Social Accountability Standards (SAS) 4

Accounting Policies

OBJECT

04.01 The main objective of this draft standard is to provide clarity on applicability and appropriateness of accounting policies. The available international accounting standards and other country specific accounting standards are not designed specifically for NGOs. Therefore there is a necessity to initiate a process for designing a guiding tool for adopting accounting policies for NGOs.

EXPLANATORY STATEMENT

04.02 The selection and application of accounting policies for NGOs should be based on the appropriateness of such policies keeping in view the inherently peculiar characteristics of NGOs. As discussed elsewhere, NGOs do not work on the principles of ownership unlike commercial organisations. Similarly they also do not work on the principles of 'for profit' unlike commercial organisations. Their project oriented activities are for specific time frame, therefore the 'going concern' assumptions do not apply to all the activities of the NGOs. In case of externally funded projects, debiting outstanding expenses at the close of the project under 'accrual basis' may again result in unresolved financial statements. When an NGO is handling different project/restricted funds then for accounting purposes there are different fiscal entities existing simultaneously which the conventional accounting standards do not account for as it is not relevant in the commercial arena. In such circumstances it is imperative that NGOs develop accounting policies which are sensitive enough to address various NGO specific practices which are not found in commercial organisations.

04.03 The international accounting standards also provide the discretionary leverage to all organisations to ensure that the accounting policies are appropriate and relevant to their work and activities. IAS 8 *Accounting Policies, Changes* *in Accounting Estimates and Errors*, specifically provides that the management should use its judgement in developing and applying an accounting policy. The summary prepared by IASC foundation on IAS 8 is provided in ***Annexure-10***.

04.04 The accounting standards issued by various authorities are mandatory only on the members of such institutes. For instance a mandatory accounting standard in India is not a legal obligation on the part of a registered society or a trust. However accounting standards provide a uniform guiding principle for accounting practices and reporting.

DISCLOSURES OF ACCOUNTING POLICIES

04.05 The relevant reference document is the AS-1 issued by the Institute of Chartered Accountants of India. The text of AS-1 is provided in ***Annexure-11***. The aforesaid accounting standards should be followed subject to the following.

04.06 Fundamental Assumptions : The fundamental accounting assumptions shall be (a) going concern, (b) consistency, (c) accrual basis. The aforesaid fundamental assumptions will be applicable to the NGO as a whole. However NGOs should follow the principles of fund accounting and as a result they should recognise various independent fiscal entities for accounting purposes. The fundamental accounting assumptions may not apply to all the fiscal sub-entities.

04.07 The assumption of going concern shall not apply to time bound projects initiated out of restricted funds.

04.08 The assumption of accrual basis shall not apply to project implemented through external funding. Because such projects are bound by contractual obligations which may not permit outstanding expenses or recognition of income in lieu of commitment[1]. Further use of accrual basis may not provide conclusive statements to the satisfaction of the donors at the time of preparing the statements at the end of the period.

[1] Certain external funders face the problem where NGOs recognise income before actual receipt and expenses are incurred from internal accruals or borrowings and when actual amount is received it is directly applied towards repayment of loan or to the general fund as the case may be. Such practices unless approved by the donor have been consistently raising issues of transparency.

ACCOUNTING POLICIES - FUND ACCOUNTING

04.09 The principles of fund accounting recommend that various funds and activities which are not necessarily in the discretionary domain of NGOs should be treated as separate accounting entities and the contractual obligation attached to each such fund or activity should be independently and exclusively addressed to. All NGOs should follow the principle of fund accounting. For details on fund accounting the Division on Fund Accounting may be referred.

04.10 Fund accounting does not require any specialised norms or policies. The normal accounting policies should be applied but as per the specific requirement of each fund or activity.

ACCOUNTING POLICIES - DEPRECIATION

04.11 The accounting standard AS-6 issued by the Institute of Chartered Accountants of India or the relevant accounting standard should be followed for provision of depreciation. The text of AS-6 is provided in ***Annexure-12***.

ACCOUNTING POLICIES - VALUATION OF STOCK AND INVENTORIES

04.12 The relevant accounting standard is AS-2 with regard to valuation of inventories. The text of the standard is provided in ***Annexure-13***. The ICAI further recommends that the NGOs engaged in trading and manufacturing activities should value the inventories at cost or net realisable value whichever is lower.

04.13 NGOs which are not engaged in any trading and manufacturing activities may also carry some goods or inventory as a part of its programme activities. In such cases if the NGOs procure, assemble or prepare goods and materials for distribution purposes, then such inventories should be treated at cost. If the replacement cost of such material is lower than the actual cost, then the valuation should be made at the replacement cost.

04.14 The ICAI further recommends that NGOs receiving goods and materials either free of cost or at nominal cost should make suitable disclosure regarding the market price or estimated realisable value of the materials lying at the year end.

ACCOUNTING POLICIES - TREATMENT OF GRANT AND REVENUE RECOGNITION

04.15 The relevant accounting standards AS-9 Revenue Recognition and AS-12 Accounting for Government Grants provided in ***Annexure-14 & 15***. However keeping in view the inherent characteristics and legal obligations of NGOs the following policies need to be considered.

04.16 A project grant shall be treated as income only if there are no restrictions placed in the project contract by the donor. Therefore restricted grants shall not be treated as income in the books of the NGOs. The restricted grants shall be recognised as a legal obligation as and when realised on the principles of fund accounting. Receipts and applications of restricted grants shall be made in the respective fund account. In other word all restricted grants received shall be accounted for on realisation/receipt basis only.

04.17 All voluntary contributions and donations received shall be treated as income as per AS-12 on the basis of duly approved grant letters, specifying timeframe/guidelines of grant accrual.

04.18 All other incomes such as membership fees, interest, royalties, dividend, income from income generation activities and income from fund raising activities shall be treated as income as per AS-9.

ACCOUNTING POLICIES - CAPITAL EXPENDITURE & FIXED ASSETS

04.19 The relevant accounting standard for accounting for fixed assets is AS-10 provided as per ***Annexure-16***. However keeping in view the trusteeship function of NGOs, the assets procured out of restricted funds need to be distinguished. Similarly there will be no distinction between capital and revenue expenditure as far as it relates to application of funds for projects and programmes initiated towards achievement of the objectives. However the normal accounting conventions pertaining to capital and revenue items shall be adhered to as far as it relates to other transactions of the NGO. The variable treatment of capital and revenue items shall necessitate the distinction between project assets and capital assets.

04.20 The assets shown as application of fund under various projects shall be treated as project assets. If the source of fund against such assets is treated as income, then such assets should be shown at nominal value in the books of accounts. The NGOs may also create a notional asset fund to show the assets at their original value. But if the source of funds against project assets is not treated as income, then such assets should form a part of that particular fund account like any other asset.

04.21 The recommended guidelines for NGOs issued by ICAI are also provided in ***Annexure-17***.