

### **Case Study of Association 'X' located in 'Red' State**

1. Association 'X' was formed as a society registered under the Societies Registration Act of 'Red' State with the following objects:
  - 1.1 Educating economically backward and downtrodden children,
  - 1.2 Providing shelter and food to the orphan children,
  - 1.3 rehabilitating the handicapped,
  - 1.4 rendering voluntary help, educational assistance, relief work in national emergencies,
  - 1.5 rendering medical assistance and various forms of philanthropic activities,
  - 1.6 printing, publishing and exhibiting films, journals, periodicals, books and other reading and pictorial matter for the diffusion of useful knowledge as well as conveyance of the teachings of a religion and keeping with educational, medical charitable and moral ideas of the society as well as the belief of the society,
  - 1.7 raising loans and funds and receiving and using gifts, donations, voluntary contributions in cash or other movable or immovable property of all descriptions and to undertake and carry out the office duties and functions as the trustee, managers and administrators solely or jointly with other in respect of any such gifts, voluntary contributions, donations, whether vested or otherwise,
  - 1.8 subscribing or giving donations and financially or otherwise providing aid or any other charity with similar objects,
  - 1.9 establishing reading rooms, library, show cases and sign boards in private or public places and production of movies.
2. The association applied with the FCRA division, Ministry of Home Affairs, Government of India for registration under FCR Act, 1976, which was granted during the year 1990-91.

3. The association has been furnishing Form FC - 3 with the Ministry in accordance with Rule 8 of the FCR Rules, 1976. As per the information submitted in the said form, the association has received the foreign contributions as per the following:

Year	Amount (Rupees in lakhs)
1992-93	60
1993-94	40
1994-95	50
1995-96	60
1996-97	80
1997-98	85
1998-99	110
1999-2000	70
2000-2001	50
2001-2002	60
2002-2003	NIL

In the year 2002-2003, though no foreign contribution was received by the association, it had received the maturity proceeds of the Fixed Deposits and interest on the deposit made out of foreign contribution funds, from the Bank. The association utilized such amount and other unspent foreign contribution funds during the year.

4. The Ministry of Home Affairs was reported regarding involvement of Association 'X' in the transfer of foreign contribution accepted by it to associations not registered under the FCR Act. The associations receiving the foreign contribution from Association 'X' had not also obtained prior permission for the purpose from the Ministry.
5. In order to ascertain the position regarding the violation of provisions of the FCR Act and the rules framed there under by the association, an inspection of accounts/ records of Association 'X' u/s 14 of the FCR Act was undertaken by the Ministry. During inspection, the following facts transpired before the inspecting officials:
- 5.1. Form FC-3 prescribed under Rule 8 of the FCR Rules, 1976 contains the description of the various purposes for which the foreign contribution is proposed to be accepted and actually utilized. The inspecting officials analysed the Form FC - 3 filed by the association with the Ministry during last three years. In Form FC - 3 relating to one of these years, the association had shown the receipt of foreign contribution under a single description i.e. running of schools and hostels and maturity proceeds of the deposits made out of these funds. In another year, the Form FC - 3 furnished by the association had shown the purpose as the

repairs and maintenance of school/college building and maturity proceeds of the deposits made out of these funds. Similarly the funds were disclosed to have been utilized by the association under these heads. The statement of receipts and payments and income and expenditure filed along with Form FC - 3 relating to the respective years however contained the details of expenditure incurred by the association for various activities, which could have been covered under different descriptions stated in Form FC - 3.

5.2. Form FC - 3 contains a certificate from a chartered accountant in the prescribed format. As per the format, a chartered accountant is required to check and certify the following in respect of the foreign contribution:

- (i) Brought forward balance of foreign contribution at the beginning of the year;
- (ii) Foreign contribution received during the year; and
- (iii) Balance of unutilized foreign contribution at the end of the year

The chartered accountant is also required to certify that the association has maintained the accounts of foreign contribution and records relating thereto in a manner specified in section 13 of the FCR Act, 1976 read with Rule 8(1) of the FCR Rules, 1976 and that the information furnished by the association in the balance sheet and the statement of receipts and payments has been checked and found to be correct.

The provisions of the FCR Act/Rules do not accordingly require the certifying chartered accountant to express opinion on the ultimate utilization of the funds received as foreign contribution for labeled usage.

5.3 A portion of the foreign contribution received by the association had been transferred to various bodies in India. The association explained the inspecting officials that these bodies were the branches established by the association to carry out its mission and facilitate its functioning spanning the respective States. The inspecting officials however discovered that these bodies were registered under the Societies Registration Act of the respective States and possessed identity separate from Association 'X'.

5.4 The association was discovered to have advanced loans to individuals, which had not been realized.

5.5 Association 'X' had, with the direction/concurrence of one of the donor agencies of foreign contribution, was found to have transferred foreign contribution to some 10 associations, which were not registered under the FCR Act. Section 6(1-A) of the FCR Act, 1976 also provides that the unregistered associations may seek prior permission from the Ministry to accept the foreign contribution. No such permission was also obtained by these associations before accepting the foreign contribution from Association 'X'

- 5.6 Section 13 of FCR Act and Rule 8(1) of the FCR Rules provide for the maintenance of proper accounts and records by the acceptor of foreign contribution. The inspecting officials found that the transactions undertaken with only one of these associations were duly recorded. No proper records/ account of the funds transferred to the remaining associations were found.
- 5.7 As per its bye laws, Association 'X' had an executive body, which met on regular basis to carry out the affairs of the Association 'X'. As per the direction of one of the donors of foreign contribution, a new Director for the Association 'X' was appointed. The change in the composition of the executive body was informed to the Ministry by the association. The Societies Registration Department of 'Red' State in which Association 'X' was registered later on informed to the Ministry that no change in the executive body was authorized and as such the new executive body did not own legal sanctity.
- 5.8 The new executive body had, prior to the receipt of information regarding illegality of the alteration in the composition of the executive body of the association, applied with the Ministry for change in the designated foreign contribution bank account. Upon receipt of permission from the Ministry, the association arranged to open the new bank account and accepted and deposited the foreign contribution funds in the fresh bank account.
- 5.9 The Ministry, while observing diversion of funds to various associations/bodies, which were not registered under the FCR Act, 1976 and not had they sought prior permission from the Ministry for the receipt of foreign contribution, also came across an Association 'A', which received foreign contribution from Association 'X' as well as from one of the donor agencies of Association 'X'. Association 'A' was found to be registered under the Societies Registration Act of the State in which it is located with most of the members as constituents of a single family. Association 'P', since not registered under FCR Act, did not maintain the prescribed proper accounts and records for such foreign contribution received from Association 'X' and the other foreign donor agency.
6. The following shortfalls were considered material and relied upon by the Ministry to formulate opinion in respect of the irregularities in the affairs of the association tantamounting to violation of the provisions of the FCR Act/Rules:

*6.1 Inadequate information in Form FC-3*

Rule 8(3) of the FCR Rules, 1976 inter alia provides for the submission of the yearly account of the acceptance and utilization of the foreign contribution in the prescribed form FC - 3, which is required to be certified by a chartered accountant, to be submitted with the Ministry within four months of the closure of the year.

The information required to be stated in the said Form was not however properly filled resulting therefore into mitigating the assessment of the usage of the foreign contribution received for the specified purposes.

### *6.2 Transfer of foreign contribution to various other bodies*

As per section 6(1) of the FCR Act, 1976, no association having a definite cultural, economic, educational, religious or social programme may accept foreign contribution unless the association gets itself registered with the Central Government under the provisions of the Act and agrees to receive such foreign contribution in a specified bank account, which is informed to the Ministry in the application for registration. Alternatively the association may obtain the prior permission, provided u/s 6(1-A) of the FCR Act, 1976, from the Ministry for acceptance of such foreign contribution.

The association claimed that certain branches had been established to function in the respective States. These bodies were however proven to be registered as societies under the Societies Registration Act of the States and thus owned distinct identity for the purpose of the Act. The act of the association amounted to the violation of the provisions contained in section 4 of the FCR Act, which prohibits transfer of foreign contribution to persons or associations other than on behalf of which such contribution was received. The facts signaled misappropriation of foreign contribution received by the association.

No association to which Association 'X' had transferred the foreign contribution was either registered under the Act or obtained prior permission in respect of the acceptance of the foreign contribution. All these associations had thus violated the provisions of the FCR Act.

### *6.3 Non realisation of loans/advances*

The foreign contribution had been received by Association 'X' for deployment for specified purposes. The association granted loans to individuals prior to the actual utilization of funds for the intended purpose.

Although the provisions of the FCR Act do not have application to the individuals, the act of the Association to advance the noticed amount to these individuals could be treated as diversion of funds as the end-use was not met.

### *6.4 Accounts and Records were not properly maintained*

Section 13 of the FCR Act, 1976 requires for every association registered under the Act or which has obtained prior permission to obtain foreign contribution, to maintain an account of any foreign contribution received and record of the utilization of such contribution. Rule 8 of the FCR Rules, 1976 provides that a

separate set of accounts and records shall be maintained exclusively for foreign contribution received and utilized. The said rule also prescribes the manner in which the accounts and records as above said are required to be maintained by the associations.

As the Association was not found to have maintained the accounts and records in the prescribed manner, it violated the provisions of the FCR Act/Rules relating to the maintenance of accounts and records.

7. The Ministry, finding that the provisions contained in sections 4 and 13 of the FCR Act, 1976 and Rule 8(1) of FCR Rules, 1976 had been contravened by Association 'X', prohibited, in the public interest, the association from accepting any further foreign contribution from the date of issue of order. The prohibitory order was issued in terms of the provisions contained in section 10(a) of the FCR Act, 1976.

The Ministry also issued an order u/s 10(a) of the Act prohibiting Association 'X' from accepting any further contribution from the date of the issue of the said order.

8. *These issues emanate from the analysis of the circumstances of the case and demand thinking:*

- 8.1. *Does the current framework of the submission of information by the associations registered under the Act or which have obtained prior permission provided under the Act permits adequate opportunity to analyse the facts to gauge the irregularities in functioning of the associations and forestall misappropriation of funds?*
- 8.2. *Is the extant dispensation regarding certification of Form Fe - 3 adequate? Or the chartered accountant should be required to audit the accounts of the associations relating to receipt and utilization of foreign contribution? Should not the Ministry seek opinion from a chartered accountant in respect of satisfying himself that the foreign contribution funds have been utilized for the purpose intended?*
- 8.3. *Should the associations be required to furnish the financial statements relating to activities undertaken separate from the foreign contribution also, with the Ministry?*
- 8.4. *Should not the Ministry impress upon the associations to adhere to the accounting standards issued by ICAI for their income generating pursuits?*
- 8.5. *Does the stand taken by the Ministry to prohibit the association from accepting the foreign contribution seems to be just? Should not the prohibition to further accept the foreign contribution be invariably accompanied by cessation of the availability of funds received in contravention of the provisions of the Act for any further use?*
- 8.6. *Does the magnitude of the transactions undertaken by the associations accepting the foreign contribution for proclaimed usage warrant assumption of a stricter role by the Ministry? Should the exercise of punitive powers be made*

*mandatory, considering the instances replete with contraventions, to which the recourse is seldom witnessed?*

- 8.7. Should the extant provisions of the FCR Act and the Rules framed there under be amended to accommodate more effective supervisory role of the Ministry to implement, in letter and spirit, the regulatory provisions?*
- 8.8. What role could be played by chartered accountants to assist the Ministry in rendering effectiveness to the overall surveillance and compliance framework?*
- 8.9. Do the laws relating to foreign contribution stand the test of contemporary dynamics? Is the amendment in the framework warranted?*

## **Case Study of Association 'Y' located in 'Green' State**

1. Association 'Y' is situated in 'Green' State and registered as a society under the Societies Registration Act of the State with the following objects:

- 1.1 To promote the cause of education in general and the cause of the education of some backward sections of the country in particular.
- 1.2 To provide religious, cultural, technical and scientific education and vocational training so as to raise living and social standards of the weaker sections of the society and thereby serving the nation as a whole.
- 1.3 To provide instruction in some religious texts so as to remove ignorance, superstition, and anti-social practices prevailing amongst the population and thereby contributing to the advancement of the Indian society.
- 1.4 To arrange for the educational and vocational training to the physically handicapped to enable them to earn their living.
- 1.5 To publish and propagate the works of the Indian scholars religious texts and specially of those with secular credentials and having mass appeals.
- 1.6 To organise seminars and symposia with a view to create a better atmosphere of understanding and mutual co-operation among the different communities of the Nation and to promote communal harmony.
- 1.7 To provide aid and facilities including financial assistance to the deserving scholars and craftsmen.
- 1.8 To establish dispensaries and provide medical aid to the needy and the poor of all sections of the society.
- 1.9 To establish nursery, primary, secondary schools, colleges, libraries, research centres etc., for boys and girls in the various parts of the country.
- 1.10 To establish sections to translate and compile books in the different regional and international languages regarding the searching in religious texts.
- 1.11 To provide material and special assistance to the individuals and organisations engaged in the promotion of the above said objects.
- 1.12 All income of the society shall be utilized for the promotion of the above aims & objects only.

- 2 Association 'Y' was registered under the FCR Act, 1976 in the year 1988 as an educational association to accept and utilize foreign contribution for its activities. The association has, under its auspices, 04 educational, technical & welfare institutions in the capital of 'Green' State and 06 in other parts of the country. At the time of registration, the association designated a bank account into which the foreign contribution was proposed to be accepted.
- 3 An information regarding likely misappropriation of the amount collected by the association outside India in foreign exchange was received by the Enforcement Directorate, which probed the records of the association to unveil the facts.
  - 3.1 Enforcement Directorate, upon investigation, found that the association opened a bank account outside India and collected foreign exchange in the account in respect of which the permission from the Reserve Bank of India was not obtained.
  - 3.2 Enforcement Directorate opined that the foreign exchange was collected for a noble cause and also the funds were not found to be misutilised.
  - 3.3 Enforcement Directorate concluded that the association 'Y' and its Chief Functionary had contravened the provisions contained in sections 8(1) and 14 of the Foreign Exchange Regulation Act, 1973 (which had been in force at that time) by not obtaining permission from Reserve Bank of India to open and maintain a foreign bank A/c outside India. Finding both association 'Y' and its Chief Functionary guilty of violation under Sections 8(1) and 14 of the Foreign Exchange Regulation Act, 1973, the Enforcement Directorate initiated penalty proceedings under Section 50 of FERA.
  - 3.4 In terms of the powers conferred under section 50 of the Foreign Exchange Regulation Act, 1973, the Enforcement Directorate imposed a penalty to the tune of Rs. 5,00,000/- payable by the Association 'Y'. Penalty of an amount of Rs.250000/- was also not imposed to be payable by the Chief Functionary of the association "Y" The association 'Y' was also ordered to repatriate the foreign exchange amounting to Rs. 4 crores held in the bank account outside India on or before a date specified in the order under necessary information to the Directorate and the FCR division of the Ministry of Home Affairs, Government of India.
  - 3.5 In compliance with the order of the Enforcement Directorate, the amount of penalty was deposited. The repatriation, as ordered, was also effected by the association 'V' in its designated bank account in India.
- 4 Considering the matter relating to repatriation of Foreign Exchange holding to India by Association 'Y', the Ministry scrutinized the information furnished by association 'Y' in Form FC -3 filed by it during last three years as per the provisions of Rule 8 of the FCR Rules, 1976. The following were evident:-
  - 4.1 During last three years, the association 'V' had received the following amount as foreign contribution:-

YEAR	Amount of FC(Rs.)
2000 -01	Rs.1,10,00,000/-
2001-02	Rs. 90,00,000/-
2002-03	Rs. 7,00,00,000/-

The amount of foreign contribution received during the year 2002 - 03 also included the amount of Rs. 4,00,00,000/- repatriated to India which was held in the bank account outside India.

4.2 Form FC-3 filed by the association 'Y' for the year 2001-02 contained the following statement of foreign contribution received and utilized:-

S.No.	Purpose	Previous	Receipt during the Year		Total	Utilised	Balance as on 31.03.2002
			As 1 <sup>st</sup> rceptient	As 2 <sup>nd</sup> Receptient			
1	Donation General	-	25,00,000	-	25,00,000	25,00,000	-
2	Donation	-	2,50,000	-	2,50,000	2,50,000	-
3	Fund-I	-	3,20,000	-	3,20,000	3,20,000	-
4	Building Fund	17,00,000	43,00,000	-	43,00,000	43,00,000	-
5	Fund II	-	1,90,000	-	1,90,000	1,90,000	90,000
6	Fund III	2,25,000	-	-	-	2,25,000	-
7	Flood Fund	65,000	-	-	-	-	65,000
	Total	19,90,000	75,60,000	-	75,60,000	76,95,000	1,55,000

4.3 The Receipt and Payment Account of association 'Y' for the year 2001- 02 contained the following entries :-

<b>Receipts</b>	<b>Amount(Rs.)</b>	<b>Payments</b>	<b>Amount(Rs.)</b>
Opening Balances		Addition to Fixed Assets	62,00,000.00
- Cash in Hand	18,000.00		
- Cash at Bank	7,30,000.00		
Donation - General	25,00,000.00	Salary to staff	11,00,000.00
Donation - Salary	2,50,000.00	Boarding Expenses	16,50,000.00
Misc. Income	3,20,000.00	Consumable Expenses	14,000.00
General Fund	1,90,000.00	Conveyance expenses	24,000.00
Building Fund	43,00,000.00	Electricity Water expenses	2,10,000.00
Advance Adjusted/returned	21,00,000.00	Legal & Prof. Charges	2,00,000.00
Others Adjustment	4,00,000.00	Miscellaneous Exp.	23,000.00
		Newspaper & Magazine	2,000.00
		Postage & stamps	30,000.00
		Printing & stationery	50,000.00
		Repair & Maintenance	2,30,000.00
		Telephone & Fax Exp	68,000.00
		Traveling Exp. - Domestic	10,000.00
		Travelling Exp. - Foreign	1,25,000.00
		Vehicle running & Maintenance	3,000.00
		Advertisement Exp.	12,000.00
		Bank Charges & comm	13,200.00
		Other Expenses	99,000.00
		Penalty (FCRA)	4,00,000.00
		Closing Balances:	
		- Cash in hand	48,500.00
		- Cash at Bank	2,96,300.00
	10,80,8000.00		10,80,8000.00

- 4.4 As can be viewed from above, Form FC - 3 was not filled as prescribed as the details in respect of the purpose for which foreign contribution had been utilized were not stated properly. The format for Form FC-3, as prescribed, enclosed as Annexure A.
- 4.5 The figures of foreign contribution received and utilized and their opening and closing balances as disclosed in Form FC-3, as above, were not even arithmetically accurate. The total of previous balance and the foreign contribution received during the year should have been **Rs. 95,50,000.00 (19,90,000.00 + 75,60,000.00)** and not Rs. 75,60,000.00 as stated in Form FC-3 filed by association 'Y'. Accordingly, assuming the amount of foreign contribution utilized was shown correctly as Rs. 76,95,000.00, then the closing Balance should have been **Rs. 18,55,000.00** instead of Rs. 1,55,000.00 shown in Form FC-3, as above or vice versa, if closing Balance as shown was correct then amount shown as foreign contribution utilized was incorrect.
- 4.6 As could be discerned from the Receipt and Payment Account, as above, the total amount of payments made during the year for various purposes by Association 'Y' comes to Rs. 1,04,63,200.00/-(Rs.1,08,08,000.00 - closing balance [48,500.00+ 2,96,300. 00]) while the amount of foreign contribution utilized was shown as Rs. 76,95,000.00.
- 4.7 During the year 2002 - 03, as per the Form FC - 3 filed by The association 'V', following were the balances of foreign contribution received and utilized:-

Opening Balance	Rs. 1,55,000.00
Foreign contribution received	Rs. 10,00,00,000.00
Foreign contribution utilized	Rs. 1,52,00,000.00
Closing Balance	Rs. 8,49,55,000.00

- 4.8 The figures of Form FC-3 filed by association 'V', in accordance with the provisions of Rule 8 of the FCR Rules, 1976, did not tally with the balances of foreign contribution at the beginning and close of the years respectively as per the receipt and payment account.
- 5 The following issues were considered and relied upon by the Ministry of Home Affairs to formulate opinion in respect of the irregularities in the affairs of the association tantamounting to violation of the provisions of the FCR Act/Rules:

5.1 The association 'Y' had not only accepted foreign contribution outside India in a bank account different from the one designated under FCRA but foreign contribution was also accepted directly by the Chief Functionary of association 'Y' in his personal account which was later on transferred to the designated bank account of association 'V'. This was clearly in violation of the provisions of Section 6(1)(b) of FC (R) Act, 1976 which, inter alia, states that no association

shall accept foreign contribution unless such association agrees to receive such foreign contribution only through such one of the branches of a bank as it may specify in its application for such registration. It also noted that Hon'ble Supreme Court while disposing off a case relating to violation of FC (R) Act, 1976 had, inter alia, stated that it is "needless to mention that if associations and political parties would be allowed to receive foreign contribution and would deposit the same into any bank they like, notwithstanding their declaration (in the concerned form) with the Central Government at the time of registration, then the very purpose of conferring power on the Central Government to regulate, would be frustrated and all other provisions for inspection and auditing conferring power on the Central Government would be futile."

5.2 The Form FC- 3 for the year 2001-02 revealed that association 'Y' had paid a penalty of Rs. 7.5 lacs, as imposed by Enforcement Directorate for violations under FERA, out of the foreign contribution funds which were received for specific purposes. As stated above, the Enforcement Directorate had imposed a penalty to the tune of Rs 5,00,000/- payable by the Association 'V' and a further penalty for an amount of Rs 2,50,000/- was imposed to be payable by the Chief Functionary of the association 'Y'. The Ministry of Home Affairs found that payment of this personal penalty of Rs. 2.5 lacs, as imposed on the Chief Functionary of association 'Y', out of the foreign contribution funds which were received for specific purposes amounted to diversion of funds for activities other than bonafide activities of association 'V' and thus was in violation of the provisions of Section 4(3)(i) of FC (R) Act, 1976.

6. In view of the above, the Central Government, while observing that association 'V' had contravened the provisions of Section 4(3)(i) and Section 6(1 )(b) of the Foreign Contribution (Regulation) Act, 1976, in exercise of the powers conferred by clause (b) of Section 10 of FC (R) Act, 1976, ordered to require association 'V' to obtain the prior permission from the Central Government to further accept any foreign contribution from the date of issue of the order until further orders.

7. The following issues emanating from the analysis of circumstances of the case demand detailed deliberation:-

***7.1 Do you think that the current framework of the submission of information by the associations, registered under the Act or those who have obtained prior permission provided under the Act; is sufficient and provides adequate opportunity to analyse the facts to gauge the irregularities in utilization of foreign contribution funds? Do you think that format as prescribed under Form FC - 3 is alright or does it require amendments to provide the required information in a more meaningful manner?***

***7.2 In the instant case, what more, do you think, could have been done considering the arithmetic discrepancies noticed in the Form FC-3?***

***7.3 Is the extant dispensation regarding certification of Form FC - 3 adequate? Or the chartered accountant should be required to audit the accounts of the associations relating to receipt and utilization of foreign contribution? Should not the Ministry seek certification from a chartered accountant in respect of satisfying himself that the foreign contribution funds have been utilized for the purpose intended?***

***7.4 Should not the Ministry impress upon the associations to adhere to the accounting standards issued by ICAI for their income generating pursuits?***

***7.5 Does the magnitude of the transactions undertaken by the associations accepting the foreign contribution for proclaimed usage warrant assumption of a stricter role by the Ministry? Should the exercise of punitive powers be made mandatory, considering the instances replete with contraventions, to which the recourse is seldom witnessed?***

***7.6 Do the laws relating to foreign contribution stand the test of contemporary dynamics? Is the amendment in the framework warranted?***

***Source:***

***Joint Seminar on Foreign Contribution (Regulation) Act, 1976***

***Case Studies on Foreign Contribution Regulation Act 1976***

***Ministry of Home Affairs, Government of India & The Institute of Chartered Accountants of India***