian Rupees, and the purpose for which and the manner in which it was utilized.

Provided that no such intimation is required if the value of such hospitality in emergent medical aid is up to one lakh rupees or equivalent thereto.

31. What is the procedure for seeking change in the name/address of the association?

For seeking change in the name/address of the association, one should use the prescribed form available on MHA's website http://mha.nic.in/fcra/forms/chng_name_addr.pdf and submit the same along with the requisite documents specified therein.

32. Can an organization, whose violation under FCRA has been condoned, apply for registration/prior permission?

After the violation committed by an association has been condoned, the association can apply for prior permission (PP) only by submitting an application in form FC-4 <http://mha.nic.in/fcra/forms/fc-4.pdf>. Once the PP has been granted and foreign contribution received for specific purpose has been fully/partially utilized and organisation has submitted annual FC-6 <http://mha.nic.in/fcra/forms/fc-6.pdf> returns and accounts in prescribed format pertaining to the PP, it becomes eligible for consideration of registration under FCRA. Registration would be granted under FCRA, if other parameters are fulfilled by the association.

Frequently Asked Questions (FAQs) Related to FCRA, 2010

33. Can an association invest the foreign contribution received by it in profitable ventures and proceeds can be utilized for welfare activities?

No. The association should utilize such funds for the welfare purpose or activities for which it is received. The utilization should be in line with the objectives of the association. However, foreign contributions can be utilized for self-sustaining activities, not meant for commercial purposes.

34. Whether interest earned out of foreign contributions be shown as fresh foreign contribution receipt during that year or not?

Yes. The interest earned out of such deposit should be shown as second / subsequent foreign contribution receipt in the annual return during the year in which it is earned.

35. Can the fee paid by the foreign delegates/participants attending/participating in a conference/seminar etc. be termed as foreign contribution and thus require permission from FCRA?

Foreign delegates/participants paying "delegate/participation Fees" in foreign currency for participation in a conference/seminar which is utilized for the purpose of meeting the expenditure of hosting the conference/seminar and is not treated as foreign contribution and as such no permission under FCRA is required.

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