

# Finance for Non Finance Staff (On- going)

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# Role of Finance & Accounts in an NGO

## Objectives of an NPO

- Primary objective: Maximise social benefits/services/impact for beneficiaries it serves
- Secondary objective:
  - Economy - control costs
  - Efficiency - achieve objective in minimum costs (Process, doing things right)
  - Effectiveness - measure of achievement with reference to objectives (Result, doing the right thing)

## Change - The New Norm for NPOs

- Change
  - Donor expectation
  - Statutory and regulatory landscape
  - Govt orientation towards charity
  - Technological developments
- Change offers: Risks and opportunities
- Impacts organisation in terms of future growth, even existence.

## Types of Resources an NPO uses

- Material - capital goods, program goods, supplies, technology
- Money - financial resources
- Manpower - Human resources of organisation

## Main Functions of an NPO

- Program

- Finance & Accounts
- Admin
- Communications, Advocacy and Public Relations
- Research
- New Business (fund raising)
- Training & Capacity Building
- Every staff in every of above function performs a finance role

## Financial Management

- Financial Management is the business function that deals with planning, organizing, monitoring and controlling financial resources of an organization.
- It focuses on spending financial resources to deliver greater social impact
- Why financial management:
  - Accountability and Transparency to donors and communities we serve
  - Allocation of financial resources for organisation activities
  - Investment decision for resources
  - Statutory/regulatory compliance
  - Financial Reporting to stakeholders
  - Futuristic planning-Financial security, Sustainability and long term growth
  - Internal Controls framework
  - Custody of financial resources to minimise resource misuse and embezzlement
  - Better decision making on Finance to fulfil the Mission based on data and analysis
  - Enhanced credibility and trust thereby giving a competitive edge
  - Managing risk through Internal Controls
  - Meeting organisation goals

## Finance Function in an NPO

- Finance function ensures organization's financial health and sustainability
- The finance function's role in an NGO is:
  - Manage financial resources of the organization
  - Make strategic finance decisions for sustainability
  - Operational support-uphold internal controls and support other functions including fundraising

- Report to stakeholders to help decision-making
- Statutory and regulatory compliance
- Manage risks through suitable internal controls

Difference between Accounting & Finance though used interchangeably: Accounting looks Back while Finance looks Forward!

## 3 key roles of Finance function in an NPO

1. Enable Value Creation
  2. Shape Value Creation
  3. Narrate Value Creation
- These are in chronological order
  - Role is performed by CFO and team he/she leads in Finance function duly supervised by Chief Functionary and Governing Board
  - Value creation for an NPO means maximising social outputs/outcomes using the various resources

# Role of Finance Function in NPO

## Enables Value Creation through

1. Planning:
  - Financial Resources for operations
  - Financial sustainability
  - For Controls (Framework)-Policies
2. Forecasting-long term and short term
  - Budgets-organisation and programs/projects
  - Fund flows
  - Operating Cash
3. Resource Allocation: manpower, material, money
  - Banking
  - Treasury & cash management
  - HR, Goods and services procurement as per policy and prevalent laws

- Inventory management-slow moving, waste, loss
- Asset management-depreciation, obsolescence, loss etc

#### 4. Recording:

- a. Book keeping i.e. recording transactions
- Accounting i.e. summarisation, analysis and interpretation of financial data
- Closing and reconciling-bank, vendor, employee, grant etc

## Role of Finance Function in NPO

### SHAPES value creation through

1. Performance Measurement and Management
  - Budget monitoring (budget variance analysis) - organisation, projects
  - Measuring Value for money (VFM) - ratios
  - Return (social return) on investment (SROI), Social impact audit
2. Monitoring Controls
  - Budgetary (realignment, reallocation)
  - Adherence to policies and procedures for Internal control
  - Audits and assurances-statutory, internal donor, Govt
  - Monthly MIS-Financial, Program
3. Facilitator - support on finance to all other functions

### NARRATES the value creation through

1. Financial reporting
  - Donors - periodic FR, annual audited UC, supporting fundraiser with financial data
  - Govt bodies - IT, FCRA, Registering agency, EPF, ESI, TDS, GST
  - Board/top management - financial health
2. Focal point with external stakeholders on institutional matters
  - obtaining statutory approvals
  - financial assessment by donors, govt etc.

# Role of Non Finance Staff in Financial Matters

- Non finance staff handle resources which have value
- Non finance staff authorise various types of expenditure - travel, procurement, office exp, statutory dues
- Non finance staff own and operate project budgets
- Project decisions of Non finance staff in field have financial implications - allowance/disallowance
- Decisions in field of Non finance staff have compliance implications with laws of land
- Non Finance staff actions affect reputation and even our very existence

Please note: Information is for reference only. Read our disclaimer [here](#).

# Grant Management

## What is a Grant?

- Funds given from one entity to another for a public benefit/charitable purpose
- Usually given to a charitable entity or NPO
- Is not an automatic entitlement, it is for an obligation to be discharged
- Grant is trust money with 3 actors-grantor, grantee (trustee with fiduciary responsibility to grantor and beneficiary) and beneficiary
- Grantor does not get direct benefit and grantee is not expected to payback if utilised for the intended purpose
- Grant comes in different forms from different sources-govt (grant-in-aid), retail, corporate, foundation
- Are awarded directly or through a competitive process

## Exchange Transaction vs Grant

- Exchange transaction (as per GST Act) involves:
  - Supply of goods and services
  - Consideration
  - In course of furtherance of business
- Grant is not exchange transaction since there are
  - No specific beneficiaries
  - Nothing in return from beneficiaries or benefit derived by grantee
  - Not for furtherance of business

Understanding above for grant contract is crucial otherwise contributions maybe considered as exchange transactions inviting GST and TDS implications and also charitable status maybe jeopardised.

## Grant Management

- Involves two key players:

- Grantmakers-grantor/donor
- Grantseekers-grantee/donee
- Grant management is a system that includes identifying, applying for and securing grants, adhering to grant conditions, evaluating outcomes.
- Grant management process in grant management system (GMS) is the grant management lifecycle.

## The Grand Management Process

- Planning
- Opportunity
- Application
- Award
- Execution
- Closeout

## Grant Management Life Cycle

- Pre award
  - Planning-need identification, SWOT, due diligence preparatory etc
  - Scout Funding opportunity
  - Grant application & review-eligibility and Qualification
- Award
  - Award Negotiation
  - Award Decision
  - Award Notification/Contract
- Post Award
  - fund request-advance, reimbursement etc,
  - Implementation
  - Reporting-program and finance
  - Post award amendment-key changes and approval, budget realignment, NCE
  - Performance/impact
  - Closeout
- Reapplication



# Principles of grant management

- **Accountability, Transparency & Trust** for grant funds
- **Efficiency & Effectiveness** with grant funds
- **Compliance** with laws of the land
- **Adherence** to terms and conditions of Grant Agreement
- **Internal controls** in place
- **Communication & Timely Reporting** - narrative and financial as per grant contract

## Fund Accounting

NGOs follow Fund Accounting for managing grants:

- Fund accounting is an accounting system for recording and tracking project resources (fund) whose use is limited/restricted by specific conditions by donor through a grant contract
- This accounting system emphasizes accountability/productivity over profitability which is the accounting basis for for-profits

Features:

- Separate funds (buckets/compartments)
- Restriction on use
- Separate budget established for each fund/project and income credited and expenses debited from the fund
- Transparency
- Software for recording
- Good internal controls
- Monitoring and Reporting mechanisms ensures fund accounting

## Type of funds for NPOs

Grant word is not comprehensively defined in Indian laws, referred to as Voluntary contribution/donation (VC) in Income Tax law. FC under FCRA and CSR fund under CSR law.

ICAI has classified funds for NPOs in its Technical Guide on Accounting for NPOs:

## 1. **Unrestricted funds: Funds with no specific restrictions on use (purpose)/time**

- Corpus (acknowledged in IT law)-non-refundable, non reducible, reinvestment obligation.
- Corpus only
  - when specific donor direction that it be treated as corpus by donor
  - not income but capital per IT Act
  - to be invested in section 11(5) modes of investment
  - considered application when replenished
  - not application if given to another charity. Corpus income shown in I&E.
- Donations i.e. no obligations attached, a gift
- Designated/earmarked funds-appropriated and set aside for specific purpose/future, self imposed by management and not binding in law for NPOs
- General funds-surplus/deficit transferred from I&E which are not designated. Free reserves

## 2. Restricted funds: funds with conditions/restrictions

- Project/program grants-to be utilized as per terms and conditions of award, Restriction-by purpose and by time. There could be other conditions/restrictions. Principle of fund based accounting
- Endowment: fund amount cannot be utilized, only income utilized for general/specific purpose as per donor stipulation. The recipient owns it but does not control it.
- Restricted funds maybe
  - Permanent restriction
  - Temporary restriction: restricts use for a certain period or meeting objectives after which it becomes unrestricted.

## Format of financial statements as per ICAI

BALANCE SHEET AS AT \_\_\_\_\_

SOURCES OF FUNDS (LIABILITIES)

Schedule Current Year Previous Year

- UNRESTRICTED FUNDS

## Corpus Fund/General Fund/Designated Funds

- RESTRICTED FUNDS-Unutilised Grants (Deferred Revenue), Endowment
- LOANS/BORROWINGS-Secured/Unsecured
- CURRENT LIABILITIES & PROVISIONS

TOTAL

## APPLICATION OF FUNDS (ASSETS)

- FIXED ASSETS-Tangible Assets/Intangible Assets/Capital Work-In-Progress
- INVESTMENTS-Long Term/Short term
- CURRENT ASSETS-LOANS, ADVANCES & DEPOSITS-Grant Receivable

TOTAL

## Significant Accounting Policies and Notes on Accounts

# Net Assets

- In NPOs, net assets is like net worth (share capital+reserves & surplus) in case of for profit entities
- Net assets=Total Assets-Total Liabilities
- Net assets means owner funds (capital) although there are no owners in charitable institutions generally
- In an NPO, net assets mainly include corpus and general funds

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## Format of financial statements as per ICAI

Name of Entity \_\_\_\_\_

INCOME AND EXPENDITURE ACCOUNT FOR THE PERIOD/YEAR ENDED \_\_\_\_\_

INCOME Schedule Schedule Current Year Previous Year

- Grants & Donations
- Other Income-rent, interest, incidental business Income, Fee & Subscription,

TOTAL (A)

EXPENDITURE

- Program Exp
- Administrative and General Expenses, Finance costs
- Depreciation & Amortisation Expenses

TOTAL (B)

Excess of Income over Expenditure (Surplus) or excess of Exp over Income (Deficit)(A-B) (Net Income in for profit entity)

- Balance Being Surplus (Deficit) Carried to Balance Sheet-General Fund, Transfer to Designated fund, Building fund/ Others (specify)

Significant Accounting Policies and Notes on Accounts

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## Accounting for grant recognition by NGOs in India

**Practise followed as per convention-no legal directive:**

Option 1: Gross grant treated as income

Option 2: Gross grant routed through Balance Sheet only-asset and liability side settled

Option 3: Grant treated as income to the extent of expenditure while unutilised grant is a liability-- hybrid method

- AS 9 mentions income recognition to the extent of expenditure for grants applicable if there is business/commerce etc
- Follow the principle of prudence in selecting the option for recognition.

# Recipient, Sub-recipient and Vendor

**Recipient** is the organization receiving the grant, sometimes called the Prime recipient because it has full responsibility for grant funds. The document evidencing this arrangement is grant contract

**Sub-recipient** is involved in substantive activities of the award project. The recipient passes on some or all of its duties to the sub-recipient called sub award. All the terms and conditions from the grant award flow down to sub-recipients through a document evidencing it called sub grant contract

**Vendor/service provider** provides goods/services to the recipient to accomplish project's purposes. Selected terms and conditions might be passed through to the vendor. The document evidencing is a goods/service contract

## Cost-Key concepts

**Cost-amount spent to acquire an asset**

**Expense-amount spent on regular operations**

- Classification of expense for NPOs

**Natural expense head-WHAT (type of expense) the funds are being spent on-salary, rent, hotel accommodation etc**

- The natural expenses are grouped into group heads like HR cost, Travel, capital cost, office exp, legal & professional etc
- Group head-Travel-natural expense-conveyance, airfare, meals, accommodation etc
- Group head-HR-natural expenses-salary, HRA, PF, Gratuity

**Furcation expense head- WHY (purpose of expense) the funds are being spent**

- Program cost (program implementation, MEL)
- Support cost (Accounting, Admin, Fund raising)

# Cost - Key concepts

NPOs should follow functional expense head for presenting reports, that is what is the basis for their constitution and work. Broadly the functional heads are two-Program/service delivery and Support/Admin & General

## **Costs for a project for NGO**

- Direct costs (100% direct traceability to a program/support function) to benefit the beneficiary as per project design. No cost if no project.
- Common/Shared costs-benefit multiple projects-shared cost apportionment based on time, space, no of employees/beneficiaries/ no of project locations

Understanding and computing direct and shared cost crucial for correct and realistic budget formulation

- Apportionment method and share of common cost included in common cost policy

Common cost be reviewed every year within the purview of common cost policy

## **Total cost for a project:**

- Direct cost+
- Common Direct cost
- Shared cost apportioned to the project

Institutional/Management cost/indirect cost if permitted basis donor grant management policy to address contingency/create a reserve

# Other types of cost

## **Capital & Revenue cost:**

- Capital Costs: Capital costs are one-time fixed assets purchases that will be used for revenue generation over a longer period- more than one year.
- Revenue Costs: are referred to as operating expenses are short-term expenses that are used in running the daily business operations.

## **Fixed and Variable Costs:**

- Fixed cost is one that does not change in total within a reasonable range of activity. Since the fixed cost remains constant in total, the fixed cost per unit of activity decreases when the volume increases and vice versa
- Variable cost or expense is where the total cost changes in proportion to changes in volume or activity.
- Historical cost: original cost of asset when it was purchased.
- Sunk cost: money spent that cannot be recovered.
- Marginal cost: change usually decrease in the cost of producing one more unit or serving one more customer.
- Opportunity cost: value of next best alternatives when taking a decision given the resource constraint.

## **Cost Principles in grant budgeting for NPOs**

Costs budgeted for a project grant should be

- Allowable cost-costs which are not subject to any restrictions/limitations in the grant award.
- Allocable cost-costs which are incurred specifically for the attainment of the objective of the grant.
- Reasonable cost-cost which is generally recognized as necessary to be incurred by a prudent person in the conduct of normal business
- Consistent: cost applied in same fashion throughout the grant
- Unallowable cost-those costs that cannot be incurred and paid under the grant.

## **Budget basics**

A budget is estimation of revenue and expenses over a specified future period, usually the project period for a grant.

It is financial plan (blueprint) of the project plan. One need to budget the plan and not vice versa

Budget is a Planning (align with objectives) Tool, Control (within policy framework) Tool, Compliance (ceiling) Tool and Mirrors the Financial Report

A budget covers quantitative, qualitative and cost aspects.

### **The purpose of budget is to:**

- Ascertain reasonable estimation of costs for interventions/activities in a grant proposal/award.
- Segregates costs-direct/common/indirect or OH costs
- Cost matching/sharing (co-financing) for multi donor grant, in kind match.
- Is a framework for donor-donee in a grant award
- Enables course correction based on measurement of actual achievements versus estimates
- Statement of SOF and Estimated Costs
- Enables Recognition-activity, group, period, income, expenditure, deficit, surplus

### **Pre requisites**

- Organisation structure.
- Data.
- Chart of accounts.
- Managerial support.
- Formal process for formulation.

### **Types of Budgets: Activity budget**

**Activity based budget** as the name suggests, covers the costs required for implementing a project activity.

In ABB, one looks at resources required for completing an activity and the resources cost

**For example**, if project strategy is to build capacity of civil society leaders, workshops is an activity. Workshops costs would be towards hiring resource persons, booking a venue, transportation cost, food, lodging and materials and handouts.

### **Illustration: Activity Budget for Conducting a Workshop**



Particular of Expense	Rate per unit	No of Units	Total in Rs
Trainer Fees	@ Rs 1000 per day	3 days	3,000
Venue	@ Rs 500 per day	3 days	1,500
Rental for Furniture	@ Rs 500 per day	3 days	1,500
Rental for Equipment	@ Rs 100 per day	3 days	300
Catering Exp for Lunch and tea two times	@ 100 per person	55 persons X 3 days = 165	16,500
Conveyance paid to attendees	@Rs 50 per person per day	50 attendees x 3 days = 150	7,500
Printing of handouts	@ Re 1 per page	50pages x 50 copies = 2500 pages	2,500
		Grand Total	<b>32,800</b>

### Line Item Budget

- A Line-item budget presents the budget under broad heads
- It lists income and expenses by category
- Major donors like USAID, European Commission prefer to have their budget templates by line items.
- It helps better tracking for trends in major cost categories

Illustration: Line Item Budget

Expenses	Unit	# of Units	Unit Rate (\$)	Costs (\$)
<b>Human Resources</b>				
CEO	Per day	3	350	1050
Trainer Fees	Per day	2	200	400

Expenses	Unit	# of Units	Unit Rate (\$)	Costs (\$)
<b><i>Subtotal Human Resources</i></b>				<b>1450</b>
<b>Travel</b>				
Trainer Airfare	Per Person	1	300	300
Participant Transportation	Per Person	30	10	300
<b><i>Subtotal Travel</i></b>				<b>600</b>
<b>Equipment and Supplies</b>				
Materials and hand-outs	Per Person	30	15	450
<b><i>Subtotal Equipment and Supplies</i></b>				<b>450</b>
<b>Other costs, Services</b>				
Venue	Per day	2	300	600
Catering	Per Person	30	15	<b>450</b>
<b><i>Subtotal Other costs, Services</i></b>				
Subtotal				3550
Overhead (10%)				355
<b>TOTAL</b>				<b>3905</b>

## Other Types of Budget

1. **Incremental budget:** Next year's budget prepared by making marginal changes to the current year's budget. The current budget is used as a base to which incremental assumptions are added or subtracted from the base amounts to determine new budget amounts.
2. **Value Proposition Budgeting** focuses on allocating the ideal amount of financial resources that provides the highest value to the customer. Another name for Value Proposition Budgeting is Priority Based Budgeting or value based budgeting.
3. **Zero-based budgeting (ZBB)** based on efficiency and need at that point rather than budget history. Formulation starts from scratch that only includes operations and expenses essential, no expenses are automatically added to the budget.
4. **Performance based budget (PBB)** considers input of resources and the output of services. The goal is to link funding to results delivered, thus called Outcome based budgeting
5. **Fixed Budget:** not modified for variation in actual activity and costs.
6. **Flexible budget:** budget changes in response to activity level and costs

## Budget Justification Note

- Separate word document to explain the budget nos.
- For each line item and activity, provide complete details so that it can be referred for direction and validation during implementation.
- Provides narrative clarification of each budget item demonstrating the necessity of the costs and how they relate to the program activity Provide justification of the calculation of the estimated costs. Note that the estimation should be based on real costs

## Balanced, Surplus and Deficit budgets

A balanced budget is a e budgeting process where total expected revenues are equal to total planned spending.

A budget deficit occurs when expenditures surpass revenue.

A budget surplus means there is additional money to spend at the end of the accounting period

# Budget Monitoring & Budgetary Control

## **Budget Monitoring is the process:**

- Record actual expenditure versus budget estimates at the line/activity level in books
- Measure variance using a budget variance report to ascertain positive/negative deviations
- The workplan delivered helps budget monitoring at a particular point of time
- Tally software can setup budget and record expenditure. So, the Variance report is real time.

## **Budgetary Control is the process to:**

- Evaluate results of budget monitoring i.e. actual income and expenditure versus original/revised (realigned) budget through variance report
- Deviation/tolerance triggers action
- Budgetary control ensures timely action/approvals i.e. budget realignment, reallocation, NCE

## Interest apportionment

1. With a single bank account for multiple projects, interest apportionment for reporting to donor has to be made as per well defined method
2. Interest apportionment not applicable for dedicated bank account
3. Interest can be additive or deductive from grant as specified in grant agreement.

## HR cost allocation

- Staff cost for shared HR in a grant should be allocated and charged to donor grants as per project grant in line with common cost allocation policy
- Monthly salary register/sheet with salary allocation of staff to donor projects, deductions/adjustments, variance versus previous month with reasons and banking streams for payout. This is required for donor verification and audit
- Payment of salary out of FC and local funds
- Applicability of time sheets in donor contracts

## Robust Grant Monitoring System

Grant monitoring is a process to measure/review performance during grant period. It assesses physical & financial progress, identify risks and corresponding mitigation measures, ensure that funds are used as intended and programs achieve desired outcomes and impact.

### **Important Tools and Process:**

- Complete understanding of terms and conditions of Grant contract
- Budget and LFA clearly known to both finance and programme teams
- Periodic Budget Variance/Deviation Analysis by finance, program team and management review
- Timely course correction through realignment etc through addendum in grant contract.
- Timely reporting-narrative and financial reports as stipulated in grant contract

### **Grant Contract - General Conditions**

- MOU versus grant contract/agreement distinction
- Recitals/Preamble
- Definitions
- Grant amount and purpose (including prohibited/disallowed use)
- No Pledge
- Complementary funding
- Designated contacts-for various aspects of the grant
- Conflict of interest and ethical conduct
- Confidentiality
- Term and termination

### **Grant Contract - General Conditions**

- Notice of Changes
- Compliance with laws
- Indemnity
- Publications and Licenses
- Visibility, Publicity
- Force Majeure
- Relationship of parties

- Governing Laws
- Notice
- Waiver

## Grant Contract - General Conditions

- Severability-any clause not enforceable does not make other clauses non enforceable
- Assignment/Delegation
- Acknowledgement-understand and consent
- Counterparts
- Entire agreement
- Arbitration
- Jurisdiction
- Remedies-injunctive relief from court

## Grant Contract - Operational Conditions

- Scope of Work
- Deliverables
- Budget
- Eligible Costs
- Grant Disbursement/Reimbursement
- Log Frame and Work Plan
- Basis of accounting
- Separate Books of Account for the project
- Separate Bank Account for Grant Funds
- Bills and Voucher separately and defaced with mention of project
- Limit on Cash Expenditure.

## Treatment of interest

- Procurement rules
- Program/Financial reporting-Often there are templates for interim and final reports
- Input Tax credit
- Monitoring/Evaluation Audit
- Recovery

- Treatment of Fixed Assets-templates in case FA are not allowed to be retained automatically
- Income generated from project activity
- Sustainability
- Closure of grant
- Record and retention

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# Overview of Financial Statements of NGOs

## Need for Financial Reporting Framework for NGOs

- Financial reporting should provide true and fair view of state of affairs in conformity with generally accepted accounting principles (GAAP).
- India GAAP is based on Accounting Standards formulated by ICAI
- TFV means financial statements are accurate, complete and present a fair representation of the company's financial position and performance.
- This confirmation is provided by an external auditor as per its opinion in the auditor report. This auditor is accredited with the apex accounting body i.e. ICAI
- Financial reporting (statements) should provide uniformity, clarity and common understanding to various stakeholders.
- For NGOs, lack of awareness and uniform applicability, inconsistency in basis of accounting, non-uniform terminology etc. results in financial statements being neither standard nor comparable.
- Financial reporting framework for NGOs is detailed in *Technical Guide on Accounting of NGOs (Jan 2022)* by ICAI for uniformity and standardisation.

## Components of Accounting Framework as per Technical Guide

1. **Elements of financial statements:** Identify and define the items that should be considered as income, expenses, assets and liabilities in NPOs.



2. **Principles for recognition of items:** These principles lay down the timing of recognition (when) in the financial statements.
3. **Principles of measurement:** These lay down at what amount items should be recognised.
4. **Presentation and disclosure principles:** These explain the manner of presentation and disclosures required.

*Note: 1, 2 and 3 are sector-neutral (not different for NPOs and for profit entities), while presentation and disclosure differ for the two sectors.*

# Accounting Terms

## Assets

These are resources or items that the NGO owns Assets have future economic value that can be measured and can be expressed in monetary terms. Examples include investments, cash, inventory, accounts receivable, land, supplies, equipment, buildings and vehicles.

Three categories:

1. Fixed Assets
2. Investments
3. Current Assets

## Liabilities

These refer to the legal financial obligations or debts that NGOs incur during business operations. They are settled over time through the transfer of economic benefits such as money, services or goods. Liabilities include payables, loans, accrued expenses, provisions.

Two types:

1. Long term
2. Short term

## Equity/Capital, Net Assets

Refers to the amount of money that is required to return to its shareholders after all assets are liquidated and all liabilities paid off.

Equity capital is not returned to founders/promoters in NGOs

### **Revenue/Income**

Refers to income that an NGO generates for/on its normal operations i.e. grants, donations, interest etc.

### **Expenses**

Expenses refer to the costs of operations that for profit incur to generate revenue. In NPOs, income is received for making expenses normally. Common expenses include employee wages, payments to suppliers, equipment depreciation and factory leases.

## **What is a financial statement?**

Financial statement is a collection of summary-level reports about an organization's financial results, position and cash flows.

Financial statements include:

1. balance sheet as at the end of the financial year,
2. income and expenditure account during the financial year,
3. Receipt & payment (cash flow) statement during the financial year and
4. Accounting Policies (principles for preparing the financial statement based on Accounting Standards) and explanatory notes

These come with Auditor Report with its opinion on the TFM of financials statements

## **BS, I&E, R&P**

- **Balance Sheet:** Presents assets and liabilities i.e. what you own and owe.

- **Income & Expenditure Statement:** Presents income earned and expenditure incurred during the year, Any excess is carried to the Balance Sheet
- **Receipt & Payment Statement:** Present actual receipts of funds and payments during the reporting period.
- FCRA registered entities have to prepare FCRA financial statements separately for its FC operations.

## Key Points for Preparation of Financial Statement

- Basis of accounting: Accrual system of accounting recommended
- Prepared annually
- Contain standard information for various stakeholders
- Comparative information for at least one year
- Different from donor reporting, govt compliance but these are extracted from the financial statements
- Should reflect restricted and unrestricted funds separately
- Format: Schedule III of Companies Act for section 8 company and other forms of charitable organisations also follow CA

## MRL and ML

**Management Representation Letter (MRL)** is issued by the client (Auditee/NGO) to the auditor in writing as part of Audit Evidence. Management takes responsibility for the complete and accurate information provided to auditor to provide TFV. This document during the audit clarifies the separation of responsibilities of the auditor and auditee (management).

**Management Letter (ML)** is a letter sent from auditors to Governing Board advising them of findings indicating control weaknesses identified during the audit, and suggestions to remedy these. It is an outcome of the audit process. The Board is supposed to respond to the observations and confirm compliance within a timeframe

## Maintaining Books of Accounts for NGOs

- There was no regulation regarding books of accounts by NGOs upto FY 21-22
- Section 12A(1)(b)(i) inserted for maintaining of books of accounts and other documents wef AY 23-24.

Books of accounts & other documents:

The specified books of accounts shall include

- Cash book
  - Ledger
  - Journal
  - Copies of serially numbered receipts, original copy of invoices, etc.
1. Record of all the projects and institutions run by the organisation
  2. Record of income of the organisation during the previous year
  3. Record of application out of the income during the year
  4. Record of specified application out of the income of preceding years
  5. Record of voluntary contribution with a specific direction to form Corpus
  6. Record of contribution received under 80G(2)(b) being treated as corpus
  7. Record of Loans and Borrowings
  8. Record of properties held by the organisation
  9. Record of specified persons, as per section 13 (3) of the Act
  10. Any other document

## Bookkeeping Guidelines

1. Form of keeping books of accounts and documents: Kept in written form or electronic form or digital form or printouts or any other form of electromagnetic data storage device.
2. Place of maintaining books of accounts and other documents: shall be kept and maintained at its "registered office". If the accounts are maintained other than the registered office or at various project locations, intimate Assessing Officer in writing, giving full address of the other places supported by resolution of the board
3. Period for which books of accounts & other documents should be kept: Kept and maintained for a period of ten years from the end of the relevant assessment year
  - Organisation having income subject to section 11(4) and 11(4)(a) to maintain separate set of books of account of such income in line with the provision under

# Accounting Standards

- Formulation of uniform Accounting Standards is necessary in the preparation of accounting information and its presentation in financial statements for bringing about a greater degree of uniformity in accounting measurements.
- Accounting Standards lay down the rules for measurement and presentation of accounting information by organizations and are prescribed by ICAI

## AS-1: Disclosure of Accounting Policies

**Fundamental assumptions:** Going concern, Consistency, Accrual.

**Considerations** in selection of accounting policies to reflect true and fair view of the financial statement

- Prudence:** Profits are not anticipated but recognized when realized. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only as an estimate.
- Substance over Form:** The accounting treatment and presentation of transactions and events in financial statements should be governed by their economic substance and not merely by the legal form.
- Materiality:** Financial statements should disclose all “material” items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

## AS-1 Points to Remember

- Areas for accounting policy disclosure for NPOs-Depreciation, FA valuation, valuation of investment, treatment of employee benefits, contingent liabilities.
- All significant accounting policies used in the preparation and presentation of financial statements should form part of the financial statements as a Schedule.
- Change in the accounting policies which has a material effect should be disclosed and amount by which the financial statements is affected should also be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

- If the fundamental accounting assumptions are not followed, the fact should be disclosed in financial statements.

## AS-10: Accounting for Fixed Assets

1. Gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements;
2. Expenditure incurred on account of fixed assets in the course of construction or acquisition; and
3. Revalued amounts, the method adopted, the nature of indices used, the year of any appraisal made and whether an external valuer was involved

## AS-13: Accounting for Investments

- Investments are assets held by an organization for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits.
- Classification of Long term and short term investments should be as specified in the standards.
- The requirements of this Standard regarding cost of investment, carrying amount of investment, disposal, reclassification etc should be followed.