AccountAble™

Indian Accounting Standards **Issue # 6**

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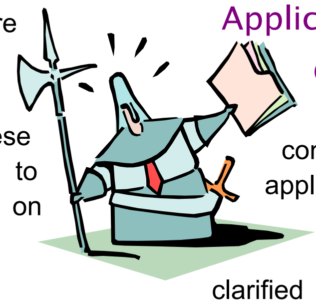
Overview

The word 'Standard' has been in use since 12th century. It comes from the Anglo-Norman *estaundart* — flag displayed in a battlefield so that troops can rally to it.

The sense 'criterion, norm' emerged in the 15th century. It probably is a metaphor based on the notion of the 'royal standard' or banner as being the point from authoritative commands are issued[1].

But what do accounting standards mean? How do these affect NGOs? This circular tries to provide some basic information on this.



Accounting Standards

Accounting Standards are a collection of generally followed accounting principles, policies and practices. These help to ensure a common basis for financial statements of different organizations. This means that people can understand these more easily and make useful comparisons.

Accounting policies

Accounting policies develop from Accounting Standards. Different organizations may have different policies, if the concerned standard allows alternative treatment.

For example, it may be necessary for everyone to charge depreciation. However, basis of charging may differ. This depends on the accounting policy followed.

International Standards for Non-profits

In UK, the Charity Commission for England & Wales (CCEW) issues guidance notes on accounting and related matters. In USA, the FASB (Financial Accounting Standards Board) and AICPA (American Institute of Certified Public Accountants) have also prepared some useful material.

Standards in India

Twenty three standards have been issued so far in India. Many of these have become compulsory for most organizations. These are summarised on next page.

These apply mainly to business or commercial organisations. However, in some cases, these are compulsory for NGOs also.

Applicability to NGOs

Compulsory for some

There has been some controversy as to whether these are applicable to NGOs or not. The Institute of Chartered Accountants of India (ICAI) has clarified that *the standards are mandatory (compulsory) for all NGOs who have any income-generating activities, no matter how small*.

Commercial or business activities

These may include sale of cards, sale of handicrafts or publications, sale of farm produce, fee-based consultancy or training etc. Some examples are:

- Charity shows where entry fee is collected
- Web designing, documentry services against charge
- Consultancy / professional services where fees are charged
- Sale of books, publications, etc.
- Sale of garments or handicrafts– *chikan* work, applique work, embroidery work
- Sale of handloom/ powerloom items: saree, towels, bedsheets
- Sale of pickles, jelly, jam, squash, honey, papad, ayurvedic medicines, *chywanprash*, *churans,* etc.

[1] John Ayto, Dictionary of Word Origins, 1990, p. 498

- Sale of agro-forestry products such as *mahua*, *mahua* seeds, *amla*, herbal medicines, etc.
- Vermiculture, pisiculture, farm animals, dairy where products are sold
- Sale of stationery, cards, hand-made papers, file folders, envelopes
- Screen-printing unit or printing press, on charge basis.
- Photocopy / phone booths
- Running waste collection / disposal or public conveniences for charge / under contract
- Schools / education centres where students pay fees
- Hospitals, clinics or veterinary centres where fee is charged
- Running guest houses, hostels, boarding halls against charge
- Training centres where hire charges or fee is taken
- Micro-credit revolving funds, where interest or service charges are taken

The essential feature in all these cases is that services / products are given against money. Secondly, the activity must be ongoing or regular. For example, if you sell your old newspapers once in a while, it does not become a business. Similarly, if you sell off a vehicle or some other asset, it would not be business.

Donation or sale?

Some people issue donation or contribution receipts for sale or fees for above things. This may be done for various reasons[2]. From an accountant's view, these remain sale price or fees. Therefore, Accounting Standards would apply in all such cases.

Voluntary for others

NGOs today deal in substantial amount of public funds. If these standards are followed, it will increase public confidence in the accountability of NGOs. It is suggested therefore, that even other NGOs should follow these on a voluntary basis.

[2] Some NGOs wrongly believe that charging a price will affect their non-profit status. Others do it to avoid sales tax complications or rules related to running of guest houses or to meet donor stipulations.

Penalty for non-compliance

If the standards are compulsorily applicable to you, and you decide not to follow these, your auditors will have to disclose this fact in their report. This may have a negative impact on your image.

Indian Accounting Standards

In India, Accounting Standards are prepared by the Accounting Standards Board, which has been set up by the ICAI.

The standards became applicable on different dates. This means that the standard applies to all financial statements for periods beginning on or after that date. For example, a standard effective from 1-Apr-95 will apply for financial year[3] 95-96.

Accounting standards apply only to material[4] items.

AS-1: Disclosure of Accounting Policies

All significant accounting policies should be disclosed in financial statements. If fundamental accounting assumptions (such as accrual) are not followed, disclosure is necessary. Effective date: 1-Apr-93

AS-2: Valuation of Inventories

How to value and account for stocks. This standard was revised in June-99. Effective date: 1-Apr-99

AS-3: Cash Flow Statements

Preparing and presenting a cash flow statement. Revised in March-97. Effective date: 1-Apr-2001

AS-4: Contingencies and events occurring after the Balance Sheet Date

How to treat and disclose contingent losses and liabilities. Treatment and disclosure of post-Balance Sheet date events (such as fire after 31st March but before signing of audit report). Revised in April-95. Effective date: 1-Apr-95

AS-5: Net Profit or Loss for the period, Prior Period Items and changes in Accounting Policies

[3] All financial years which begin on or after 1-Apr-95

[4] Where amounts are large or important. Auditors use their judgment to decide materiality.

Treatment and disclosure of these. Revised in Feb-97. Effective date: 1-Apr-96

AS-6: Depreciation Accounting

Depreciation should be charged on assets. Related information should be disclosed. Revised in Aug-94. Effective date: 1-Apr-95

AS-7: Accounting for Construction Contracts

Determining cost of construction and its disclosure in accounts. Effective date: 1-Apr-93

AS-8: Accounting for Research and Development

Criteria for determining Research and Development costs and disclosure. Effective date: 1-Apr-93

AS-9: Revenue Recognition

When and how revenue (such as interest) should be recognized. What disclosure is necessary. Effective date: 1-Apr-93

AS-10: Accounting for Fixed Assets

Determining cost of fixed assets. Disclosure of gross and net values in accounts. Effective date: 1-Apr-93

AS-11: Accounting for effects of changes in Foreign Exchange Rates

How to account and disclose foreign currency assets, liabilities and fluctuations. Revised in Dec-94. Effective date: 1-Apr-95

AS-12: Accounting for Government Grants

Covers government subsidies etc. for businesses. Effective date: 1-Apr-94

AS-13: Accounting for Investments

Accounting, valuation and disclosure on investment related information. Effective date: 1-Apr-95

AS-14: Accounting for Amalgamations

Mainly relevant for companies. Effective date: 1-Apr-95

AS-15: Accounting for retirement benefits in the Financial Statements of Employers

Provision, treatment and disclosure of provident fund, gratuity, pension etc. Effective date: 1-Apr-95

AS-16: Borrowing Costs

Accounting, capitalising and disclsoure of interest etc. Effective date: 1-Apr-2000

AS-17: Segment Reporting

Presenting financial results according to business or geographical segments. Applies to listed companies or to organisations with turnover exceeding Rs. 50 crores per annum. Effective date: 1-Apr-2001

AS-18: Related Party Disclosures

Disclosure of related parties and transactions with them. Effective date: 1-Apr-2001

AS-19: Leases

Accounting and disclosure of financial and operating leases. Traditional leases (land, mines, patents etc.) are not covered by this standard. Applies to both lessee and lessor. Effective date: 1-Apr-2001[5]

AS-20: Earnings Per Share

Relevant only for companies with equity share capital. Effective date: 1-Apr-2001

AS-21: Consolidated Financial Statements

Designed for holding companies and group companies. Applies only if consolidated statements are prepared by the group or parent company.

Some concepts are relevant to consolidation of accounts of NGOs. Effective date: 1-Apr-2001

AS-22: Accounting for Taxes on Income

Estimating and disclosing income tax. Applies selectively from 1-Apr-2001 onwards. Applies to all from 1-Apr-2003

AS-23: Accounting for Investments in Associates in Consolidated Financial Statements

Applies only if consolidated statements are prepared. Effective date: 1-Apr-2002

ICAI Clarifications

Some of the clarifications issued by ICAI are given below. These are mainly meant for

[5] Applies only for assets leased on or after this date

Chartered Accountants. Ordinary mortals should not try to read or understand these.

Accounting Standards for NGOs

'The Accounting Standards Board has received a query as to whether the accounting standards formulated by it are applicable to organizations whose objects are charitable or religious. The Board has considered this query and its views on this matter are set forth in the following paragraphs.

The Preface to the Statements of Accounting Standards states:

"3.3 The Institute will issue Accounting Standards for use in the presentation of general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members."

The reference to commercial, industrial or business enterprises in the aforesaid paragraph is in the context of the nature of activities carried on by the enterprise rather than with reference to its objects. It is quite possible that an enterprise has charitable objects but it carries on, either wholly or in part, activities of a commercial, industrial or business nature in furtherance of its objects. The Board believes that Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise irrespective of whether it is profit-oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people.)

It is also clarified that exclusion of an entity from the applicability of the Accounting standards would be permissible only if no part of the activity of such entity was commercial, industrial or business in nature. For the removal of doubts, it is clarified that even if a very small proportion of the activities of an entity was considered to be commercial , industrial or business in nature, then it could not claim exemption from the application of Accounting standards. The Accounting Standards would apply to all its activities including those which were not commercial, industrial or business in nature.'

The Chartered Accountant, Sep-95, Page 79

Responsibility of CAs

'... while discharging their attest function, it will be duty of the members of the Institute to:

(a) to examine whether Statements relating to accounting matters are complied with in the presentation of financial statements covered by their audit. In the event of any deviations from the Statements, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and

(b) to ensure that the Statements relating to auditing matters are followed in the audit of financial information covered by their audit reports. If, for any reason, a member has not been able to perform an audit in accordance with such Statements, his report should draw attention to the material departures therefrom....'

The Chartered Accountant, Dec-85

Qualification/ disclosure in Audit Report

'...12. In the event of noncompliance by enterprises not governed by the Companies Act, 1956, with the disclosure requirements of AS 1 in situations where the relevant statute requires such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification...

15. In making a qualification / disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus the auditor need not make qualification / disclosure in respect of items which, in his judgement, are not material...

17. A disclosure, which is not a subject matter of audit qualifications, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure....

The Chartered Accountant, Jul-90

What is AccountAble: 'AccountAble' covers a different topic related to NGO regulation or accounting each month and is mailed to about 1200 persons in NGOs, Agencies and audit firms. AccountAid encourages re-production or re-distribution of 'AccountAble' in work-shops or NGO newsletters for non-commercial use, provided the source is acknowledged.

Interpretation of standards: Interpretation of the standards given here is of a general nature. These are applicable in India and are valid as of July'2001.

For definitive interpretation and full text of the standards, please contact your auditors or ICAI (www.icai.org).

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Your questions, comments and suggestions can be sent to AccountAid India, 55-B, Pocket C, Siddharth Extension, New Delhi-110 014; Phones: 011-2634 3128; Ph./Fax: 011-2634 6041, e-mail: accountaid@vsnl.com; accountaid@gmail.com.