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Accounting for NGOs, Compliances and Deviations

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Abstract

For ensuring true and fair view of the financial position of NGOs, there is a need of proper accounting. The NGOs in Ethiopia are lacking standardized and harmonized accounting system. Some NGOs are to a large extent follow the GAAP as far as possible within the legal requirements. Over the years, the legal frame work in Ethiopia evolved through the provisions of Civil Code 1960 and the related proclamations, legal notices and the periodical rules and regulations, and the code of conduct issued by the RoA, the DPPC and the CRDA. All these regulations are meant to ensure true and fair view of the financial position. Apart from these legal aspects, there are a few external reporting stipulations that are applicable to the NGOs. They are given by the FASB since 1983 and over the years they are reviewed and revised. To ensure full disclosure of the financial operations and also to be highly transparent, the FASB suggests to follow the Accounting Standards No. 93 & 99, 116, 117, 124 and 136 that are directly applicable to NGOs. A field investigation as to the compliance of the NGOs of Ethiopia with the GAAP locally enforced legal stipulations and the FASB Standards reveals that there are many deviations. The nomenclature of the Statement of Activities as adopted by the NGOs are varied and rarely uniform. Further, the field investigation reveals that out of 31 NGOs only 12 prepare Balance Sheets and even the balance sheets prepared by them are not containing the vital information about depreciation in case of 4 NGOs. With regard to the Statement of Cash Flows (FASB Standard No.117) none of the 31 NGOs prepare them. Thus, the field survey reveals that there are significant deviations when compared with the accounting standards resulting a poor disclosure and transparency. To ensure fair disclosure with in the framework of FASB Standards, local accounting requirements in line with the Civil Code, and the regulations of DPPC, there is a need to develop an internationally oriented and locally developed accounting principles and an appropriate package of three Annual Financial Statements for the NGOs in Ethiopia.

Introduction

Non-governmental organizations (NGOs) have a long history of service in Ethiopia. Their involvement in the economic and social life of the country began in early 20th century. Their forceful involvement in the development efforts of the country, however, started with the drought-induced famine of 1973 – 74. Initially their operations focused on relief that saved millions of lives. Since then they have become a permanent feature in the country's development process. The recurrence of the 1984 – 85 drought gave a further boost to the growth of NGOs operations. As the NGOs were increasingly pulled into the development front, their role and areas of intervention changed from time to time. The growth of NGOs in Ethiopia has been vigorous over the last two to three decades. The number of NGOs, especially indigenous NGOs has been rising. It is, therefore, the Ministry of Justice, DPPC, and CRDA recognized the need of fully document the contributions of the NGOs community.

This study is concerned with the accounting and reporting practices of Nongovernmental Organizations (NGOs). They are distinctive from other organization by (i) hybrid structure in terms of status features, (ii) service being the main objective, (iii) absence of profit motive, (iv) public support, (v) accountability to the resource providers by stewardship function through appropriate accounting control system such as fund accounting and budgeting and (vi) democratic management.

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Accounting features of NGOs: In the context of present study the following three major accounting features of NGOs are worth noting.

(i) ***Governance by board of directors:*** *As* with a business corporation elected or appointed directors; trustees or governors govern an NGO.
(ii) ***Measurement of cost expirations:*** Cost expirations or expenses, rather than expenditures, are reported in the statement of activities of most NGOs. Allocation of expenses (including depreciation) and revenues to the appropriate accounting period thus is a common characteristic of NGOs.
*(iii)***Use** ***of accrual basis of accounting:*** NGOs employ the same accrual basis of accounting used by business enterprises. As against this, most of the NGOs are maintaining their accounts on cash or modified cash basis of accounting.

In the light of the above discussion the NGOs are the integral component of the NFPOs, and they are the organizations operating for the social welfare, relief, rehabilitation and development on voluntary basis, and not-for-profit.

The purpose of this paper, therefore, is to compare the existing accounting and reporting practices of the NGOs in Ethiopia with the standard practices and guidelines issued by the regulatory and controlling agencies like DPPC, the Registrar of Associations of the MoJ, and the Civil Code 1960 of Ethiopia and regulations framed in 1966. Thus, this paper addresses the present accounting and reporting practices of the select NGOs against the standards given by the Financial Accounting Standards Board (FASB) and the local legal requirements as per the existing rules and regulations, and then identifies the deviations or departures.

Methodology

Sample of NGOs: For this study there are 344 active and operational NGOs identified. The sample of 31 NGOs, which constitutes 9% of the total number of 344 NGOs, is considered as a representative. The purpose of this representative sample study is to facilitate an in-depth study of the accounting and reporting practices of the NGOs in Ethiopia.

The sample design is developed to use the primary as well as secondary data. Appropriately designed questionnaire is canvassed to collect the primary data. The questionnaire developed and thoroughly pre-tested to ensure the reliability and drawing meaningful inferences. The researcher's attempts to make an in-depth enquiry with the Auditors of the select NGOs could not be fruitful as they feel that revelations of the financial position (accounting and reporting aspects) of their clients amounts to breach of professional discipline. Hence, they have not been interviewed for the purpose of research.

The following procedure has been followed to make the sample as representative as possible.
Out of 344 active and operational NGOs, 224 are indigenous and the rest of 120 are international by their sponsorship. Hence a sample of 31 NGOs have been taken. Their head-offices are located in Addis Ababa. Hence, a sample frame of all the NGOs was obtained and stratified as under:

a) A stratification of all the NGOs in the sample frame are made into two categories, viz., indigenous and international.
b) Since the international NGOs are mainly for limited objectives, as many as six international NGOs were drawn on random sample without any eye upon their specified objectives.
c) Regarding the rest of the twenty-five NGOs (indigenous), the sample is further stratified according to their major objectives like: rehabilitation, health care, education, drought relief etc.

Legal Requirements of NGOs

In Ethiopia, the legal framework establishing NGOs is based upon the Article 479 of the Civil Code 1960. The Civil Code states that the Article 479 is applicable to all associations organized to undertake social, economic and other legally permissible activities. Based on the Civil Code provisions, the Associations Registrations Regulations have been framed in 1966. The primary objective of the regulations is to oversee the activities of the NGOs through administrative and accounting controls.

The detailed registration power and duty of the office is stated under the Ethiopian civil Code and Legal Notice No. 321/66. The Article 12 of this legal notice provides that every association shall keep adequate accounts and records of income and expenditure. The NGO will also make the same available to inspection from time to time or at any time upon the request by duly authorized official.

The Civil Code further, prescribes that government licensed auditors should audit the accounts. The legal Notice No.321 further requires that every association has to submit a report comprising income and expenditure statement, balance sheet, and auditor's report in respect of the major activities of the organization during the said financial year. Amending this legal Notice, another official guidelines referring to the NGOs was issued in July 1995. Accordingly, Associations' Registration Office is one of the main Departments in Ministry of Justice. Before 1995 the regulatory organ for registration of associations was Ministry of Interior, but after, this power and duty was transferred to Ministry of Justice by proclamation No. 4/1995. This was a felt necessary by the government in view of the National Policy on Disaster Prevention and Management (NPODPM) formulated to ensure coordinated approach by the NGOs. According to these guidelines, the Audit Report of the NGOs should reach the DPPC with in a maximum period of six months of the succeeding financial year. This report should explain the status of the resources of the organization, fixed assets, resource utilization and other matters relating to expenses and incomes. However, these regulatory agencies did not prescribe the formats of Annual Financial Statements. Hence, the accounts and consequential reports are influenced by GAAP. The purpose of such reports is to convey sufficient information to the concerned authorities of the FGE and the public about the associations' activities. Further, the report should also reveal the sources of its funds and also how it is expended for achieving the objectives.

GAAP as Applicable to Ethiopia

Generally accepted accounting principles (GAAP) are the development of conventions, concepts, standards, rules, principles, precepts and procedures that are necessary for the purpose of consistency and comparability at a point of time in any business environment. Fess and Warren opine that accounting principles have been developed individuals to help accounting data more useful in an ever-changing society. They represent the best possible guides based on reason, observation and experimentation, to the achievement of the desired results. These principles are continually re-examined and revised to keep pace with the increasing complexity of business operations. General acceptance among the members of the accounting profession is the criterion for determining an accounting principle. As such, it is clear that the GAAP is developed in any country after a great churning of the principles by practicing accountants and accounting educators, working both independently, and under the sponsorship of various accounting organizations. Again it is clear that the GAAP is the result of the efforts of the various national and international professional organizations.

A brief mention about the professional bodies responsible for developing accounting standards, at this stage is not irrelevant. Broadly, these accounting standard setting organizations may be categorized as US-based and international accounting standard organizations. The former (US model) focuses on the information needs of the common stockholder or the credit grantor through the application of GAAP. The latter organization is also developing international accounting standards in addition to US based organization. In US; APB was responsible from 1959 to 1973 and FASB has replaced the APB in 1973 for setting the US accounting standards. At international level, IASC (established in 1973 and located in London) was working till 2001 in developing the accounting standards to be considered for application by the member countries for harmonization worldwide. As on today, i.e., from 2001 the IASB (after restructuring of the IASC) has been issuing International Financial Reporting Standards. Though there is no uniformity between their accounting standards in certain aspects, presently there is an attempt to work together (FASB and IASB) to improve the international standards. In September 2002, the FASB issued 'The Norwalk Agreement" in which both the FASB and IASB pledged to work together to make their respective financial reporting standards as comparable as possible.

Regarding the GAAP in Ethiopia; there are no locally developed standards as on to day (September 2006). In this context there are two aspects to be noted. First, in the absence of locally developed GAAP, almost all the accountants, and auditors in Ethiopia tend to apply the US, GAAP or IFRS of IASB in case of business and non-business organizations. Second, there are three professional accountants associations such as Ethiopian Professional Association of Accountants and Auditors (EPAAA), Ethiopian Accountancy and Finance Association (EAFA), and Accounting Society of Ethiopia (ASE). Of course, these country-professional organizations have not yet come up with any accounting standards to be followed so far.

Justification of Applicability of FASB Statements to the NGOs in Ethiopia

Though Ethiopia is a least developed country, it is gearing its accounting system to the US or/and international accounting standards for the following reasons.

1. As already mentioned, that there are no locally developed generally accepted accounting principles, there is a need for Ethiopian Accounting professionals to look into other sources.
2. In accordance with Ethiopian Government Regulation No. 321/66 and DPPC's guidelines, NGO's prepare annual financial statements in accordance with GAAP as appropriate to their circumstances. It is observed by the World Bank that there are no national GAAP for Ethiopia. Standards set by FASB is the primary source of GAAP in the absence of the locally developed accounting principles.
3. In Ethiopia, almost all business and non-business organizations follow the FASB or IASB principles, as there are no specific GAAP in the country.
4. Education at higher levels in the field of accountancy, US pattern is employed and in practice there is a tendency to follow the US and UK patterns.

Accounting Standards-FASB

In the absence of the specific accounting standards in the country, it is necessary to follow the time-tested and generally acceptable accounting principles. In terms of GAAP, the following are relevant:
(a) Entity concept, (b) accounting period concept, (c) going concern concept, (d) objective evidence principle, (e) money measurement concept, (f) cost principles, (g) matching principle, (h) full disclosure principle, (i) consistency principle, (j) materiality principle, and (k) conservatism principle. In the above paragraph, it is noted that there are no specific accounting standards prescribed by the Government in Ethiopia except to demand adequate financial information that enable them to ascertain the sources of funds, their uses, fixed assets and their utilization. Hence, it is pertinent to examine how far the NGOs in Ethiopia are following the GAAP or Statements issued by the FASB.

In addition to the above generally accepted accounting principles, as stated earlier, there are five Financial Accounting Standards Board Statements (Standards: 93 & 99 for depreciation; 116 for contributions received and made; 117 for the financial statements to be prepared; 124 for investments; and 136 for transfers of assets), which are relevant to the NGOs.

As the objective of this study is to probe into the accounting and reporting practices of NGOs in Ethiopia, an attempt is earlier made to survey the practices and also the legal stipulations with regard to accounting and reporting procedures. As the FASB suggested Accounting and Reporting Standards for NGOs, a brief discussion about them is not impertinent. The purpose of this discussion, further, is to make a comparison between the prevailing practices and the standard practices amidst the accounting environment created by the law of the land.

Accounting for Contributions: It is noted that almost all the 31 NGOs are receiving donations from the local philanthropists and also from the international agencies. Further, donations are observed to be major sources of income to the NGOs. A close examination of the financial statements reveals that the details of the donations, their restrictions, and the form of donations (whether in cash or kind) are not disclosed by any NGO under study. Even the DPPC and MoJ do not insist for disclosure about the nature of donations. However, the FASB has suggested to follow their Accounting Standard No.116 for ensuring fair accounting practices and disclosure for the nature and sources of donations. Hence, a brief discussion about the Statement is given below.

This standard (No.116) indicates accounting procedures to be adopted by nonprofit entities for contributions made as well as received. Contribution is defined as an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal basis. This means that a contribution with a donor imposed condition, such as a matching requirement, should not be recognized until the condition has been met and, secondly, the donor should not be receiving anything of value back for a contribution. Contributions are recorded not just when cash is received, but also when promises (pledges) are made. This means donees must record pledges receivable and contribution income prior to receiving the cash. This will be a change in practice for many nonprofit entities, who previously only recorded pledged amounts when the cash was received.

Contributions are recorded immediately as income even though the contribution may have had donor restrictions that have not been met. This requirement has been particularly controversial as most nonprofit organizations record donor restricted contributions, that is contributions that are restricted for a specific operating purpose or future period, as "deferred revenue" on the balance sheet until the restriction of the gift has been met.

The FASB concluded that restricted contributions only limit the use of the funds but do not result in liabilities. Therefore, the amounts should be recognized as income currently even though the related expenditure that satisfies the restriction may not be made until a future period.

Non-cash contributions, such as buildings and equipment, and contributed services, (such as the time of volunteers), should be recorded, but the criteria for recognition, particularly contributed services, is much more restrictive. Non-cash contributions that do not meet the criteria cannot be recorded. Basically, a volunteer's time can only be recorded if the time is spent building an asset for the nonprofit or the volunteer possesses a professional skill such as an attorney or CPA, and the nonprofit would have paid for the service had the service not been donated. In the context of the sample NGOs, it is to be noted, that none is making distinction between the various types of contributions.

Accounting Standard on Financial Statements: The financial statements of the select NGOs, as observed in the preceding discussions, are found different from the suggested formats of the FASB. The DPPC and MoJ simply suggested to follow the standard pattern of the reporting. They have neither prescribed the formats nor guided the Auditors of the NGOs to follow such and such format available at any source. It is found that there is no consistency with regard to the presentation of the Income and Expenditure Statements. However, in many NGOs, there is, to some extent, uniformity and consistency in preparing and submission of Balance Sheet. In this context a brief discussion is presented here about the FASB Statement No.117, which deals with the presentation of Financial Statements. The set of financial statements includes a statement of financial position (balance sheet), statement of activity (Income and expenditure Statement), statement of cash flows and, for voluntary health and welfare organizations, a statement of functional expenses. Financial statements are to focus on the entity as a whole, rather than reporting on separate fund groups. Contributions and net assets (previously called fund balance) are now to be shown in three categories based solely on donor- imposed restrictions. The three categories are "unrestricted", "temporarily restricted" and "permanently restricted". Hence, expenses are to be reported (1) by functional categories (programs, management and general, and fundraising) rather than by natural categories and (2) in the unrestricted column or category even though the source of the funds may have been restricted. All capital gains and losses on investments and other assets are to be reported in the unrestricted category, unless there are explicit donor restrictions, or state law, which require the reporting of gains or losses in a restricted category. The present investigation with the select 31 NGOs reveals that all of them except 4 deviate from FASB Statement 117 in preparing annual Financial Statements. As a matter of fact no NGO prepares Cash Flow Statements, which is a major deviation from the Standards.

Accounting for Investments (FASB Statement No. 124): This standard specifies that fair value should be measurement basis for investments in all debt securities and in equity securities that have readily determinable fair values. The standard requires debt securities be valued at fair value. Investment income for the period includes interest or dividends and the changes in fair value. Changes in fair value of investments in temporarily restricted or permanently restricted net assets are recognized in accordance with donor restrictions as to the income. The NGOs in Ethiopia do not have any investments since they generally run short of funds to meet the socio-economic programs. Further, there is no stock market in the country. As such there is no possibility of determining the fair value. Hence, this Standard is not relevant to the NGOs in Ethiopia.

Transfers of Assets (FASB Statement No.136): This standard defines three parties to the typical contribution process. The donor is the initial provider of the resources. The recipient organization receives the assets from the donor. The beneficiary is the entity that eventually receives the assets through the recipient organization, as specified by the donor. This process is not that relevant since the NGOs in Ethiopia do not have such transactions.

Present Reporting Practices Vis-À-Vis Fasb Standards

In the light of the FASB, Statement No.117, it can be mentioned that out of 31select NGOs, only 4 (two local and two foreign) to some extent, are falling in line with the Standards because of flexibility permitted by the government of Ethiopia. As stated earlier, the FASB Statement No.117 states that the NGOs have to prepare Cash

Flow Statements for the year. At this stage, it is to be noted that none of the select 31 NGOs prepare the Cash Flow Statement (see Appendix).

In Ethiopia, almost all the established NGOs receive donations from foreign agencies, like churches, funding agencies, and other NGOs of foreign origin. All of the funds from the foreign agencies are received in foreign currency. As such, there is a problem of currency transactions and conversion of foreign currency into local currency (Birr). In this context, the FASB is silent with regard to foreign currency transactions in case of NGOs. However, there are a few FASB Statements relating foreign currency transactions and translations (FASB Statements Nos.52, 133 and 149) mostly for business organizations. At present, the accounting practice of the NGOs is that they recognize the receipt of foreign donations for accounting purposes at the exchange rate prevailing on the date of actual receiving of the funds. Regarding the pledges (promises) of the foreign agencies for donations, they are recognized for accounting purposes, the exchange rate obtained on the date of Statement of Financial Position. The problem of translation of pledges of foreign donations arises only with the NGOs following the accrual basis of accounting.

Recognition of Depreciation: The depreciation is provided against the fixed assets by only 8 NGOs out of the 31 under study. They are following the stipulations of the DPPC with regard to the rates of depreciation. However, out of 31 NGOs, 23 are treating the fixed assets as expense in the year of acquisition. Hence, it is neither shown in the Balance Sheet nor mentioned any where about the nature of the assets. This accounting policy is made known by the auditors in their 'Notes". This is not consistent with the generally accepted accounting principles. In continuation to this, a brief discussion about the FASB Statement No.93/99 is attempted.

This Statement requires all not-for-profit organizations (NGOs), to recognize the cost of used up long-lived tangible assets (depreciation) for making the general-purpose external financial statements. However, depreciation need not be recognized for certain works of art and certain historical treasures. The requirements of APB Opinion No.12, Omnibus Opinion-1967 are such that this information about depreciation should be shown in the financial statements. This Statement No.93 & 99 does not prescribe the method of financial statement display, recognition of assets, or measurement of used up value (depreciation) to be recognized for a particular period. The FASB No.93 & 99 suggested that this Statement relating to depreciation be implemented from the financial year commencing from January 1990.

After having gauged the accounting practices and reporting pattern of NGOs, in the context of the prescribed GAAP and the FASB Standards, an idea about the compliances and deviations between the practice and prescriptions is presented in the following table.

Accounting and Reporting Practices of NGOs- Analysis of Compliances and Deviations

FASB Standards	Regulatory Agencies Prescriptions	Practice s of the NGOs	Extent of Compliance as percentage to 31 NGOs	Extent of Deviation as a percentage to 31 NGOs
Statement of Activities	Income and Expenditure Account as per the GAAP	As stated earlier the titles of the Account is differently given by the different NGOs	------------	------------
Statement of Financial Position (Balance Sheet)	Balance sheet	Only 12 NGOs are preparing the Balance Sheet	38% of NGOs.	62% of NGOs
Statement of Cash Flows	Not prescribed	No NGO prepares.	--------------	100% of NGOs
Provision for Depreciation	Rates of depreciation are prescribed	Depreciation is recognized.	26% of NGOs	74% of NGOs

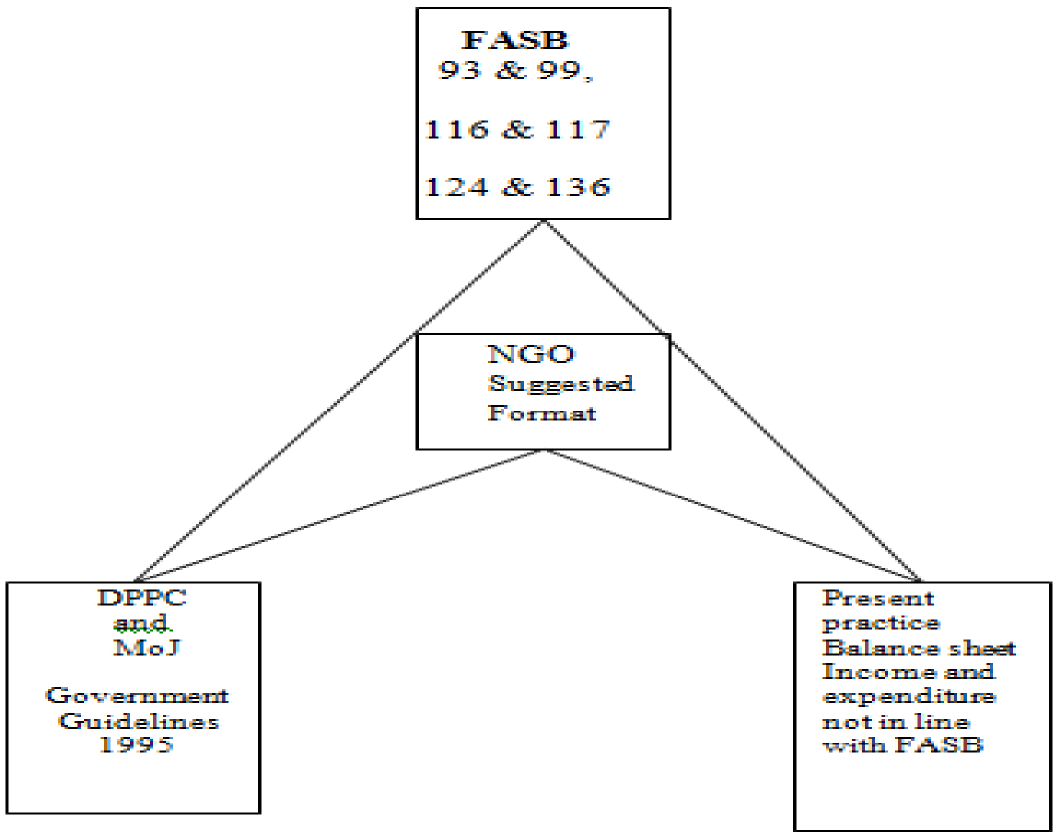
Source: Analysis of the questionnaire.

From the data presented in the above table, it can be discerned that there is a deviation in the accounting and reporting practices among the NGOs and also in terms of the prescriptions of FASB and the Regulatory Agencies.

A Triangular Reconciliation of the Accounting And Reporting Practices

Through the preceding paragraphs, a fair idea about the existing accounting and reporting practices of NGOs in Ethiopia is obtained. Further, a discussion about the government prescriptions and the FASB suggestions as to the reporting practices are attempted. Thus, the study is now in a triangle frame of the practices, suggestions and prescriptions. It is also understood through the preceding discussions, that the accounting and reporting practices are not comparable with the FASB package of financial statements. It is also not clear whether the accounting and reporting practices of NGOs in Ethiopia are conforming to the government (DPPC and MoJ) stipulations or not due to the vague and passing prescriptions. As such an attempt is made here to highlight the need for assimilation, and modification of the present practices in the context of the FASB suggestions and the field practices. Perfection in any field is the result of persistent practice and cross-fertilization of ideas and experiments. As the present study is concerned with the accounting and reporting practices of NGOs in Ethiopia, an empirical modification is indicated.

The following chart gives a pyramid of the sources of accounting and reporting principles enabling the creation of locally compatible, transparent and accountable environment for the NGOs. The peak point of the pyramid is indicating the Accounting standards given by the FASB viz., Statement Nos.93 & 99, 116, 117, 124 and 136, the left side bottom point is indicating the government prescriptions that can be sourced out from the guidelines (1995) and the agreements signed by the NGO concerned with the DPPC and MoJ and the right side bottom point of the pyramid is explaining the existing accounting and reporting practices of the NGOs such as the accounting policies, preparations of annual financial statements and the budgets. Between these three angles of the pyramid, the NGOs must tend to improve their present practices that are lacking transparency, accountability, and full disclosure. As such the NGOs are shown in the mid-point of the triangle evidencing their readiness to accept any accounting and reporting standards that suits the local and international needs. An attempt is made to suggest locally compatible package of Annual Financial Statement for the NGOs in Ethiopia.



Conclusion

Keeping in view the accounting and reporting requirements of the DPPC, and the RoA (Ministry of Justice), and the harmonization obligation with the GAAP and FASB standards, an internationally oriented and locally developed ccounting principles and an appropriate package of three Annual Financial Statements are required. They are: (i) Balance Sheet (Statement of Financial Position), (ii) Income and Expenditure Account (Statement of Activities), and (iii) Cash Flow Statement. The first two statements' Schedules should disclose various relevant details.

(i)Balance Sheet with its Schedules provides full disclosure of various assets, depreciation, details of balances of each item at the beginning and at the end of the financial year. Thus, they are more revealing and satisfy the transparency needs of the users. (ii)Income and Expenditure Account is a period based account for disclosing income and expenditure. It explains the nature and effects of activities in terms of income and expenditure for the financial period. It should show in a classified manner (restricted, temporarily restricted and permanently restricted) with total amounts against each item. A number of schedules, wherever there is a possibility of inflating or deflating costs or revenues, are required to be more transparent. Both the above statements to a large extent conform to the GAAP of the FASB prescriptions. They also meet the requirements of the regulatory agencies in Ethiopia. (iii) Cash Flow Statement is also required with the details of various sources of cash and applications of cash so as to highlight the operating and non-operating activities that take place during the year. This statement is also suggested by the FASB as GAAP.

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Appendix

Financial Statements of the Sample NGOs Different Titles Used

	Title of Statement	NGOs	% to 31
A	Income and Expenditure Statement Revenue and	24	77.42
	Expenditure Statement Receipts and Expenditure	2	06.45
	Statement Receipts and Payments Statement	1	03.23
	Receipts and Disbursement Statement Statement	2	06.45
	of Activities	1	03.23
		1	03.23
B	Balance Sheet	12	
C	Cash Flows Statement	0	38.71
		8	
D	Program wise Expenditure	31	
E	Schedules or Notes to Accounts	3	-----
		Nil	
F	Statement of Budget and Actual Comparison	28	25.81
G	Budget for the following year	31	100
		15	09.67
H	Audit Report – Notes		Nil
	□ Background of the organization	16	
		15	90.32
	□ Accounting policies	Nil	
			100
	□ Recommendations for rectifications		48.39
		3	
		31	51.61
	Audit Report – Opinion		48.39
	□ Unqualified Report (ie. Present fairly)		Nil
	□ Qualified Report Except for		09.67
	□ Disclaimer Report		100
I	Management letter of Internal Control		
	Memorandum		
J	Comparative figures of previous year		