

AuditAble

In this Issue

What are Entrusted Funds?	1
Loss or Misuse	1

We have seen that risk-based internal auditing, also known as 3rd generation auditing, can be applied to NGOs as well.¹ This approach has been consolidated as FRAMS+. We have already discussed common financial risks in Accounting Systems and Budgeting.² We now turn to entrusted funds.

What are Entrusted Funds?

Some NGOs raise funds directly from public. These could be for specific projects (such as cyclone relief) or for general activities. Funds raised for a project should normally be spent for that project only. Other funds can be used at NGO's discretion.

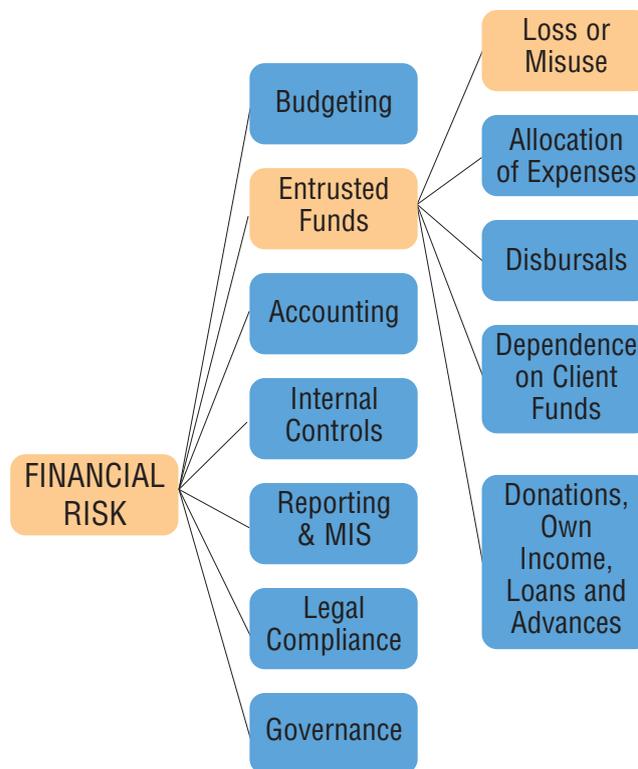
However, bulk of the funds raised by NGOs comes from other donor agencies. These are called project grants and are mostly earmarked for specific activities. If the funds are not spent, these must be returned. Alternatively, these can be repurposed³ with the donor's approval. In the meanwhile, the NGO is expected to take good care of these funds, and ensure these are not misapplied. So what can go wrong?

A. Loss or misuse

This is a good reason to worry. Most NGOs have simple accounting and control systems. They also face a number of pressures. The most common is lack of discretionary funds. This sometimes makes the NGOs divert donor funds to other activities.

Risk Statement

Unspent donor funds may not be reported/ kept safely or refunded to the donor.



Issue

This is relevant where an NGO has received a specific purpose grant. The NGO must ensure that unspent project funds

¹ See *Risk-based Auditing for NGOs* (AuditAble 5 and 6, May-09), available at www.AccountAid.net for more. Also see *ICAI Guide on Risk-based Internal Audit* (Nov-07), available at 220.227.161.86/20997_guide_riskbased1a.pdf for more.

² See *Illustrative Financial Risks – Budgeting* (AuditAble 13, Sep-12),

³ Used for a different program or activity

are not diverted to other projects. This is easy if unspent grant funds are tracked and reported to the donor as well as in audited accounts.⁴

Questions to ask

Are all unspent grant funds estimated at end of year? Is provision made in the account books for these? Do unspent grants show up as liabilities in the Balance sheet at year-end?

Are there sufficient funds in the bank to match unspent grant funds? Does the NGO have any grants recoverable on the assets side? Has it acquired land or buildings recently? Where did it get the money for these?

Are unspent Client⁵ funds identified and reported properly? Are these refunded to Client at year-end? Is there excessive build-up of unspent Client funds?

Risk Statement

Donor disbursements may not be secured during transit or collection.

Issue

Sometimes a donor remittance may be lost or stolen while it is in mail, or even during collection. As many NGOs have names similar to natural persons, it is relatively easy to open an account in their name, deposit a donor draft, and siphon out the proceeds. This risk can be reduced by adding the NGO's account number and bank name on the cheque while specifying the payee.

Questions to ask

'BORROWING' DONOR FUNDS

A reputed NGO was receiving large amounts of funds from several donor agencies. One of the donor agencies sent their auditors for a routine review.

The auditors found the NGO was constructing a large office-cum-training centre worth several crores. It was also vague about sources of funds for the building.

Closer scrutiny showed that the NGO had large unspent balances from many donor agencies. However, it did not have enough funds in the bank to cover these. Where had the unspent funds gone? These had apparently been 'borrowed' for the construction.

PRAGATI'S DRAFT

Six years ago, a donor agency sent an account payee bank draft for Rs. 2 lakh to Pragati, an NGO, by registered post. Three days later the NGO called up the agency to say it had received only an empty envelope. By the time the agency could track down the details, the draft had been encashed. How did this happen? The envelope was opened by someone during transit. The person went to a bank, opened an account in the name of Ms. Pragati, and disappeared with the money. The money remains untraced till date.



How are Client funds disbursed? Are these sent by bank transfer? Or by bank draft? Is the NGO's account number mentioned on the draft? Can the draft be stolen and encashed in transit? Are the funds sent to correct bank account (FCRA or Indian)?

If the funds are sent by bank transfer (such as NEFT), do the donor agencies obtain correct bank account details? Do the donor agencies send a separate disbursement advice?

Risk Statement

⁴ See AccountAble 86: Accounting for Project Grants at www.AccountAid.net for more on this.

⁵ The donor agency who has commissioned the FRAMS+ audit

Interest on donor funds may not be accounted or reported to the donors as required under donor agreement.

Issue

Some donors ignore interest earned on funds advanced to NGOs. Others ask them to track and use these at their discretion. Yet others may ask for the interest to be set off against future disbursements. If the NGO is not complying with these conditions, then this must be pointed out. They may also need guidance on how to allocate the interest earned to different donors.

Questions to ask

What happens to interest on Client funds? Is this being allocated to Client funds? Is the method of allocation reasonable and sound? Is the interest being reported or refunded to Client? What is this used for?



Risk Statement

Client funds can be withdrawn or paid without sufficient and specific authorisation

Issue

Some NGOs bypass the rule regarding two signatories on a cheque. This is done by asking one of the signatories to sign a bunch of blank cheques. The NGO can be advised to either opt for multi-tier signatories,⁶ or ensure that blank cheques are not signed.

In many cases, cash payment vouchers are not authorized properly. This may be due to lack of delegation – many NGOs are not aware that these tasks can be delegated to

staff members as well.

Questions to ask

Who are the cheque signatories? Are they available in town or live far away? Does the NGO get blank cheques signed by one of them from time to time?

Can cash vouchers be paid without prior-authorisation? Are there any limits for payment of small expenses without authorisation? Who is expected to approve payments? Does the person have enough time to go through each voucher?

Is an advance requisition prepared and approved before giving program advances? Is the amount of advance projected properly? Are any advances given to Project Holder, Secretary etc. without estimate or voucher?

Risk Statement

Fixed assets procured with a donor's funds may not be recorded, safeguarded or sufficiently protected from diversion or misuse

Issue

Fixed assets acquired with project funds should be tracked for each donor. NGOs should also send reports as to how these are being used. There should also be some clarity on what will happen to these assets after the project is over.

If this is not done, then the assets may be diverted or misused for personal purposes, particularly after the project is over. In some cases, the assets might be sold off and the proceeds used for other activities without the donor's consent. Most NGOs are already sensitised on this issue – however, donors should make their stand clear to the NGO.

Questions to ask

Has the NGO purchased any assets with Client funds? Have they received any equipment (in kind) from the Client? Have these been accounted in books as assets or as expenditure? Are these purchased in the organisation's name?

Are these entered correctly in the Fixed Assets Register? Are these available in the office? Does the model / asset serial number on invoice match the actual item? What about assets funded by Client in past years? Are these being tracked?

⁶ See *Blank Cheques* (AccountAble 11, Oct-95) at www.AccountAid.net for more on this.

Is there an issue register for taking these out to the field for use from time to time? Is a log book kept for use of vehicles? Is insurance advisable for the assets? If so, has an insurance policy been taken out?

Risk Statement

Non-budgeted expenses may be charged to the donor without approval.

Issue

In project-based funding, donor agency and the NPO jointly finalize and agree on a budget. This consists of budget line items and calculations showing how the money will be spent.

The line items may be very specific or rather broad. NGOs are expected to spend money accordingly. However, sometimes an NGO may charge non-budgeted activities to the project accounts.

control will become meaningless.

Questions to ask

Are expenses being debited to correct budget line items? Does a program person guide the accountants about correct budget line items? Do they approve the voucher after the account head has been marked? Does the approver have some basic understanding of accounts?

In the next issue of AuditAble, we look at other financial risks related to entrusted funds.

⁷For example, 10 teachers were budgeted @ Rs.5,000 p.m. The NGO is paying 5 teachers Rs.10,000 p.m. This is a variation – it may have to be pointed out if there is significant program impact.

FRAMS+

Questions to ask

Check the supports for vouchers charged to Client funds. What types of expenses are being charged? Are these related to Client-supported activities? Do these match the budget line item description? What about the line item calculations? Are there significant differences in the way costs were budgeted initially and are being paid now?⁷

Are overheads such as electricity, software license, outstation travel, etc. debited to unrelated heads such as office maintenance, stationery, conveyance, etc.? Are capital purchases being booked under other budget line items?

Risk Statement

Transactions may be booked under incorrect budget line item.

Issue

Booking under wrong budget heads is sometimes an error. At other times, this may be done to avoid budget variance in particular line items. If this is not checked, then budgetary

What is AuditAble:

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