

GAPS IN “GAAP”: ISSUES IN NONPROFIT ACCOUNTING & REPORTING IN INDIA

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Abstract

Nonprofit Organisations (NPOs) in India play an important role as change agents for social and economic development. Though they command substantial amounts of resources, their financial performance measurement and reporting is a major concern. In absence of a single regulatory authority and specific accounting standards for NPOs, the practices of accounting and reporting vary across organisations. Based on an exploratory study, this paper documents the current status on requirements of accounting and reporting vis-à-vis the current practices of NPOs, identifies the gaps, and proposes an action plan to bridge the gaps. The paper classifies the gaps in accounting and reporting under conceptual and institutional frameworks. In order to bridge the gaps in the conceptual framework, the paper recommends the need for developing a uniform accounting and reporting system for all NPOs that should start with conceptualizing information needs of the stakeholders and end with conceptualizing appropriate financial statements to meet these needs and, in the process, resolve any ambiguity in the accounting treatment of specific transactions. At an institutional level, the paper suggests consultative processes among various stakeholders to develop the proposed system and recommends a need for amendments in various Acts to implement it.

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Introduction

Nonprofit Organisations (NPOs) provide important services throughout the world. Their scope covers *inter alia* health and welfare, research, education, social organisations, and professional associations. The fundamental features of NPOs are: (1) they exist to fulfil a charitable purpose, (2) they function without the use of coercion, (3) they operate without distributing profits to shareholders, and (4) they exist without simple and clear lines of ownership and accountability (Keating and Frumkin, 2001).

In India, the state played a dominant role in the process of economic and social development after independence in 1947. NPOs also emerged soon after independence as many followers of Mahatma Gandhi established voluntary agencies to work closely with the governmental programmes on social and economical issues. They organised handicrafts and village industries, rural development programmes, credit cooperatives, educational institutions, etc. The second stage of growth of NPOs in India took place around 1960 when the governmental programmes were found to be inadequate to deal with the deprived sections. Many individuals formed grass-root organisations and started working at the micro-level with limited resources. They worked on behalf of the poor, the landless, the tribals, the bonded labourers and other social groups that were being discriminated against by the policies of the state and social structure. In 1980, with the Sixth Five-Year Plan (1980-1985), the government identified new areas in which NPOs as new actors could participate in development. The subsequent Five-Year Plans enhanced the role of NPOs to aid in making communities as self-reliant as possible, and as participants in rural appraisal for drawing up development plans at low cost and involving the local communities (ICAI, 2003).

Today, India has a dominant NPO sector and NPOs are of increasing importance as partners in the process of development and as employers. As of 31st March 2001, there were 22924 NPOs registered with the Ministry of Home Affairs, Government of India under the Foreign Contribution (Regulation) Act (FCRA), 1976. According to the figures from the Ministry of Home Affairs, NPOs in India received Rs. 45352 million by way of contributions from abroad during 2000-01 alone (Yesodharan, 2003). The total funds at the disposal of NPOs would be substantial considering the amount mobilized within the country.

Need for communicating economic performance

NPOs do not have clear ownership and there are no clear lines of accountability. Their external stakeholders include donors, beneficiaries, oversight bodies and society at large whereas internal stakeholders include the governing members or trustees and the staff. Each one has stake in the organisational performance. Donors want to ensure that the resources are used for charitable and specified purposes. Beneficiaries want to ensure that the quality of services is maintained and the costs do not rise. Oversight bodies are

interested in compliances. Community members do not want government to grant funds for those programs which are not beneficial for a larger population. The governing members by virtue of their duties require to ensure proper utilisation of resources for the purposes of the organisation. With relatively lower remuneration, the staff has a financial and job security stake in the performance of their organisations. Another reason for which the need for performance measurement of NPOs has become critical is increasing competition among themselves for funds both from donor agencies and government.

Future economic success of NPOs depends not only on the quality of its social and economic activities, but also on communicating their performance to the multiple and diverse stakeholders. The primary objective of nonprofit performance assessment is to determine how well an organisation is fulfilling its mission. If such an assessment is not possible then public trust in NPOs is bound to be lost (Herzlinger, 1996).

Role of accounting

NPOs communicate economic information related to flow and status of their resources to the multiple and diverse stakeholders through financial statements which provide (1) information on flows during a period, and (2) information on financial position at the end and beginning of a period. In this context, accounting is an information system that governs preparation of financial statements within the framework of generally accepted accounting principles (GAAP).

Historically, GAAP have been developed by various standard-setting bodies across the world keeping the environment of business enterprises in mind. However, there are major areas where the accounting principles relevant for NPOs often differ in varying degree from the accounting principles followed by business organisations. Gross et al. (2000, p. 23) report seven such differences:

- (1) Cash versus accrual accounting
- (2) Fund accounting
- (3) Inter-fund transfers and appropriations
- (4) Treatment of fixed assets
- (5) Treatment of contributions, pledges and noncash contributions
- (6) Accounting for investments, and
- (7) Functional reporting of expenses.

Accounting significance of such differences is important for NPOs due to their impact on the contents of the financial statements and their utility in terms of assessing organisational performance and doing comparative analysis across the organisations. In order to address the above issues, the standard-setting bodies like the Financial Accounting Standards Board (FASB) in the USA are working on developing accounting standards for NPOs. For example, the FASB has issued, till date, five Statements of Financial Accounting Standards bearing numbers 93,116,117,124 and 136 for NPOs having significant impact on nonprofit accounting. However, in India, no significant progress is made in this regard. The financial accounting and reporting system for NPOs

is still governed by many of the same principles followed by business enterprises and is inadequate to meet the user requirements.

The study

The exploratory study was carried out during 2001 to 2003 with the following objectives:

- (1) To document the current status on requirements of accounting and reporting under various Acts applicable to NPOs in India
- (2) To study current practices of accounting and reporting in selected NPOs
- (3) To identify the gaps between the two and propose an action plan to bridge the gaps.

Methodology

The details on the current status and requirements of accounting and reporting by NPOs were compiled through review of provisions of all the Acts and Rules pertaining to formation and operations of NPOs in India and review of various publications of the Institute of Chartered Accountants of India (ICAI), a standard-setting body in India. The data on current practices of accounting and reporting were collected through analysis of financial statements, the auditors' reports, the statements of accounting policies and notes to accounts of 80 organisations. These financial statements were obtained from the participants from various NPOs who attended various management development programmes at the Institute of Rural management, Anand (IRMA) during 2001 to 2003. The discussions on accounting and reporting issues were held with the representatives of these organisations. Similar discussions were also held with four statutory auditors associated with auditing of the accounts of NPOs. The sample excluded government nonprofit organisations as their accounting and reporting requirements are very different.

Findings on current status and requirements of accounting and reporting

There is no single regulatory body for NPOs in India. They can be registered as public charitable trusts, societies or companies (section 25 companies), and the accounting and reporting requirements are governed by the provisions of the act under which they are registered. In addition, such requirements are governed by the provisions of the Income Tax Act and the Foreign Contribution (Regulation) Act, and the accounting standards prescribed by ICAI.

Legal form

Public Trusts: NPOs can be registered as public trusts under the Public Trusts Act. In some states like Gujarat, it is obligatory for NPOs registered as societies to also register under the Public Trusts Act. The provisions related to accounting and reporting require an organisation to maintain regular accounts of receipts, payments, property and all encumbrances created on the property and to get them audited by a chartered accountant (a member of ICAI) if the gross annual income exceeds a specified limit (for example, Rs. 15000 under Bombay Public Trust Act applicable in Gujarat and

Maharashtra). This Act specifies the formats of the balance sheet and the receipt and expenditure statement to be submitted to the Charity Commissioner but does not specify the basis of accounting system (cash versus accrual) and the accounting principles to be followed.

Societies: The Societies Registration Act, 1860, is a central Act (enacted by the Government of India) but many states have either adopted it after modifying some of the clauses with specific additions or have enacted their own state-level Acts. NPOs registered as societies have to maintain regular accounts in the form approved by the Registrar of the Societies and to get them audited by a chartered accountant if the gross annual income exceeds Rs. 5000. This Act neither specifies the formats of the financial statements nor other matters like the basis of accounting system and the accounting principles to be followed.

Companies: The Companies Act, 1956 is a central Act. A separate Section 25 is created in the Companies Act for the purpose of setting up companies to promote commerce, art, science, religion, charity or any other useful object. This Section specifies that profits of such organisations, if any, should be used in promoting their objects, and prohibits payment of any dividends to the members. The organisations registered under this Section are referred to as the “Section 25 companies”. The provisions of another Section 209 of the same Act govern the accounting and reporting requirements according to which, the accounts are to be maintained for receipts, expenses, sales, purchases, assets, and liabilities on accrual basis and according to the double entry system. The depreciation rates and the formats of the financial statements are specified in the Act. The accounts are required to be audited by a chartered accountant irrespective of the size of the gross annual income and the books of accounts are required to be preserved for eight years.

The Income Tax Act, 1961

The Income Tax Act is a central Act and its provisions are uniformly applicable to all NPOs, that is, public trusts, societies or companies. The Act has three exemptions for NPOs, namely, exemption to NPOs from taxability of their income, donor rebates, and exemption from tax deduction at source. The NPOs have to register themselves with the tax authorities for such exemptions and have to fulfil the specified conditions. Such NPOs have to maintain their accounts and get them audited by a chartered accountant. The Act requires filing of an audit report in a specified format.

The Foreign Contribution (Regulation) Act, 1976

The NPOs who wish to receive foreign contributions for their programmes or activities have to register with the Ministry of Home Affairs, Government of India, under this Act. They have to keep a separate bank account for such funds. The details of receipts and expenditure of such funds are maintained separately on a double-entry basis and audited by a chartered accountant. NPOs have to submit the details of such receipts and expenditure to the Ministry in a specified format. There are 56 headings in this

format and the details of receipts and expenditure are required to be reported under appropriate heading(s). In addition, country-wise and donor-wise details of the receipts are also required to be submitted.

Accounting Standards prescribed by ICAI

There are twenty nine accounting standards in force as on 1st April 2004. However, only one accounting standard viz. AS-12 dealing with accounting for government grants can be considered as a specific standard for NPOs. Even, this standard refers to “government” grants and one has to “infer” its applicability to receipt of grants, contributions and gifts from non-governmental agencies.

There is a paradoxical situation as far as the applicability of the accounting standards to NPOs is concerned. The clarification on the “Preface to the Statements of Accounting Standards” issued by ICAI (1995, p.79) states: “The Accounting Standards will not, however, apply to those activities which are not of commercial, industrial or business nature (for example, an activity of collecting donations and giving them to flood affected people).” This clarification implies that the accounting standards issued by ICAI are not applicable to an NPO if no part of the activities of such an entity is commercial, industrial or business in nature. At the same time, chartered accountants audit the accounts of several NPOs because of the requirements of the relevant Acts as mentioned earlier. The activities of such NPOs may not be commercial, industrial or business in nature. Still, auditors continue to apply various standards to NPOs in the same manner as applied to business organisations though the facts and circumstances underlying the accounting transactions may not be similar to those of business organisations.

In 2003, the Research Committee of ICAI issued the technical guide on “Accounting and Auditing in Not-for-profit Organisations” (ICAI, 2003). Among other things, it lists salient features of all 28 standards that were in force in 2003 and attempts to justify applicability of these standards to NPOs with either no or minor changes. However, this technical guide has remained as “suggestions” only and has not taken the shape of accounting standards for NPOs like those prescribed by FASB.

Findings on current practices of accounting and reporting in sample organisations

Gross et al. (2000)’s typology of differences in accounting principles relevant to NPOs and business organisations is used in this study to report the findings on the current practices among 80 organisations in the sample. The findings are listed under the following heads: cash versus accrual accounting, fund accounting, fixed assets and depreciation, accounting of contributions or grants, investment income, and financial statements.

Cash versus accrual accounting

The organisations in the sample were using all three systems viz. cash, accrual and a combination of cash and accrual accounting systems. The organisations where the

accrual system was not mandatory (mainly public trusts or societies) preferred to use either a cash basis or a combination wherein regular accounting was done on cash basis and provisions were made on accrual basis at the end of the accounting period. However, in India, the cash basis of accounting system is not in accordance with the fundamental accounting assumptions as per the accounting standard AS-1 and the organisations following this system require specific disclosure.

Fund accounting

The organisations were preparing various statements like donor-wise, programme-wise or country-wise receipts and expenditure statements either to meet statutory requirements under FCRA or requirements of the donor agencies. The fund accounting was not done as a part of financial reporting as per general classification like unrestricted funds, designated funds, restricted funds, or endowment funds. No information was available on inter-fund appropriations and the discipline followed by them in this regard.

Fixed assets and depreciation

The assets acquired by NPOs out of their own funds were recorded at the cost of acquisition. The assets whose costs were partly met from contributions or grants and partly from own funds were capitalised either at a value net of the grants received for the specific assets or at the gross value by treating the grants as deferred income as per the accounting standard AS-12. The major problem was with the fixed assets whose whole, or virtually whole, cost was met from the grants. Though AS-12 requires such assets to be recorded at a nominal value, a few NPOs did not record such assets at all on the ground that no organisational resource was spent in acquisition of such assets, and a few recorded them at their fair market value on the ground of full disclosure.

Majority of the respondents did not account for the contributed services of volunteers used in creation or enhancement of the fixed assets while computing the value of the underlying assets for capitalisation purpose. Such services were not accounted as either they were considered “free” as far as recipient organisations were concerned or valuation of such services was found to be difficult.

The treatment for depreciation also varied across NPOs. Some of them did not record depreciation at all on the ground that it was a non-cash expense and that they were providing free/subsidised services to the clients. Some recorded depreciation of those assets which were directly used in providing services on the ground of knowing the direct cost of the services. Others recorded depreciation on all the fixed assets.

Accounting for contributions/grants

The contributions which were intended to compensate specific expenses and revenue in nature, were recognized as per AS-12 as “other income” on a systematic basis in the profit and loss statement over the periods to ensure matching them with the specific

expenses intended to be compensated. The contributions or grants without any restrictions from the donors were recorded as “other income” in the year in which received.

Investment income

In India, NPOs are not permitted to invest their funds in common stock (equity) of any company. Hence, such funds are primarily invested in fixed-income securities. NPOs recognised the income on such investments as per the accounting system followed i.e. either on receipt basis or on accrual basis. Though NPOs ensured to use the income on investments of restricted endowment funds only for the specified purposes, in many cases, such information was not shown separately in the profit and loss statement or receipts and expenditure statement.

Financial statements

The balance sheet and the profit and loss statement or receipts and expenditure statement were the two financial statements prepared by NPOs. However, there were variations in the contents and formats. Additional statements were prepared to meet statutory requirements and those of the donor agencies. Large NPOs having multiple donors and receiving foreign contributions prepared around 35-40 statements from the same books of accounts.

The Gaps

The findings of the exploratory study indicate significant gaps in the accounting and reporting system. Such gaps can be grouped under the conceptual framework of accounting and reporting and under the institutional framework governing NPOs.

The gaps under the conceptual framework include:

- (a) Problems in meeting information needs of stakeholders for performance measurement and evaluation
- (b) Absence of specific accounting standards for NPOs, and
- (c) Absence of uniform treatment of similar transactions and events across NPOs.

The gaps under the institutional framework include:

- (a) Absence of uniform accounting and reporting requirements under different Acts
- (b) Inadequate specifications of these requirements, and
- (c) Multiplicity of formats with non-uniform contents.

Bridging the gaps in conceptual framework of accounting and reporting

The conceptual framework for the design of a uniform accounting and reporting system for NPOs should consider three areas:

- (a) Conceptualising information needs of various stakeholders of NPOs
- (b) Conceptualising appropriate financial statements to meet these needs to the extent feasible, and
- (c) Removing any ambiguity in the accounting treatment of specific transactions.

Information needs of stakeholders

The process of identifying information needs before hand involves judgment as the users can either comment on or appreciate information only after it is provided to them. Anthony (1978, Chapter 2) identifies three likely needs of various stakeholders, namely, to assess financial viability and management performance, to ascertain the degree of compliance, and to know the cost of services rendered.

Financial viability and management performance

The assessment of financial viability and evaluation of management performance are interrelated. It is about NPO's ability to continue to provide the services and sustain them, and about effective utilisation of resources for the given objectives. The proposed accounting and reporting system should facilitate reporting of information needed to compute various financial performance measures that can help the stakeholders to assess these two dimensions. The following indicative financial performance measures under three categories can be considered based on various studies (Tuckman and Chang, 1991; Siciliano, 1996 and 1997; Greenlee and Bukovinsky, 1998; Ritchie & Kolodinsky, 2003):

| | Performance Category | | |
|-----------------------------------|--|---|--|
| | Fund raising Efficiency | Public Support* | Fiscal Performance |
| Relevant financial measure | 1. Direct Public Support divided by fund-raising expenses 2. Total revenue divided by fund-raising expenses | 1. Total contributions received divided by total revenue 2. Direct public support divided by total assets 3. Percentage of revenues from various sources as an indicator of revenue concentration | 1. Total revenue divided by total expenses 2. Total contributions received divided by total expenses 3. Programme (activity) expenses divided by total expenses 4. Administrative expenses divided by total expenses 5. Own funds (corpus or equity funds) divided by total sources of funds 6. "Bottom line" – operating surplus |

* Contributions received directly from individuals, companies and other institutions or agencies

Compliance

The information reported in various financial statements should help the stakeholders to assess the degree of compliance of either legal requirements or of expressed intentions of the stakeholder(s) about use of resources for intended purposes. It is related to the issues of transparency and governance.

Cost of services rendered

The financial statements, by themselves, can not help in judging quantity and quality of services rendered by NPOs, relationship between the amounts of resources on hand and the amount of services provided, or the ability of the members of the governing body and staff. But, they should help the users to compare magnitude and costs of various services of one NPO versus those of another NPO through program or functional reporting and should serve as a starting point for analysis.

Financial statements

The important considerations for identifying the financial statement information are: distinction between capital and operating inflows, operating measure reporting, program or functional reporting, fund statements, and current value reporting.

Distinction between capital and operating flows

The donors specify the end use of the resources provided by them and normally there is no common pool of capital in NPOs that can be used for different purposes. Hence, NPOs need to distinguish the operating inflows received for current operations from those received for acquisition of fixed assets, and report them separately. Such distinction helps in many ways. A financial statement related to operations can be used in evaluating spending for operating activities against the operating budget set for these activities. The financial performance of the management can also be evaluated to some extent based on the data on the current period's operations. For evaluation of the cost of services provided during the current period, it separates such costs from those related to future periods. Finally, it helps the users to assess the degree of compliance of the conditions attached to various inflows.

Operating measure reporting

NPOs need an operating statement to report the "bottom line". The bottom line is the difference between operating inflows and expenses resulting in to either operating surplus or deficit. Though the difference between revenues and expenses does not indicate how well the organisation has accomplished its purpose, the bottom line is considered to be a good indicator of financial health. Anthony (1978, p.87) justifies significance of reporting the bottom line as operating measure for NPOs. According to him, the bottom line: (a) is an indicator of "capital maintenance" – conceptually a NPO maintains its capital if its operating inflows at least equal its expenses (b) helps to have a balanced budget by limiting expenses to the amount of inflows expected (c) helps in revision in fees, charges or taxes based on the extent of surplus or deficit, and (d) helps in evaluating policies related to creating surplus to provide funds for expansion, for reserve for contingencies or for replacement of fixed assets. He further indicates that, subject to these qualifications, if a NPO does not spend all its operating inflows, it is not providing as much services as it could, or, if it consistently spends more than its operating inflows then it will go bankrupt.

Program or functional reporting

The goal of NPOs is to provide services and their end products are programmes under various areas like health, education, livelihoods, etc. The donors also provide resources as per the programmes and they are interested in the magnitude of spending for programmes and sub-programmes vis-à-vis their budgets rather than heads of expenditure like salaries, capital expenditure, etc.

Fund statements

In India, the organisation is considered as an accounting entity and not the funds. Hence, the financial statements are at the organisational level. In the recent years, the issue of fund accounting and fund statements is increasingly becoming relevant due to multiple funds with specific end uses, their growing size and restrictions on inter-fund

transfers. The fund statements help the users to assess compliances of terms and conditions of the resource providers and provide a correct picture on the fund balances and their availability for specific purposes. The major types of funds for reporting purposes can be current unrestricted funds, current restricted funds, designated funds, fixed assets funds and endowment funds.

Current value reporting

At present, there is no uniformity in reporting donated fixed assets. Such assets need to be reported at current fair market value to give a true picture of financial position.

Accounting treatment of specific transactions

Finally, the issue of ambiguity in accounting treatment of specific transactions needs to be addressed. The process of evolving accounting standards for NPOs needs to consider specific transactions which normally do not take place in POs or occur in both NPOs and POs but under different circumstances, and prescribe the accounting treatment for the same. Such transactions may include:

- (a) Contributed services of volunteers
- (b) Fixed assets and depreciation
- (c) Income on investments
- (d) Retirement benefits to employees, and
- (e) Contributions and grants forming part of operating inflows.

Contributed services of volunteers

The receipt of voluntary services by NPOs is very common in India. For example, beneficiaries provide contributions in the form of local materials and labour for programmes on infrastructure development like roads, community buildings, and others. Accounting of such services is essential to accurately show the efforts involved in creation of the fixed assets or in providing programmes, to indicate resources required to maintain the programmes at the current level and to increase comparability of the financial statements.

Two issues need to be addressed while specifying the accounting treatment, namely, the circumstances under which NPOs would record a value for such services and the basis for arriving at the value of such services. The FASB Statement No. 116 permits recording a value for such services if either of the following conditions is satisfied: (1) the services that create or enhance nonfinancial assets, or (2) the services that require special skills, are provided by persons possessing those skills, and would typically have to be purchased if not provided by donation. A similar set of guidelines needs to be developed. The valuation of professional or clerical services is usually not difficult as the organisation would like to record a value only if the services are significant in amount. In such cases, it can establish a reasonable estimate of the costs involved if employees were to be hired. The volunteers can be classified in to different groups according to the types

of services rendered and a uniform rate for all volunteers in a given group can be estimated and used in valuation.

Fixed Assets and depreciation

If the balance sheet has to reflect the true picture of the financial position then the donated assets – either fully or partially – need to be recorded at their current fair market value. Hence, the current Accounting Standard, AS-12 needs to be modified.

Several arguments either in favour or against charging depreciation can be made. However, considering the cost of services rendered as important information need, it is necessary that NPOs recording their fixed assets as mentioned above charge the depreciation on such assets.

Income on investments

The issues of accounting of income on investments to be received at the time of maturity (cumulative schemes) and that of income arising due to gain/loss through the difference between the cost price and realisable value need special attention. Accounting of interest on cumulative schemes on a systematic basis over the period of holding is consistent with the accrual concept but such funds are not available for the current operations in the current period. The second issue is relevant for those investments (such as investments in permitted mutual funds) where the acquisition cost and realisable value differ over the period of holding. FASB Statement No. 124 follows the “total returns” approach under which both unrealised and realised gain or loss is allowed to be recognised. On the other hand, in India, the provisions in the Accounting Standard AS-13 on investments do not permit to record any unrealized gain but requires provision for any permanent diminution in the value of investments held on long term basis.

The appropriate ways of reporting such revenues need to be debated and settled.

Retirement benefits to employees

Such benefits are payable in future but their costs arise out of the services rendered by the employees in the current period. Their accounting in the current period creates specific problems. On one hand, their accounting in the current period is reflected in full cost of services rendered to the current clients in the current period and does not transfer these costs to the future services to be provided to future clients. On the other hand, their accounting in the current period leads to recovery of such costs from the current donors though such costs are to be paid in future. Further, their accounting in the current period requires several assumptions for computation of such amounts.

Contributions and grants

The issue of contributions and grants forming a part of operating inflow is important because such receipts are nonrevenue receipts and do not arise out of exchange

transaction. Anthony (1978, p.124) discusses two approaches for measurement of such inflows. In the “matching” approach, spending is measured first and then operating inflows are matched with spending. The “availability” approach records such inflows as operating inflows available during the period to meet operating expenses. The provisions of the current Accounting Standard, AS-12 on government grants have combined both the approaches and prescribe “matching” approach for such amounts received to compensate for specific expenses and “availability” approach for the amounts received without any restrictions. This provision need not be changed.

The pledges (promises to give) and bequests are also contributions of a different type. Whether to account them on accrual basis or on receipt basis is an important issue. If they are to be recognized on accrual basis then the present value of such future receipts would require to be computed. Like an allowance for doubtful receivables, an allowance for uncollectible pledges may also be required under the accrual basis.

Some sellers supply goods to NPOs at the reduced prices in recognition of their charitable activities. If the difference between the market price and the price paid by a NPO is significant then it may be prudent to record the difference as a contribution and purchases at the market value.

Some NPOs get the benefits of using office premises or such other facilities without any cost or at a nominal cost. Some NPOs also get “free” services like telephone, electricity, data processing and so on, from their affiliated organisations. A value for such facilities needs to be reflected in the accounts of such NPOs.

Bridging the gaps in Institutional Framework

As mentioned earlier, the gaps under the institutional framework include:

- (d) Absence of uniform accounting and reporting requirements under different Acts
- (e) Inadequate specifications of these requirements, and
- (f) Multiplicity of formats with non-uniform contents.

In order to overcome the abovementioned gaps, a uniform accounting and reporting system for all NPOs, irrespective of their legal form - a public trust, a society, or a company, needs to be prescribed. This system shall address various conceptual issues discussed above, shall prescribe a set of accounting standards to be followed by NPOs and shall also specify the contents and formats of various financial statements.

ICAI is considered to be an appropriate body for designing a uniform accounting and reporting system as its members are already engaged in auditing the accounts of NPOs where it is mandatory. It has the expertise and the infrastructure to carry out consultative processes among various stakeholders on the issues discussed in this paper and those that emerge during the consultative processes. ICAI may prepare and circulate a draft conceptual paper covering various issues and the proposed recommendations and

invite suggestions from various stakeholders. Such consultative processes would help in resolving apprehensions and ambiguity on various issues and provide a sense of ownership to NPOs for the proposed system. Once the system is developed and ready for implementation, the necessary amendments in the Companies Act for Section 25 companies, in the Public Trust Act and in the Societies Registration Act would be required to implement the proposed system of accounting and reporting.

The issue of applicability of the proposed uniform system of accounting and reporting to the governmental nonprofit organisations also needs to be considered. The three possibilities are: they may be excluded on the grounds that a different system of accounting and reporting already exists for them, they can be covered under the proposed system, or a separate system may be developed for them. The choice would require debate on a larger platform involving all the stakeholders.

Summary

NPOs in India play a significant role in the process of social and economic development. There is no single regulatory body in India for a large number of NPOs with substantial resources at their command. Different Acts specify different accounting and reporting requirements which do not meet information needs of various stakeholders. There is only one specific accounting standard for NPOs. There is no uniform treatment of similar transactions and events across NPOs. Hence, the conventional financial statements with different contents and formats are of limited utility and do not permit comparative analysis across NPOs. The stakeholders, especially donors, demand financial information as per their requirements. In the process, NPOs end up with a large number of financial statements. This is a major limitation for performance measurement and evaluation.

These gaps in accounting and reporting need to be addressed at the conceptual level and at an institutional level. The process of developing a uniform system for all NPOs needs to start with conceptualizing information needs of the stakeholders and end with conceptualizing appropriate financial statements to meet these needs. In the process, it has to resolve any ambiguity in the accounting treatment of specific transactions. The major information needs of stakeholders can be to assess financial viability and managerial performance, to ascertain compliance, and to know cost of services rendered. The financial statements need to consider distinction between the capital and operating inflows, operating measure reporting, program reporting, fund statements, and current value reporting. Finally, the process of evolving accounting standards for NPOs needs to consider specific transactions which normally do not take place in POs or occur in both NPOs and POs but under different circumstances. The important transactions like contributed services of volunteers, fixed assets and depreciation, income on investments, retirement benefits to employees, and contributions and grants forming part of operating inflows need special attention. At an institutional level, the amendments would be required in various Acts to implement the proposed system of accounting and reporting.

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