Chapter – 1

ACCOUNTING FOR NOT-FOR-PROFIT ORGANISATIONS

Accounting is always done with respect to an entity. This entity may be either commercial entities or not-for-profit entities. Not-for-profit entities are not engaged in business activities. The main aim is to provide services to the people without an intention of making profit. They stand for achieving social, cultural, educational, religious or charitable objectives. Sports club, Social organizations, religious institutions, hospitals, educational institutions, professional bodies, libraries etc. are the examples of not-for-profit organizations.

Some not-for-profit entities may undertake trading activities in order to add the income to its working fund. The income obtained from such activities is used for attaining their objectives. For instance, a sports club may run a stationary shop. The income so obtained can be used for developmental activities of the club.

Differences between Commercial entities and not-for-profit entities

Basis	Commercial entities	Not-for-profit entities
1. Motive	To earn profit	To render service
2. Status	Proprietors or owners	Subscribers or members
3. Distribution or profit	Among the owners	Not distributed to any one
4. Result of activities	Profit or loss either withdrawn or retained in the business	Surplus or deficit, which cannot be withdrawn by the members
5. Accounting statements	Manufacturing or Trading account, Profit and loss account and Balance Sheet	Receipts and payments account, Income and expenditure account and Balance sheet
6. Accounting system	Accrual system	Hybrid system (combination of accrual and cash system)

Characteristics

1. Providing service to a specific group such as education, healthcare etc.
2. Organized as charitable trusts or societies and subscribers are called members.
3. Managed by a managing committee elected by the members.
4. Sources of income – subscription from members, donations, legacies, grant-in-aid etc.
5. Funds raised by such organizations are credited to capital fund or general fund.
6. Surplus is not distributed to the members, rather credited to capital fund.
7. They earn reputation not on the basis of customers' or owners' satisfaction, but on the basis of their contribution to the welfare of the society.
8. Records maintained are meant for members as well as to meet statutory requirement.

Accounting Records of Not-for-profit organizations – As the not-for-profit organization is a different type of entity, it needs a different type of accounting procedure. They receive money from its members and other agencies to promote their activities, and they want to know from where the funds are generated, how these funds are utilized and whether there is any surplus or deficit. They are required to maintain a stock register with a complete record of assets and consumables. They do not have a capital account; instead, they maintain a capital fund which includes surplus generated, life membership fees, legacies, donations, grant from government etc.

Final Accounts or Financial Statements

These organizations are also bound to prepare their financial statements at the end of each accounting period. Since they are not carrying out any trading activities, they need not prepare trading and profit and loss account. But they would be interested to know whether the income is sufficient to meet the expenses, and is there any surplus or deficit, for this purpose they prepare the following statements:-

1. Receipt and Payment Account.
2. Income and Expenditure Account.
3. Balance Sheet.

Receipts and Payment Accounts – It includes all cash receipts and cash payments. It is similar to a cash book and hence it serves the purpose of a cash book. All cash transactions whether revenue or capital in nature are accounted. This account begins with opening cash balance and ends with the closing cash balance.

Preparation of Receipts and Payments Accounts – While preparing a Receipts and Payments account, the following points are to be taken into account:

1. This account is always starts with opening balance of cash in hand and cash at bank. Cash in hand always has a debit balance and hence in debit side whereas cash at bank has either debit or credit balance.
2. All receipts made in cash during the accounting year will be shown on the debit side and all cash payments on the credit side. The nature of transaction i.e. capital or revenue and the period to which the transaction may belong i.e. previous year, current year or future year will not be considered.
3. Only actual cash receipts and cash payments are recorded in this account. All non-cash items such as depreciation on fixed assets, outstanding expenses, outstanding incomes, etc. are not recorded.
4. At the end of accounting period, this account is balanced and it shows the closing balance of cash in hand and at bank or bank overdraft.
5. As the receipts and payments account is maintained under cash system, it serves the purpose of a cash book. So that the management is able to know from where cash was generated and how it was utilized. Also it provides necessary information for the preparation of Income and Expenditure account and Balance Sheet.

Assignment: Format of Receipts and Payments Account and Income and Expenditure Account and the Balance Sheet of Not-for-Profit organizations.

Items of Receipts and Payments Account – The items of receipts and payments account may be classified as 1. Revenue Receipts, 2. Capital Receipts, 3. Revenue Payments and 4. Capital payments.

1. **Revenue Receipts –** These are the amounts received by the organization on a recurring nature.

a. Annual membership subscription.
b. Admission fee not capitalized.
c. Receipts from sale of old news papers and magazines.
d. Hall rent received.
e. Interest received on investment, fixed deposits and loan advanced.
f. Donations, grants and legacies (receipt as per the will of a deceased person).
g. Locker rent, cloak room rent received.
h. Receipts from sale of refreshment.
i. Any other items of similar nature.

2. **Capital Receipts –** These are the amounts received during the current year, the benefit of which will relate to future years also. Such receipts are not received at regular intervals. They include:

a. Donations from outsiders or members for specific purpose.
b. Amount received as loans.
c. Life membership subscription.
d. Admission fees to the extent capitalized.
e. Sale proceeds of fixed assets.
f. Legacies for specific purposes.
g. Grants received from Government for meeting capital expenditure. E.g. construction of a Library building.
h. Any other receipts of capital nature.

3. **Revenue Payments –** These are the payments of recurring nature and to be paid at regular intervals.

a. Salaries, wages and honorarium paid.
b. Travelling and conveyance allowances.
c. Rent, taxes, insurance, electricity charges, printing and stationary, postage and telegram, repairs etc.
d. Payments for organizing sports meets and tournaments.
e. Payments for purchase of refreshment, dinner etc.
f. Interest paid on loan and on bank overdraft.
g. Any other payment of revenue nature.

4. **Capital Payments –** These are the payments made during the current period, the benefits of which are available in the future years also. They are not made at regular intervals.

a. Construction expenses.
b. Purchase of fixed assets like furniture, office equipments etc.
c. Purchase of books for library.
d. Amounts advanced to outsiders as loans.

e. Purchase of sports goods and equipments.
f. Any other payments of capital nature.

Income and Expenditure Account – Not-for-profit organizations prepare Income and Expenditure Account which is similar to a Profit and Loss Account of a trading concern. It is a nominal account and is debited with all expenses or losses and credited with all incomes and gains. At the end of the accounting year, if the credit side of the account exceeds the debit side (income over expenditure), it results in '**surplus**' and if the debit side exceeds the credit side (expenditure over income) it results in '**deficit**'.

The surplus has to be either added to capital fund or can be utilized in the manner provided in the specific provisions of such organization and similarly the deficit decreases the capital fund.

Preparation of Income and Expenditure Account – While preparing income and expenditure account, the following points are to be considered:

1. It is usually prepared in "T" form taking revenue expenses on debit side and revenue incomes on credit side.
2. It can also be prepared in vertical form, showing revenue incomes first and revenue expenses next. Total of expenses is deducted from total of incomes for ascertaining surplus or deficit.
3. Only revenue items are taken into consideration and capital items are totally excluded.
4. Since it is maintained under accrual basis, current year's income and expenditure alone are shown. So the revenue receipts and payments relating to previous year(s) and future year(s) are to be adjusted.
5. Outstanding expenses, accrued incomes, prepaid expenses, income received in advance, depreciation, provisions etc. in the current year are to be adjusted.
6. At the end of the accounting year the income and expenditure account is balanced and it reflects surplus or deficit which is transferred to capital fund. Surplus increases the capital fund and deficit decreases the capital fund.

Balance Sheet for Not-for-profit organizations – After preparing the income and expenditure account, a balance sheet or statement of affairs is prepared to ascertain the financial position at the end of the accounting period. This is prepared in usual manner by showing the assets on the right hand side and the liabilities on the left side. Quite often, there may not be any formal capital for a non-trading concern. The excess of assets over liabilities is called capital or general fund. This is made up of surplus of income over expenditure and certain items which are capitalized. Further, all funds raised for specific purposes are shown separately on the liabilities side.

Procedure for preparing Balance Sheet:

1. Find out the capital fund at the commencement (unless it is the first year of operation). For this, an opening balance sheet is prepared, setting out the liabilities on one side and assets on other side. The difference shows capital fund in the beginning.
2. Adjust the capital fund for surplus or deficit during the year and also adjust the items to be capitalized.
3. Bring forward previous year's liabilities, if they are still outstanding.

4. Show the closing balance of Receipts and Payments account, i.e. cash in hand and at bank on the assets side (unless it is overdraft).
5. Assets which already exist in the books in the beginning of the year should be adjusted for additions and disposal, if any, made during the year and also for any depreciation charged on such assets.
6. Show new assets acquired if any during the year. This can be traced from the payment side of receipts and payments account.
7. If there are any fresh liabilities incurred during the year should be shown on the liabilities side.
8. Outstanding assets such as incomes accrued, expenses prepaid etc. should be shown on the assets side.
9. Outstanding liabilities such as incomes received in advance, outstanding expanses etc. should be shown on the liabilities side.

Income and Expenditure Account Vs. Receipts and Payments Account

No.	Basis	Income & Expenditure A/c	Receipts & Payments A/c
1	Nature	It is like a P&L A/c	It is the summary of cash book
2	Nature of Items	It records income and expenditure of revenue nature	It records receipts and payments of revenue and capital nature
3	Period	Items related to the current period only	Items related to preceding and succeeding periods
4	Debit Side	Records expenses and losses	Receipts are recorded
5	Credit Side	Records incomes and gains	Payments are recorded
6	Depreciation	Includes depreciation	Does not include depreciation
7	Opening Balance	No opening balance	Opening Balance represents Cash in hand / at Bank or Overdraft at the beginning
8	Closing Balance	Balance represents surplus or deficit	Closing Balance represents Cash in hand / at Bank or Overdraft at the end

Differences between Income & Expenditure A/c and Profit & Loss A/c:

No.	Basis	Income & Expenditure A/c	Profit & Loss A/c
1	Type of organization	It is prepared by not-for-profit organizations.	By profit seeking (trading) organizations.
2	End result	Surplus or deficit	Profit or loss
3	Distribution of surplus or profit	The surplus cannot be distributed among the members, but it is added to the capital fund.	The owners are entitled to profit.

Treatment of some peculiar items:

1. **Subscription –** Current year subscription is to be calculated and it is shown on the credit side of Income and Expenditure Account. Whereas, subscription received for some <u>specific purpose</u> like subscription for tournament fund, subscription for construction of a building etc. should be capitalized and hence shown on the liability side of the Balance Sheet.

2. **Donation**

a. Specific donation – Donation for building, donation for library etc. must be treated as capital receipt and shown on the liability side of balance sheet.

b. General donation – Given for general purpose, if it is a large amount it should be capitalized and shown on the liability side and if it is a small amount it can be shown on the credit side of I&E account.

3. **Grant** received from central govt., state govt. or local bodies for day to day expense are treated as income. But grant for specific purpose like construction of a building is to be capitalized.

4. **Legacy –** It is the amount received as per the will of a deceased person. It is a capital receipt and shown on the liability side. But if it is a small amount, it may be treated as income. In the absence of specific information, it is preferably be capitalized.

5. **Endowment fund –** Fund meant for providing permanent means of support. It is a capital receipt.

6. **Entrance fee –** It is the amount of fees collected on the admission of members. Some Accountants argue that it should be capitalized as it is collected only once (non-recurring), but others argue that the organization receives this amount regularly in every year because of regular entry of members, so it should be shown as an income. In the absence of correct information, students may treat it any way, but they must append a note justifying the choice.

7. **Sale of old assets –** The amount realized from the sale of an asset must be capitalized. But if there is a profit or loss, it should be treated as income or expenditure.

8. **Sale of newspapers, periodicals etc.** – It should be treated as an income.

9. **Expenditure stock items –** Items like stationery, sports materials like bats, balls etc. are called expenditure stock items. The value of such items used is considered as expense and the value of unused items are treated as assets.

10. **Sale of scrap, grass etc.** – These are treated as income.

11. **Life membership fee –** It is a lump sum amount received from certain members towards life membership instead of annual subscription. It should be capitalized as it is a capital receipt.

12. **Special purpose fund –** E.g. Tournament fund, Charity fund, Prize fund, Endowment fund etc. If there is any expense or income relating to that fund, it should not be shown in the Income and Expenditure account, but adjusted to that fund on the liability side as follows:

	Dr.	Cr.
Tournament fund		15000
Tournament fund investment	15000	
Tournament expanse	1750	
Tournament income		1400
Interest received on tournament fund invt.		1200

Here, tournament investment Rs.15000 will be shown on the assets side of the balance sheet. Whereas, the tournament fund will be shown on the liability side as follows:

Tournament fund	15000	
Add: Tournament income	1400	
Add: Interest on Tournament fund invt.	1200	
	17600	
Less: Tournament expenses	1750	15850

Precautions to be taken while preparing Income and Expenditure Account

1. Income and Expenditure account for the year should show the income and expenditure for that year only.
2. If current year's income includes income of previous year and next year, it must be deducted.
3. If current year's expenditure includes expenses of previous year or next year, it must be deducted.
4. Generally we assume that outstanding expenses for the previous year must have been paid during the current year. Similarly, outstanding income of the previous year must have been received during the current year.
5. If any income received in advance in the previous year, it should be considered as the income of the current year.

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