

Legal and Financial Challenges for the Voluntary Sector

1.0 Overview of the Voluntary Sector

India, is a welfare state. Therefore education, health and social welfare are the responsibility of the state. In late 60's and early 70's, a new breed of organisations emerged, called "Voluntary Organisation". Now they are known in many names. They are:

- Non-Governmental Organisations (NGOs)
- Non-Profit Organisations (NPOs)
- Not-for-profit Organisations (NPOs)
- Voluntary Organisations (VOs)
- Non-Governmental Development Organisations (NGDO's)
- Government Promoted NGOs (GONGOs)

There are many differences between "Non-Profit Organisation" and "Profit Organisation". We need to understand that non-profit organisations are not debarred from earning profit. The key difference between a 'Non-Profit Organisation' and 'Profit Organisation' is in its purpose of existence. Whereas 'Profit Organisations' exist to earn profit, for "Non-Profit Organisations", profit comes as incidental to its operations. Secondly, in profit organisation, the surplus/ profit is distributed among the owners/ shareholders of the organisation. In a non-profit organisation, the surplus is used to

further the objective of the organisation.

The main sources of receipts for voluntary organisations are:

- Self Generated Funds
- Grants
- Donations
- Membership Fees (subscription)
- Surplus from Business Activity

As per a study conducted by John Hopkins University on the voluntary organisations, there are 1.2 million voluntary organisations in India. There are 20 million people associated with voluntary organisations as paid or voluntary staff. Approximately, 20,000 crore rupees are mobilized from within and outside the country in a year. About 5,000 crore rupees are received as foreign contribution every year. There are about 30,000 FC(R)A registered organisations in India.

2.0 Key Issues

The voluntary sector plays a key role in the social and economic development of the country. Voluntary organizations have been able to reach the remote corner of the country braving adverse situations. Voluntary organizations have also been known for exemplary selfless service to the less privileged and marginalized sections of the society.

In spite of all these the voluntary sector suffers from lack of clarity and operational difficulties in its accounting, reporting, management and legal framework. For the sake of discussion, I have divided the areas into four.

2.1 Legal framework and Governance

2.2 Accounting and Reporting

2.3 Income Tax

2.4 FCRA

We will discuss each of these areas and bring up certain key issues.

2.1 Legal Framework & Governance

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Voluntary organizations can be registered broadly in three ways. They are:

2.1.1 Registered Public Charitable Trust

2.1.2 As a Charitable Society

2.1.3 As a Not-for-Profit Company (Sec.25 of Companies Act 1956).

Each of them have their own issues to deal with.

2.1.1 Registered Public Charitable Trust

Indian Trust Act, 1882 is not applicable to Public Charitable Trusts. Therefore, Public Charitable Trusts are registered as a Trust under General Law with guidance from:

- Charitable & Religious Trust Act 1920.
- Religious Endowment Act 1863.
- Bombay Public Trust Act 1950.

The trust deed is only registered. As a result, once these organizations are formed, there is no mechanism within the framework of the law to regulate them. The only exception being the states of Maharashtra, Gujarat and Goa where there is charity commission. But a very little facilitation for trusts is observed. They have to be registered under Income Tax Act, 1961 when they seek Income Tax exemption and under FCRA, 1976, if they apply for foreign contribution. But the basic regulatory mechanism for public charitable trusts is not there. Therefore, it is entirely left to the organisations to make necessary practices and procedures for good governance.

2.1.2 Charitable Societies

Charitable Societies are registered under Societies Registration Act, 1860. On one hand, the Act is very old and in some sense has outlived its utility. On the other hand, there is every poor administration of the Act. Then there are different requirements for different States as there are State Acts as well. For example, in the state of Karnataka, the Act requires that 1% of the total receipts for the year is paid as

filing fees along with the annual return of the society for the year. In the State of Uttar Pradesh and in some other States, the registration is available for only five years and then it has to be renewed. Since many of these offices of Registrar of Societies are not computerised, it is very difficult to know the status of the returns of any society. Therefore, the Registrar of Societies plays a very little regulatory role for Societies. In this scenario, it is difficult even to get data about the actual member of active NGOs registered under the Act. Since there is no real compulsion to dissolve the organisation once the members are not actively pursuing its objective, therefore there are plenty of dormant NGOs.

2.1.3 As a Not-for-Profit Company (u/s 25 of Companies Act, 1956)

This form of registration is by far the best regulated. The Registrar of Companies is quite active in regulating entities registered under the Act. However, since the reporting requirements are more, small and medium sized organisations find it difficult to cope with it.

2.2 Accounting & Reporting

The accounting legislation applicable to NPOs do not lay down the form of balance sheet and the requirements as to income & expenditure account. Even there are no requirements for additional disclosure. As a result of which these issues are left to the

judgement of the accountants and auditors. Therefore, we can see today that there are many annual accounts of NPOs which do not even have previous years figures, leave alone disclosure practices.

There are no specific accounting standards for NPOs in India. The Institute of Chartered Accountants of India has come out with “Technical Guide on Accounting and Auditing in Not-for-Profit Organisations“. The guide strongly recommends:

- Maintenance of books as per accrual basis;
- NPOs should follow the accounting standards irrespective of whether any commercial, industrial or business activity has taken place.

However, we must note that there are certain areas very much NPO specific which have been left un-explained. For example, NPOs raise a lot of non-cash local contribution. The accounting and reporting of it is a major challenge before the sector. The Income Tax Act does not recognize non-cash contributions and therefore they have to be kept outside of the return for income tax. The FCRA requires a Receipt & Payment Account and Balance Sheet. This again implies that the non-cash contributions need not be reported to FCRA authorities as well.

The second example is treatment of restricted fund. The restricted funds are not the income of the organisation as they are for a pre-determined purpose and the NGOs do not have

any control over it. Therefore, a clear direction from ICAI on this issue will be helpful.

Thirdly, ICAI strongly suggests accrual basis of accounting for NPOs. It also needs to come out with a practical guide on ways to implement it in an organisation. There would be issues like grants due but not received, corresponding expenses etc.

Fourthly, ICAI also needs to suggest certain disclosure norms for NPOs as well as standardized form of Balance Sheet and fund based accounting statements (instead of Income & Expenditure Account).

2.3 Income Tax

Under the Income Tax Act, 1961, the NPOs are not required to pay tax if they follow certain reporting requirements. However, NPOs are facing certain operational difficulties under this Act as well.

- Until the year 2001, the NPOs were able to accumulate income up to 10 years and spend it within that period. However, in the Finance Act, 2001 the 10 years period was reduced to 5 years.
- In the year 2002, accumulation of income which was earlier allowed up to 25% of the total income was reduced to 15%. Further Inter-Charity donations out of accumulated funds were also not allowed.
- Now in 2006, Section 115BBC was inserted according to which any charitable organisation receiving

anonymous donations would be charged to tax at the maximum marginal rate.

We can see that systematically certain privileges which were earlier available are being withdrawn. This is a cause for concern. Whereas as an NPO there is no doubt that it would be committed to highest level of accountability, certain amount of space need to be provided for it to perform better. Another issue that comes up is that India becoming the hub for development in South Asia, there is a need for mobility of funds within South Asian countries. As per the Income Tax Act, at present, the funds can be utilized only within India to be eligible for exemption from Income Tax.

2.4 FCRA

FCRA was enacted in the year 1976. Therefore it is now 30th year of the implementation of the Act. Being an internal security legislation, this is under the Ministry of Home Affairs. There are few issues/concerns which need to be addressed for smooth functioning of the sector.

2.4.1 Bank Accounts:

There needs to be a clarification from the FCRA department authorities about multiple bank accounts. As per the Act, only one designated bank account can be opened for receipt of foreign contribution. However, it is not explicitly stated that for utilization, there can be more than one

bank account even through practically, it is implied that an organisation cannot operate with a single bank account for implementation of its programme given the fact that the actual operational area may be far away from the place where FCRA designated bank account is situated. The draft Foreign Contribution (Management & Control) Bill, 2005 makes it explicitly clear that multiple bank accounts are allowed for utilization of foreign contribution. Therefore, it may be deduced that the intent of the law makers is to allow multiple bank accounts for utilization.

The second issue under bank account is the change of designated bank account. It may be helpful to stipulate a time-limit for disposal of the application for change of designated bank account. This will help many NGOs who struggle with certain inefficient banks to operate their designated bank account and are apprehensive to approach the FCRA department to change lest they have problem with their FCRA registration.

2.4.2 Change of Office Bearers:

On 27.12.1996, the Form FC-8 was changed which includes a declaration by the Chief Functionary to give an undertaking which among other conditions, specifies that foreign contributions should not be accepted if more than 50% of office bearers as mentioned in the application at the time of registration are replaced or changed. This is not valid for organisations registered before 27.12.1996.

This declaration in certain ways limits good governance. One of the ways of promoting good governance is rotation/term of board members. Therefore, this declaration needs to be removed to enable organisations to be better governed.

2.4.3 Time Limit for regular registration

Presently, there is no time limit prescribed under the Act to approve or reject the application in Form FC 8 for regular registration. It is important that a time limit is prescribed for disposal of application for regular registration.

**2.4.4 Foreign Contribution
(Management & Control)
Bill, 2005- Few
Concerns :**

The draft Foreign Contribution (Management & Control) Bill, 2005 which was put in the public domain for discussion has thrown up some very serious concerns for functioning of NGOs. Some of them are:

- Renewal of registration every five years;
- Fixing of Administrative Cost;
- Disposal of Assets,

We do hope that the government would take note and act on a series of representations from the voluntary sector to this effect.

Conclusion:

In conclusion, one must say that accountability issues are non-negotiable for the voluntary sector. Whereas the accountability issues should not be compromised at any cost, at the same time, enabling environment must be created for voluntarism. At the moment, the laws are such that it is quite a challenge to setup a voluntary organisation. Right from legislation to other laws like Income Tax, FCRA etc. need to be easily accessible to encourage and sustain voluntary efforts. The laws need to be compliance oriented rather than control oriented. Further, there should be uniformity in compliance requirements from various legal bodies. For example, if ICAI recommends accrual basis of accounting, then that should be acceptable to FCRA as well. Similar is the case with accounting for non-cash local contribution. Common understanding on these issues will save the voluntary organisations from compliance hardships and they can target their efforts to the social objectives.

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