Section II: Financial Statements

Financial statements are of many kinds: the ones we ha discussed here are annual financial statements. These are prepared once a year, on the basis of account books maintained by the organisation.

There are three main statements that a non-profit normally prepares: Receipts and Payments Account, Income and Expenditure Account, and the Balance Sheet. These are then checked by the auditors, who issue a report. This is called an audit report.

The Receipts and Payments account is similar to a cash flow statement. Most NGOs follow cash basis of accounting. Therefore, in most of the cases, this is virtually the same as the Income and Expenditure Account. Both these statements show the activity during the year, and are, in a way, parallel to a narrative program report.

The Balance Sheet, on the other hand, shows the financial status of the organisation on a particular day. Mostly, this day now is 31st March each year, when the Government of India closes its financial year. You are free to choose another date for closing the accounts -- so long as you close them on 31st March also!

The audit report is an important document. It can, and often does, give important information about the organisation's financial health. Unfortunately, it is not written like a juicy news-story; most people, therefore, do not read it. The importance of audit report and the role of auditors is also discussed in this section.

Going through this section will not make you a financial wizard or analyst. However, it will give a basic understanding of the annual financial statements, and how to use these in your work.

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Receipts and Payments Account

What is a Receipts and Payments Account?

NGOs are required each year to prepare a summary of their cashbook. This summary shows all the money that they received during the year. It also shows the payments that were made. This is called the Receipts and Payments Account.

The Peacemaker

Payment is a noun. It comes from the verb pay. And where does pay come from? It's been used in English for more than 800 years.



It seems that the original root of pay was the Latin word *pax*. *Pax* means peace (as in *Pax Romana*). One of the Latin forms of *pax* was *pacare*, which meant pacify. The idea was that you could pacify an angry creditor by paying him!

The French changed *pacare* to *payer*. From there, it reached English in the 12th century as pay. It was often used in the sense of 'pacifying' people till the 16th century. After that, this meaning died out. For the last 500 years, payment has been used only to mean 'the act of giving money'.

Utility

Some people think that the Receipts and Payments Account is a leftover from the time of cash accounting. This is not quite correct. The Receipts and Payments Account has several advantages. This is more so in the case of non-profit sector:

1. Trustees and other laypersons find the Receipts and Payments Account easier to understand.
2. This Account discloses all loan transactions, even those which have been squared-off during the year.
3. Some accountants do not disclose revenue Grants in the Income and Expenditure Account. In such cases, the true Income of the Non-profit can be known only from the Receipts and Payments Account.
4. Manipulation of financial statements has become very common these days. It is, however, not easy to manipulate the Receipts and Payments Account[1] and the Income and Expenditure Account together.

Receipts vs. Income

All receipts are not income. For example money received from sale of fixed assets, loans taken, advances from customers, etc. is not income.

Similarly, all income may not be received during the year. This happens if the organisation follows accrual accounting[2]. For example, money for credit sales may be received in the next year. Interest earned on fixed deposits.

Payments vs. Expenditure

Using the same logic, all payments are not expenditure. For example, money paid for purchase of fixed assets, loans repaid or given to others, advances to contractors, etc. are not expenditure.

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[1] In recognition of this fact, corporate reporting requirements have now changed to include cash flow statements also.

[2] See 'Basis of Accounting' under chapter 'Commonly Confused Terms' on page 95.

In some cases, an expense may occur but may be paid later. For example, you may have organized a mela in Feb '02, but the bill of the tent house may be paid later in April '02.

In this case, if you are following accrual accounting, then this will be shown as an expense in 2001-02, and as a payment in 2002-03.

Common issues

Before discussing the methods of making a Receipts and Payments Account, let us deal with some commonly confused issues:

Loan transactions

The Receipts and Payments Account should show all cash and bank transactions. This includes loans given or received. It even includes those loans that were given out and received back during the same year.

Unfortunately, many accountants simply prepare the Receipts and Payments Account from the Balance Sheet and the Income and Expenditure Account. As a result, transactions settled during the year do not show up at all. This is not a good practice and should be avoided[3].

Advances for expenses

During the year many staff members may be given advances for expenses. For example, people are given advance for traveling, for organising events, for purchasing stationery, etc. Should all these be shown in the Receipts and Payments Account?

This is a difficult question. If we do not show these advances then some people may feel that we are suppressing information. But if we show these, then the Receipts and Payments Account will become hopelessly cluttered.

There are two ways to deal with this. One is to take a decision that all routine advances settled during the year will not be shown in the Receipts and Payments Account. This can also be disclosed in the Receipts and Payments Account by giving a note.

Second option would be to show all advances given on the payment side as one line item 'Advances for Expenses'. On the receipts side, a corresponding one line item can be shown as 'Settlement of Advances for Expenses'. This may look like below:

FCRA Receipts and Payments Account (partial)

Receipts	Amount	Payments	Amount
Settlement of Advances for Expenses	40,224	Advances for Expenses	46,250

Why is there a difference of Rs.6,026 between the two sides? This represents advances given to staff, for which bills have not been submitted by the end of the year.

[3] There is an important reason for this. Let us assume that there is a clever trustee of a wealthy Trust. On 1st April '00, he took a loan of Rs.5,00,000 from the Trust. On 31st March '01, he returned the entire Rs.5,00,000. The loan was interest-free.
Then again on 1st April '01, he took another loan of Rs.5,00,000. He returned this loan also on 31st March '02.
In both years, the loan has been squared-off within the financial year. Should this loan be shown in the Receipts and Payment Account?

Accrued Expenses / Income

What happens to expenses or income, which have accrued during the year but not paid or received so far? These should not be shown in the Receipts and Payments Account of this year. These will be shown in the next year when the actual cash payments or receipts occur.

Cash or Bank?

For making the Receipts and Payments Account, cash and bank transactions are treated as **being the same. Therefore, deposit or withdrawal of cash from bank account** not shown as a receipt or payment.

However, if you invest money in bank fixed deposits, this will be shown as payment item in the Receipts and Payments Account. Similarly, encashment of fixed deposits will be shown as a separate item of receipt.

Level of Detail

Receipts and Payments Account is a summary of the cash and bank book. This means that all items of one type can be added together and shown as a single line item. For example, salary is paid twelve times a year. However, we need not show 12 entries for salary. We can show just one entry 'Salary paid' in the Receipts and Payments Account.

However, can we add up all our expenses[5] and show these as one item, say 'Rural Development'? No. This will give very little information. The basic purpose[6] of preparing a Receipts and Payments Account will be defeated.

We should therefore, try to give reasonable level of detail[7] in the Receipts and Payments Account.

Using Trial balance figures

Most accountants use a shortcut to make the Receipts and Payments Account. They pick up most of the income / expense figures from the trial balance. Then they derive other figures[8] of receipts / payments by using opening and closing balances of various accounts[9].

This can work if the organisation is following cash basis of accounting. In case, the organisation follows accrual basis or mixed basis, then this shortcut can give wrong results.

Depreciation

Depreciation is not a cash payment. It is an estimated charge towards wear and tear of fixed assets. Therefore, depreciation never appears in the Receipts and Payments Account.

Computerised Accounts

What is the command for making a Receipts and Payments Account if your accounts are computerised? We do not know of any accounting software, which can generate a proper Receipts and Payments Account automatically. This may be because the software is unable to link up an advance with its settlement.

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[4] Sometimes called 'cash-bank contra'
[5] Including salary, rent, various function, fuel, etc.
[6] That is, financial disclosure
[7] For more in this, see 'Level of Detail' in AccountAble Handbook: FCRA, page 77
[8] Non-revenue items such as loans, purchase of fixed assets, etc.
[9] This often means that some transactions do not get reported in Receipts and Payments Account, particularly where loan account had been squared during the year.

Local Contribution and FCRA

Does your FCRA funded project require local contribution also? Be careful how you account for it. Any local contribution, whether cash or in kind, can not be brought into FCRA account books.

This should be accounted in the General or Indian cash book and posted to another sub-ledger maintained for concerned project. Please note that this sub-ledger is part of the Indian set of books and is different from the FCRA project ledger.

Also do not include this local contribution in the FCRA Receipts & Payments Account when you file your FC-3. If you do, you may get a notice from FCRA 'for mixing up local and FCRA funds'.

How to make a Receipts and Payments Account

Receipts and Payments Account should normally be consolidated, that is, it should show the picture of the entire organisation. This includes FCRA funds, government funds, other funds as well as own funds.

Consolidated Receipts and Payments Account for the year ended 31st March '02			
Receipts	**Amount**	**Payments**	**Amount**
Opening Balance:		Salaries: Program Staff	9,24,300
– Cash 500		Salaries: Admn. Staff	2,75,200
– Bank 1,15,500	1,16,000	Watershed Development Works	24,27,356
Local Contribution	10,250	Rent	42,000
Grants from:		Stationary	24,350
– Indian Agencies	14,55,500	Loan to staff	15,800
– Foreign Agencies	55,75,500	Revolving Fund Loans given	4,85,760
– Govt. Dept.	8,75,000	Purchase of land	1,00,000
Interest from:		Education Centres	11,85,320
– Bank	1,500	Health Program	19,32,851
– FDs/ Investment	10,500	Traveling Expenses	2,53,057
– Rev. Fund Beneficiaries	12,500	Fuel & Maintenance	71,950
Loans taken	1,45,000	Leadership Program	2,26,860
Sale of Motorcycle	5,000	Advances for Exp.	80,500
Advances for Exp. settled	75,354	Loans returned	1,06,000
Rev. Fund Loan recoveries	1,10,200	Closing Balance:	
		– Cash 10,506	
		– Bank 2,30,494	2,41,000
Total	**83,92,304**	**Total**	**83,92,304**

However, in some cases, a limited Receipts and Payments Account is prepared. For example, a Receipts and Payments Account showing transactions for FCRA funds only is prepared and

attached to the FC-3. Similarly, some donor agencies ask for project based Receipts and Payments Account, showing transactions of projects supported by them.

Following guidance applies mainly to the consolidated Receipts and Payments Account.

Opening Balance

Start with the opening balance[10] of cash in hand, and cash in bank accounts. Remember to include the balance of all bank accounts and all cash books[11].

Opening bank balances should be taken from the bank book[12] and not from the bank pass book.

Receipts

Summarize all receipts appearing on the receipts side of the cash book and the bank book. These are added up separately for each head of account and shown on the receipts side of the Receipts and Payments Account.

Payments

Similarly, all payments appearing on the payments side of the cash book and the bank book are summarized. These also are added up separately for each head of account and shown on the payments side of the Receipts and Payments Account.

Closing Balance

The closing balance is once again taken from the cash book and bank book[13], as appearing at the end of the year.

Tallying the two sides

Now add up both the sides. The two totals should tally, if all the figures have been taken correctly. If the totals do not tally then you may have to go back to your account books and cross check the figures again.

[10] At the beginning of the year
[11] If you maintain multiple cash books for each project or for different locations
[12] Or bank column of the cash book/ bank account in the ledger
[13] Bank book maintained by you, not the bank pass book

Income and Expenditure[14]

As the development sector grows, size and complexity of NGOs is also growing. To handle the large amount of funds, both the NGOs and the funding agencies need a better understanding of financial statements. This will help them raise and answer questions.

The Balance Sheet shows how wealthy (or bankrupt) a person or organisation is. It is a status report and shows where the organisation has reached on a particular date. In this chapter, we deal with the Income and Expenditure Account.

Income and Expenditure Account is like an activity report – it shows what you did in one year. Mostly this account is prepared for a year though it can be prepared for a longer or shorter period also. It shows all the income for the year on one side (the 'auspicious' right hand side) and all the expenditure on the other side (the 'evil' left hand side).

The difference between the two sides is shown as 'surplus' or 'deficit'. If the right side (income) is more, you get a surplus. If the left side (expenditure) is more, it means you spent more than you earned – the result is a 'deficit'.

How can I spend more than I earned?

This is not difficult at all – see how easily the Government has been doing it for 50 years. You do this mainly by:

- Borrowing money from others. The loans will not show up on the Income side – these are shown as liabilities.
- Spending stored surplus related to an earlier year. This adjustment will also show up in the Balance Sheet.

What can the Income and Expenditure Account tell us?

For a good analyst, a decently prepared Income and Expenditure account is better than an annual narrative report. It can tell you:

- How much the NGO received from different sources: grants, donations, interest, and other income.
- How did it spend the money: salaries, travel, and physical program work.

And when you compare two or three accounts, you will know:

- Whether the income of the NGO is rising or stagnating.
- Whether it has been able to spend the money it receives.
- Which types of expenses are growing at a higher rate than others.

With these figures, you can raise some relevant questions:

- Is it practical to raise such large amount of donations from villagers or from small towns?
- What are the expenses incurred against other income from consultancy, training, etc.?
- Why is the pattern of expenditure changing?
- Whether activities given in the narrative reports tie up with the Income and Expenditure Account?

[14] Based on AccountAble 38: Income and Expenditure

Is it different from the Receipts and Payments Account?

The Receipts and Payments Account shows all receipts, including donations, grants, loans taken, sale of assets, and recovery of staff advances. In the Income and Expenditure Account, loans, sale of assets, recovery of staff advances, etc. are not shown.

Similarly, repayment of loans, purchase of fixed assets, etc. are shown in the Receipts and Payments Account, but not in the Income and Expenditure Account.

Receipts and Payments Account is like a summary of the cash and bank book — it starts and ends with cash and bank balances. It can not tell you whether there is a surplus or deficit.

Why is that important?

You may be spending more than you earn by borrowing money. In the long run, this will get you into serious financial problems. The Receipts and Payments Account does not distinguish between 'income' and 'loans', etc. The Income and Expenditure Account can tell you whether you are breaking even each year or not. In any case, you need to know the figure of surplus or deficit to prepare your Balance Sheet.

What happens to the surplus?

The surplus is transferred to the Balance Sheet and carried forward to the next year. In most cases, the surplus shows up due to wrong accounting policies. It represents unspent grants which will be spent next year. There are really very few NGOs who will have a genuine surplus. These NGOs may be doing public fund-raising or may be running some income generation activity, where they earn a profit.

Is 'Profit' different from 'Surplus'?

The word 'Profit' is used for commercial organisations. 'Surplus' is used for non-profit bodies. Surplus is also sometimes called 'excess of income over expenditure'. The main difference between 'profit' and 'surplus' appears to be that you are not free to distribute the surplus among the members of the NGO. Even the profit earned in income generation activities can not be given to the members of the NGO – it must be used for the organisation's objectives.

Can we transfer surplus to General Fund?

In most cases the surplus includes unspent grants. This part of the surplus can not be transferred to General Fund without the concerned Agency's permission. However, general donations from public or other similar income (interest, etc.) can be transferred to General Fund or some other specific fund.

What about transfers to Corpus?

The entire surplus can not be transferred to the Corpus. Some part of the surplus will represent amounts received for purchase of fixed assets. This can be transferred to 'Corpus' or 'Fixed Assets Fund' when the assets are purchased. This provides a balancing effect on the liabilities side. If you receive a specific grant for your corpus, this can be transferred to the corpus. Donations from general public can be transferred to corpus, unless the donor has given some other instructions.

Are grants 'Income'?

Some people say that grants are received for specific purposes and represent a liability. These should not be taken to Income and Expenditure Account but directly to the Liabilities side of the Balance Sheet. Unfortunately, this results in a distorted view. Even in case of NGOs receiving and spending crores as grants, the Income and Expenditure Account may show very little income or expenditure.

Another view is to treat such grants as 'Conditional Income'. This would mean that these become the organisation's income if these are spent properly. That is to say, these are spent according to the terms and conditions of the grant. In such case, the entire grant is shown as income and a provision is made for unspent grant at the end of the year. This presents a picture which is closer to reality.



What is a Consolidated Income and Expenditure Account?

NGOs often prepare separate Income and Expenditure Account for each funding agency. This reflects the transactions related to that particular project. However, they also need to prepare a Consolidated Income and Expenditure Account showing transactions related to all projects (FCRA or Indian) as also the General section. This is a compulsory requirement under Income Tax, Societies Act, as also Bombay Public Trust Act.

What is Depreciation?

When you build or purchase a fixed asset, it will last you for several years. A jeep may be useful for 5-10 years, a good building will last you for 90-100 years. When you charge depreciation, you write off a proportionate amount each year. The jeep may be written off over 10 years by charging 10% depreciation each year; the building will be written off over 100 years by charging a lower rate.

Who pays for depreciation – the NGO or the funding agency?

Neither the funding agency nor the NGO pays for depreciation in a direct sense. Indirectly, the funding agencies or donors pay for it in most of the cases. This happens when they give grants to purchase assets as new or replacement.

Should NGOs charge depreciation?

It is very difficult to work out a proper rate of depreciation. Commercial concerns charge depreciation because a) it is required for calculating taxable profit; b) it is compulsory for companies if they want to declare dividend; c) it is recommended by most accounting bodies so that a reserve for replacement of the asset is created.

The first two reasons are not relevant for NGOs. They get a 100% tax write-off in the year they purchase an asset. They do not declare dividend either. Moreover, most assets are created out of grants. When the asset becomes worn out, a fresh grant is sought for replacement.

The ICAI has made AS - 6 on Depreciation Accounting compulsory from 1st April 1995. This applies to all NGOs which have any business or commercial type activities (see under 'AS-6: Depreciation Accounting' on page 101.

For other NGOs, it is up to them whether they charge depreciation or not. If they wish to charge depreciation, they can use the rates given in Income Tax act or Companies Act (see chart alongside).

Depreciation rates

The rates shown here are taken from the Companies Act and the Income Tax Act. In these Acts, many more rates are specified – for accurate information you should consult your auditors.

WDV or SLM?

These indicate the method of calculating depreciation: SLM means straight line method. Here the rate is applied to original cost of the asset each year. If an asset is worth Rs.10,000 and the SLM rate is 10%, then the depreciation each year will be 10% of 10,000 or Rs.1,000 each year.

WDV means written down value method. Here the rate is applied is applied to the net balance of an asset. If the asset is worth Rs.30,000, and depreciation rate is 10%, then in the first year, depreciation will be Rs.3,000. In the second year, it will be Rs.2,700 [(Rs.30,000-Rs.3,000) x 10%]. In the third year, deprecation will be Rs.2,430 [(Rs.30,000-3,000-2,700) x 10%].

Asset	Companies Act		I. Tax
	SLM %	WDV %	WDV %
Office Building	1.63	5	10
Residential building	1.63	5	5
General Equipment	5.15	15	25
Cars / jeeps	7.07	20	20
Tractors	11.31	30	25
Bus / truck	11.31	30	25
Other vehicles	7.07	20	25
Computers	16.21	40	25
Furniture	3.34	10	10
School furniture	5.15	15	15

SLM: Straight Line Method
WDV: Written Down Value

Format: Gujarat and Maharashtra

A special format has been given under the Bombay Public Trust Act. This format gives minimum disclosure requirements. This has to be used by all NGOs registered under BPT Act (the Act applies to Gujarat and Maharashtra only).

Horizontal or Vertical?

Horizontal Format

Most NGOs prepare the Income and Expenditure Account in horizontal format. Income is kept on the right hand side and expenditure on the left hand side. In this, it is similar to the Profit and Loss Account prepared by commercial organisations.

Using Schedules

But there the similarity ends. NGO tend to put all the line items on the main Income and Expenditure Account, instead of classifying these into schedules. This makes the accounts very difficult to understand. Use of schedules could solve this problem.

Classifying account-heads

Secondly, there is no standard basis of classifying account-heads – it follows the agency budgets. Similar expenditure may be classified differently under two different agency budgets. This causes confusion and makes comparisons difficult. In the present situation, there appears to be no real solution for this.

Vertical Format

When the Income and Expenditure Account is prepared vertically, Income items go on top. Below these the Expenditure items are shown. Total expenditure, when subtracted from Total Income gives you the surplus or deficit.

There is no major advantage in the vertical Income and Expenditure Account except that it is easier to type and file, and shows total income and expenditure clearly.

Schedule B: Grants	
Hivos	230,465
CRY	364,964
CAPART	482,928
ActionAid	328,227
CSWB	200,000
Oxfam America	314,086
Total	**1,920,670**

Details are given in Schedules like this

Income & Expenditure Account of Lok Jagran Manch for year ended on 31st March 1997

Expenditure	Amount (Rs.)	Income	Amount (Rs.)
Watershed program (sch. C)	830,471	Grants (schedule B)	1,920,670
Education program (sch. D)	665,340	Community Contribution:	
Credit program (sch. E)	41,274	— in kind	230,710
Emergency Relief (sch. F)	530,223	— in cash	4,360
Institutional Expenses (sch. G)	149,878	Donations	12,451
Depreciation (sch. A)	19,952	Bank Interest	23,852
Audit Fees	4,500	Income from investments	100,045
Surplus carried to Balance Sheet	50,450		
Total	**2,292,088**	**Total**	**2,292,088**

Horizontal Format

Notes to Accounts

These provide explanations or clarification regarding accounting policies, etc. This helps people understand your Income and Expenditure Account better. These can be given with the horizontal format as well.

Income & Expenditure Account of Lok Jagran Manch for year ended on 31st March 1997

	Amount (Rs.)
Income:	
Grants (schedule B)	1,920,670
Community Contribution:	
— in kind	230,710
— in cash	4,360
Donations	12,451
Bank Interest	23,852
Interest / dividend on investments	100,045
Total Income	**2,292,088**
Expenditure:	
Watershed program (sch. C)	830,471
Education program (sch. D)	665,340
Credit program (sch. E)	41,274
Emergency Relief (sch. F)	530,223
Institutional Expenses (sch. G)	149,878
Depreciation (sch. A)	19,952
Audit Fees	4,500
Total Expenditure	**2,241,638**
Surplus (carried to Balance Sheet)	**50,450**
Notes to Accounts: Schedule H	

Vertical Format

Balance Sheet[15]

A Balance Sheet is, to a true accountant, the crowning glory of a year's hard work. To an auditor, it is the beginning of an exciting hunt. What does a Balance Sheet mean to you – a piece of paper with meaningless figures? An annual ritual to keep the authorities and donors happy?

If you say yes, you are probably right. Many Balance Sheets are the result of careless or 'creative' accounting. But not all. An honest Balance Sheet can give you invaluable insights into an organisation.

How to read a Balance Sheet

Quite simply, the Balance Sheet is a sheet of Balances to be carried forward to next year. However, accountants are rarely satisfied with simple things. They have divided the Balance sheet into two parts: Assets and Liabilities. To make things more complicated, they offer you two forms of Balance Sheet: the traditionally Horizontal and the trendy Vertical (See on pages 79 and 80). But the Balance sheet is merely one part of the Final Accounts.

Final Accounts

Final Accounts are also called Financial Statements. Apart from the Balance Sheet, there are two other statements which form the Final Accounts: 'Income and Expenditure Account' and 'Receipts and Payments Account'. All three are prepared at the end of each financial year. In India, the financial year now is uniform and runs from 1st April to 31st March. In other countries, the financial year varies.

Audit Report

In addition to these three, there is an important statement called the 'Audit Report'. The audit report contains comments of the auditor regarding the truth and fairness of the first three statements. The Audit Report is prepared by an independent auditor (normally a Chartered Accountant).

Income and Expenditure Account

The Income and Expenditure Account is like an activity report. It tells you the income earned during one particular year (e.g. 1st April 1996 to 31st March 1997). It also shows all the expenses for that year. For IGPs, this is called a Profit and Loss Account.

Receipts and Payments Account

The Receipts and Payments Account is also like an Income and Expenditure Account. But there are two important differences: one, it includes capital transactions (like loans taken and assets purchased) during the year; and, two, it shows only those transactions where cash or cheque has been given or received during the year.

Balance Sheet

The Balance Sheet is like a status report. It will tell you what were the assets and liabilities of the NGO on, say, 31st March 1997. It will show all their assets (buildings, vehicles, investments, cash in hand, bank balances). If the NGO has taken loans these will also be shown here. The Balance Sheet will also show you whether the NGO has a Corpus or Endowment Fund. Other things to look for:

Dynamic or Stable

You can often tell the age of an organisation by its Balance Sheet. As it grows older, its Balance Sheet grows heavier. Assets acquired for operations over the years get accumulated in the

[15] AccountAble 36: Balance Sheet

Balance Sheet. The organisation's need for a secure future leads to a larger corpus. But insecurity is often a spur to action. Once there is a feeling of stability, the organisation becomes less dynamic. This is reflected by the less active Income and Expenditure Account.

How much cash

Cash in hand is important for day-to-day expenditure. But large amount of cash increases risk of theft and misuse. Normally a cash balance for three days' payments is sufficient. A larger balance may mean unusual circumstances (planned purchase of land), several field offices, lack of planned withdrawals or even a partially fictitious cash balance.

Bank Balance

Money lying in a savings account or current account is no good for anyone except the Bankers. Good financial management will show up in small bank balances (sufficient for a month or 45 days), with the rest of the money lying in short term bank deposits. Most funding agencies now accept this so long as the program is not affected.

Ratio Analysis

While the word 'ratio' has links to the word 'rationality', some of the ratio analysis can be quite hilarious and irrational (see 'Business India Index'). Ratio analysis means analysing a relationship between two figures when there is a relationship.

For example, there is a relationship between amount of work done and infrastructure needed. So you can see the relationship between value of fixed assets and amount of program expenditure. This can be done by dividing the total program expenditure by the value of fixed assets. A ratio of '1' will raise eyebrows while a ratio of '5' may be quite acceptable.

Window dressing

Very common in the corporate sector. Virtually unknown in the voluntary sector[16].

Notes to Accounts

Some of the figures in the Final Accounts often need additional explanation. These are given in the Notes to Accounts. Read these for better understanding of the Balance Sheet. Often important accounting Policies are also given here.

More tips on reading a Balance Sheet

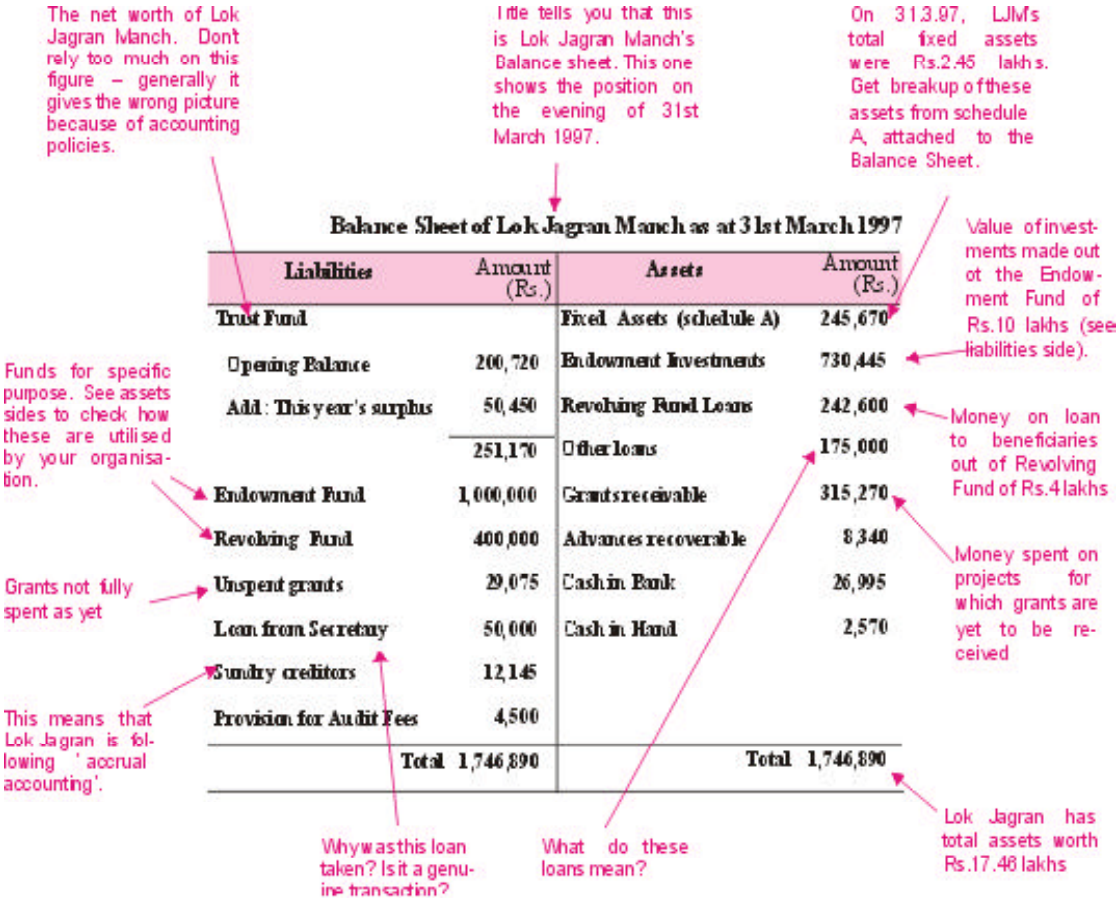
- If the Balance Sheet is not consolidated, it will carry some comment below the heading (such as FCRA Accounts; CRY Project etc.).
- It is also useful to compare this year's figures with last year. See if some of the amounts have remained unchanged.
- If creditors or debtors appear on the Balance Sheet, they are probably following Mercantile Basis (accrual) of accounting.
- Revolving Fund loans are often treated as expenditure in accounts (though not in reality). In such a case, no such loans will appear on the assets side.
- Grants are sometimes not taken to Income and Expenditure Account — balance of amount received and spent is shown in the Balance Sheet.
- Fixed Assets are sometimes charged off to program expenditure.
- Surplus shown in the Income and Expenditure is often due to expenditure on fixed assets — it is not a real saving of funds.

[16] Some say that it prefers to keep the windows closed rather than resort to dubious window dressing!

- Endowment Funds are often not properly set aside on the Liabilities side but merged with surplus for the year.

The Horizontal Balance Sheet

Most NGO Balance Sheets are prepared in the Horizontal form. This has two sections: right and left. Assets are shown on the right side; liabilities are shown in the left. There is an interesting history to this. Traditionally, left has been considered evil: at one point in Europe's history, left handed persons were thought to be witches and magicians and burnt at the stake. As we all know, all liabilities are also 'evil' – these are therefore shown on the left side of the Balance Sheet.



Assets

All the assets which you own are put on the Right Hand side. Secondly, these are put in a descending order of 'durability' or 'ease of realisation'. This means 'Land' comes right on top. 'Cash in Hand' comes right at the bottom. Buildings, equipment, furniture, debtors, recoverable advances, investments, bank balances come somewhere in between.

Fictitious Assets

The last line shows the total of all the assets. But watch out for the 'fictitious assets'. These should be deducted from the total of assets side, if you want to make any sense out of the Balance Sheet. Examples of fictitious assets are: 'accumulated deficit'; 'Miscellaneous expenditure remaining to be written off'. These are normally shown at the bottom, below 'cash in hand'.

Liabilities

On the left side, the most pressing liabilities are put at the bottom: these include bills payable, creditors, provision for expenses. Above these come short term 'unsecured loans' taken by you. Going upwards, you then put the 'secured loans' taken from people. Then come the Endowment Funds. Corpus comes right at the top: this is a notional figure and shows the net worth of the organisation.

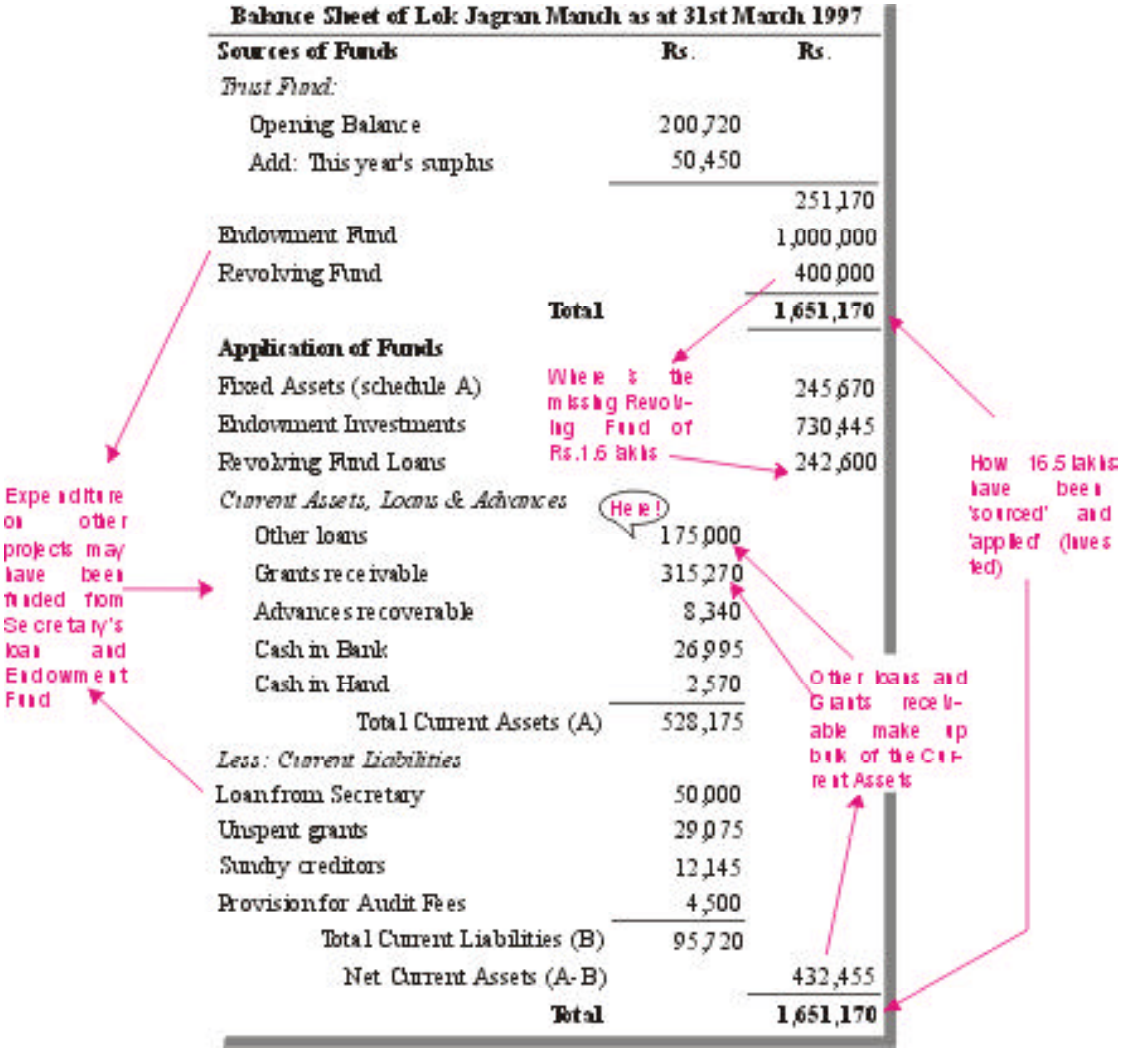
The Vertical Balance Sheet

Some people find this easier to prepare: you do not need a double-spread sheet for typing this. Most companies use this format – however, it is rarely seen in NGOs. The vertical form has given up its prejudice against left handed people – there are no left or right sides to this. It has two sections: 1. Sources of funds; and 2. Application of Funds

Application

The second section (Application of Funds) shows the assets of the organisation in descending order of durability. Fixed assets come first, Investments second and current assets come third. Current assets include debtors, advances, stocks, cash at banks, cash in hand.

However, the current liabilities (bills payable, creditors) are deducted from the current assets to give a figure of net current assets. Only the net figure is shown in the total column.



The fictitious assets (‘accumulated deficit’; ‘Excess of expenditure over income’) are shown at the absolute bottom, below the current assets.

Sources

Going back to the first section, this shows the sources of these funds. At the bottom of this section, you have your unsecured loans (received), preceded by secured loans (received). Above this come the Endowment Funds. Right at top is the corpus, which is a difference between the total assets reduced by loans taken.

In many ways, vertical form is easier to understand. The information is more organised and it is easier to work out ratios. Being typed on single sheets means less complications in xeroxing, filing and physical handling.

Unfortunately, in several states (e.g. Gujarat and Maharashtra), local regulations do not allow NGOs to use the vertical format.

NGO Auditors[17]



Most human beings consider audit as an unnecessary evil. Fortunately, there are some who differ: they think that it is a necessary evil.

There is much confusion among NGOs and agencies as to what an audit means. An auditor's rubber stamp is often thought to be the ultimate certificate of financial propriety. On the other hand, if an employee fudges his travel bill, someone is bound to ask: 'what were the auditors doing?'

Here, we try to provide a perspective on the auditor's role, duties and liabilities.

Audit Report

Does an auditor's stamp mean that everything is all right?

No, the stamp simply identifies the accounts which the auditors have checked. The stamp is put both on good accounts as also bad accounts. You have to read the audit report to understand whether accounts show a proper picture.

You mean a report like: 'checked and found correct'...

These reports (technically called 'audit statement') are not sufficient. For example, these do not tell what was checked. Someone may say that they simply checked the totaling of the accounts and found it correct. Another person may say that they checked the spellings only! The ICAI (Institute of Chartered Accountants of India) discourages such brief reports as these can be misleading.

What does a proper audit report look like?

Good audit reports are typed on the letterhead of the auditor. They show what was the scope of the audit, what type of checking was done and what are the findings. The details of the report depend on the type of audit. An example of a proper audit report is given in the box.

Auditors' Report

We have audited the attached Balance Sheet of _____ (Society) as at 31st March 2002 and also the Income and Expenditure Account and Receipts and Payments Account for the year ended on that date, annexed thereto and report as follows:

1 We have obtained all the information and explanations which to the best of our knowledge were necessary for the purpose of our audit;

2 In our opinion, proper books of account as required by law have been kept by the Society so far as appears from our examination of the books;

3 The Balance Sheet, Income and Expenditure Account and Receipts and Payments Account dealt with by this report are in agreement with the books of accounts;

4 In our opinion and to the best of our information and according to the explanations given to us, the accounts give a true and fair view:

a. in the case of the Balance Sheet, of the state of affairs of the Society as at 31st March 2002;

b. in the case of the Income and Expenditure Account, of the surplus of the Society for the year ended on that date; and,

c. in the case of the Receipts and Payments Account, of the receipts and payments of the Society during the year ended on that date.

for xyz & Co.

Chartered Accountants

Place:

Date:

(abc) Partner

[17] Based on AccountAble 39: NGO Auditors

All audit reports are same – should we really read each one?

It is true that most audit reports are not very exciting or different. The language used is very stereotyped and standard. Firstly, this is because each phrase in the report has been selected carefully to for its exact meaning. Secondly, the clients prefer to correct whatever mistakes the auditors find. If they don't correct the mistake, then the auditors may give a qualification. You should look for qualifications when reading a report.

What is a qualification?

Qualifications are sometimes called 'notes' or 'comment' also. A qualification means that auditors are not very happy about something in the accounts. Qualifications are made only when the matter is quite serious – small errors are normally ignored. A strong qualification normally starts with the words '... subject to note number...'. Milder qualifications are indicated by the words '... read with note number ....'.

How does a qualification affect the accounts?

This depends on the wording and the amounts involved. Each qualification has to be read carefully and its meaning understood. Qualifications can be very embarrassing for the organisation concerned.

Our auditors refuse to type the Balance Sheet on their letterhead...

They are right. The ICAI discourages use of letterheads of CA firms for typing Balance Sheets, etc. These can be typed on plain paper. The auditors then put the stamp of their firm to authenticate the accounts. The letterhead should be used only for typing the audit report.

Can audited accounts be checked again by another auditor?

Yes. Firstly, auditors merely express their opinion on accounts. One auditor's opinion may be different from another.

Secondly, each audit may have a different scope of work. A normal audit of financial statements is concerned with true and fair view. An audit commissioned by a funding agency may be concerned with proper utilisation of funds. Both audits may result in differing reports.

The Things That Auditors Do…

What is statutory audit?

Any audit that is required under a law (statute) is a statutory audit. Audit under Income Tax (form 10-B), FCRA (form FC-3), Societies Act are all statutory audits. CAs normally refer to company audits as statutory audit.

What is internal audit?

Larger organisations set up internal audit system so that some one can review their accounting systems regularly. This results in less mistakes and makes internal controls strong. This may be done by some experience person or a CA firm. However, the statutory auditors of an NGO should not take up its internal audit.

What do CAs do, apart from audit?

CAs help NGOs mainly with registration, income tax, sales tax, computerisation of accounts, certificates, FCRA matters, and book-keeping. Discuss your accounting problems frequently with your auditors. This will give them a better understanding of your work and they will be able to give you good advice.

Our auditors don't know anything about FCRA...

FCRA is not a major area of practice for most CAs. However, your auditors have been trained

to understand and interpret various laws and their financial implications. If you share some relevant training material and the FCRA act with them, they will be able to help you much better.

What is 10-B report?

This audit report is issued under Income Tax and covers various issues. These include questions on the amount of salary, etc. paid to Governing Body members, investment of funds in private companies, etc.

Is it all right if my auditors write my accounts also?

No, it is not. Your auditors or their staff should not write your account books. If this is allowed, it becomes difficult for them to do a proper audit.

Should we re-appoint auditors each year?

This depends on your bylaws. If the bylaws say that auditors would be appointed by the General Body each year at each Annual General Meeting, then this procedure has to be followed. For this you will have to pass a resolution at the meeting. Generally speaking, it is a good practice for the auditors to be appointed by the General Body. This practice is followed in all companies.

If the bylaws allow Governing body or chief Functionary to appoint the auditors, then they can do so.

Professional Ethics

Who can audit our accounts?

In a general sense, almost any person can audit or check your accounts, whether or not they are professional auditors. This includes gazetted officers and donor agency representatives. However, for a proper audit of the Balance Sheet, Income and Expenditure Account, Receipts and Payments Account, the concerned person has to be either a practicing Chartered Accountant, a part-B state auditor or a person approved by the government. Of these, practicing Chartered Accountants are governed by rules of ICAI.

What is ICAI?

ICAI means Institute of Chartered Accountants of India. It has been established by the Chartered Accountants Act, 1949. It trains new CAs, conducts examinations and declares results.

Audit Under	CA	B– State Auditor	Approved person
FCRA	Yes	No	No
Income Tax Act	Yes	Yes	No
Bombay Public Trust Act	Yes	No	Yes
Societies Registration Act (as amended by states)	Yes	In some states	In some states

The CA profession is very strictly controlled as compared to other professions in India. After a CA qualifies, he has to become a member of the Institute if he wishes to practice as a CA or conduct certain types of audits. All members of the ICAI are subject to disciplinary action by the Institute if they are negligent in their work.

What is negligence?

If a CA does not perform their work properly or according to professional standards, they may be treated as negligent.

Can any one complain against the auditors?

Yes. If the matter is serious, the complaint can be made on plain paper by writing to the ICAI. The reason for complaint and relevant documents should be sent along with the complaint. The

name and membership number of the concerned CA should be given. You should also give your name and address so that ICAI can ask you for additional facts, if required.

Can the auditors be sued by the funding agency?

Yes. Apart from complaining to the ICAI, the funding agency can also file a civil suit against the auditors, if their negligence has caused loss of money to the agency.

How many CAs are there in India?

Some people do not take up or continue membership of the ICAI after qualifying. Excluding these, there are 96,392 CAs in India according to latest figures (1.4.01). Out of these, 56,626 are practicing as auditors. Most of the CAs are working in the five major metros. However, you will also find CAs in small places such as Akhnoor, Kadamtala, Naroli, Ayyampet, and Saugor. Their addresses are published each year by the ICAI in a directory of firms and a list of members. These are available from the ICAI offices.

Has ICAI fixed some minimum audit fees?

These requirements apply mainly to larger firms having at least four partners. Such firms should charge at least Rs.1,000 (if the city has a population of less than 20 lakhs). If the population is more than 20 lakhs, then they have to charge at least Rs.1,500. For still larger firms, having at least eight partners, these rates are doubled. In case the work is done on honorary basis (that is, without any fees or by charging Re.1 or so), then the requirements are not applicable (Sch. 2, part 2, cl. 5 of the CA Act; notification no. I-CA(7)/158/87 dated 25.5.87).

Can we pay our auditors fees @ 1% of total grants received?

No. This is allowed only in the case of cooperative societies, where fees can be paid as a percentage of paid up capital, gross income, profits, etc. (Sch. 1, part 1, cl. 10 of the CA Act; Regulation 192).

Then how much fees should we pay the auditors?

The fees should be calculated on the basis of time spent, complexity of work, whether senior or junior persons are required, and the responsibility associated with the work. Your auditors can give an idea of the fees calculated on this basis. However, amount of fees alone should not be a criteria for appointment of auditors. You should consider other factors such as accessibility, credibility, integrity, professional expertise, etc.

Can the auditors leak our secrets?

By training and habit, auditors do not normally discuss matters related to their clients with others if these are confidential in nature. Moreover, all auditors are legally bound by a code of conduct. This includes maintaining client confidentiality. Leaking confidential information to others, without consent of the client is treated as misconduct. It can lead to disciplinary action by ICAI.

However, they can be compelled to disclose such information if required by any law.

Sorting out differences

Our auditors are too strict...

In the case of commercial concerns, the audit issues are different, accounting department is strong and there is a good internal check system. This is missing in most NGOs. NGO accounts tend to be controlled by the chief functionaries. Most NGOs also do not have sufficient budget allocation for paying competitive salaries to accounts staff. These factors make NGO audits more risky for the auditors.

Secondly, most auditors view NGOs as working with public money. This calls for higher standards of accountability. The presence of funding agencies and involvement of their auditors also may make your auditors more careful and strict. This should be welcomed as it will help strengthen your accounts department.

How can we remove our auditors?

This step should not be considered lightly. If you are dissatisfied about the quality of work or time and attention which you get, discuss this with the auditors. You can also wait till the appointment lapses with the end of the year. You can then appoint a different auditor.

If for some reason, you have to remove the auditors midway, then such removal can only be done by the body which appointed them (General Body or Governing Body as the case may be). You will have to pass a resolution at the meeting for removal. As a courtesy, you should also intimate the concerned funding agencies regarding change of auditors. In some cases, funding agency insist that they should be informed if the auditors are changed.

The new auditors will first write and discuss the reasons for change with the earlier auditors (Sch.1, part 1, cl. 8). When they are satisfied, then only they will accept the audit.

Unkindly yours, ...

"According to a writer in Time Magazine, accountancy is a profession whose idea of excitement is sharpening a bundle of No.2 pencils..."

— Guinness Book of Humorous Anecdotes by Nigel Rees

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"... in your report here, it says that you are an extremely dull person. Our experts describe you as an appallingly dull fellow, unimaginative, timid, spineless, easily dominated, no sense of humor, tedious company and irrepressibly drab and awful. And whereas in most professions these would be considered drawbacks, in accountancy they are a positive boon."

— Penguin Dictionary of Modern Humorous Quotations, compiled by Fred Metcalf

What were the auditors doing...?

This question is often heard when some mistake is discovered in the accounts or some employee is found to have cheated the organisation. When auditors report on true and fair view, they are not expected to check each mistake or look for minor frauds. Overall they look for reasonable quality of book-keeping, supporting documents, a true and fair view. For this they may check all transactions or pick up a sample. Their responsibility is limited to exactly what they say in their report.