Non Profit Organization

Meaning of NPO

Not-for-Profit Organizations (NPO) are set up with the prime objective of providing services and not to earn profit thereby enhancing the welfare of society. Such organizations include schools, hospitals, trade unions, religious organizations, etc. The person/s or the groups of individuals who govern and manage the working of an NPO are known as trustees. NPO's main sources of income are donations, subscriptions, life membership fees, grants etc. As these organizations are not set up with profit motive, they do not prepare Trading and Profit and Loss Account. Instead, they maintain Receipt and Payments Account, Income and Expenditure Account and Balance Sheet.

Examples of non-profit organizations

Charitable organizations such as Human rights groups, animal right organizations, Hospitals, health care clinics, Emergency relief services such as Red Cross, charitable schools / colleges etc.
Professional Associations and Trade Associations such as chamber of commerce, Association on American Indian Affairs, American Lung Association, Association for Firefighters and Paramedics, Teacher's Retirement fund Associations etc.
Religious organizations for example churches, mosques, Islamic International Foundation of Cooperation (IslamIFC)
Welfare organizations and clubs such as Calgary women's emergency shelter, Institute of Field Research Expeditions, sports club, social clubs etc.
Scientific groups such as general research groups, cancer research groups, chemistry research group

The Final Accounts of non-trading concerns consists of:

1. Receipts and Payments Account
2. Income and Expenditure Account, and
3. Balance Sheet.

1. Receipts and Payments Account:

It is a Real Account. It is a consolidated summary of Cash Book. It is prepared at the end of the accounting period. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side .Cash Book consisting of entries of receipts and payments in a chronological order while the Receipts and payments is a summary of total cash receipts and cash payments. It starts with opening balance of Cash and Bank and ends with closing balance of Cash and Bank. It does not take into account outstanding amounts of receipts and payments. Receipts and Payments may be of Capital or Revenue nature; they may relate to the current or previous year or subsequent year; so long as they are actually received or paid, they must appear in this account.

Summary Features of Receipts and Payment Account,

1. It starts with opening balance and ends with closing balance

2. It is the summary of cash and bank transactions.
3. Actual cash transactions are entered.
4. It includes capital as well as revenue items
5. It follows cash system of accounting
6. It shows cash position and excludes all non-cash items.
7. It is a real account.
8. It does not take any income/expense outstanding at the beginning or at the end.

Features of Receipt and Payment Account in briefs:

The following are the features of Receipt and Payment Account:

1. ***Nature***: It is a Real Account. It is a summarized version of Cash Book.

2. ***Nature of Transactions***: It records only cash and bank transactions. Transactions other than cash and bank like depreciation, loss/ profit on sale of assets, etc. are not recorded in this account.

3. ***No distinction between Capital and Revenue items***: It records all cash and bank receipts and payments of both capital and revenue nature.

4. ***Opening and closing balance***: It begins with the opening balance of cash and bank and ends with the closing balance of the cash and bank (balancing figure) at the end of the accounting period.

5. ***Purpose***: It reveals the cash position of an organization. It helps to ascertain the total amount paid and received during an accounting period.

2. Income and Expenditure Account:

It is a Nominal Account. It is in the form of Profit and Loss Account. It is concerned with only revenue items—expenses and incomes. It records all losses and expenses on its debit side and all incomes and gains on its credit side. Of the incomes and expenses of revenue nature, only the portion pertaining to the current year is shown in the Income and Expenditure Account i.e. amount relating to the previous year or future year are excluded. Again, the incomes and expenses of current year, whether received or not, must be shown. In other words, incomes and expenses have to be adjusted for both out-standing and pre-payments. All non-cash items, Depreciation, Bad Debts, Provision for Doubtful Debts etc. are taken into account.The difference between the debit side and the credit side is either surplus or deficit for the year concerned and the difference will be transferred to the Capital Fund (also called General Fund or Accumulated Fund) appearing in Balance Sheet.

Summary Features of Income and Expenditure Account

1. It is prepared in lieu of Profit and Loss Account.
2. It is a nominal account.

3. It is based on mercantile system of accounting.
4. There is no opening balance.
5. It ends with Surplus or Deficit.
6. It excludes all capital income and capital expenses.
7. It includes only revenue items.

8. It records all expenses whether paid or not, and all incomes whether received or not.

Features of Income and Expenditure Account in brief:

The following are the basic features of Income and Expenditure Account

1. ***Nature***: It is a Nominal Account. The debit side of I&E records all expenses and losses and the credit side records all incomes and gains related to the current accounting period.

2. ***Basis***: It is prepared on the basis of Receipt and Payment Account (R&P). All the revenues items whether incomes or expenditures are transferred from R&P.

3. ***Excludes Capital Transactions***: The transactions those are capital in nature are excluded from this account. For example, only profit or loss on sale of fixed assets is recorded but the total amount of sales is not recorded since sale of fixed asset is considered as a capital receipt.

4. ***Akin to Profit and Loss Account***: Income and Expenditure Account (I&E) is similar to the Profit and Loss Account in the sense that while the former is prepared to ascertain surplus or deficit during an accounting period the latter is prepared to ascertain net profit or net loss incurred during an accounting period.

5. ***Records only Current Year's items***: This account records only those transactions that are related to current accounting year. In other words, transactions related to the preceding or succeeding accounting period are excluded even if these transactions are realized in the current period.

6. ***Adjustments***: Various cash and non-cash items like, outstanding expenses, prepaid expenses, income received in advance, income due but not received, depreciation, bad debts, etc. can be adjusted in this account.

7. ***Balancing Figure***: The balancing figure of this account is expressed in terms of either surplus (if incomes > expenses) or deficit (if expenses > incomes). The surplus balance, if any, is added to the Capital Fund, whereas, the deficit balance, if any, is deducted from the Capital Fund.

3. Balance Sheet:

Balance Sheet in case of non-trading concern is prepared in the usual manner and consists of all liabilities and assets on the date on which it is prepared. The excess of assets over liabilities is termed Capital Fund or General Fund. Again, The Capital Fund are accumulated with Capital Receipts, Receipts that are capitalized and further increased by surplus or decreased by deficit, during the

year. At the inception of a non-trading concern, there will be no formal Capital Fund and in such case, the Surplus, if any, earned during the year constitute the Capital Fund at the end of the year.

Steps are taken to prepare Income and Expenditure Account (I&E) from Receipts and Payment Account (R&P).

The following steps are taken to prepare Income and Expenditure Account (I&E) from Receipts and Payment Account (R&P).

Step 1: All the revenue expenditures paid for the current accounting period are transferred from the Payments side of R&P to the Expenditure side of I&E.

Step 2: All the revenue receipts for the current accounting period are transferred from the Receipts side of R&P to the Income side of I&E.

Step 3: Expenses outstanding for the current period and expenses paid in advance (prepaid expenses) for the current period in the preceding accounting periods are to be added (adjusted) to their related expenses in the Step 1.

Step 4: Income outstanding (accrued income) for the current period and income received in advance for the current period in the preceding accounting periods are to be added (adjusted) to their related incomes in Step 2.

Step 5: Non-cash items like depreciation, appreciation for the current accounting period are to be adjusted in the I&E.

Step 6: After adjusting all the revenue items for the current accounting period, the Income and the Expenditure sides are totaled. If the sum total of the Income side exceeds (or is lesser than) the sum total of the Expenditure side, then the balancing figure is termed as surplus (or deficit).

Distinguish between Receipts and Payments Account and Income and Expenditure Account.:

Basis of Difference	Receipts and Payments Account	Income and Expenditure Account
1. Nature	It is a summary of cash and bank transactions	It is a summary of current year income and expenses
2. Revenue and Capital	It records transactions related to both revenue and capital nature.	It records transactions related to revenue nature only.
3. Debit Side	Debit side of this account records cash and bank receipts during an accounting period.	Debit side of this account records expenses and losses incurred in the current accounting period.
4. Credit side	Credit side of this account records payments in cash and through cheques.	Credit side of this account records income and gains earned in the current accounting

		period.
5. Type of account	It is a Real Account	It is a Nominal Account
6. Period	It records receipts and payments made during the year that may be related to the current accounting period or the preceding period and the succeeding accounting period.	It only records income and expenditure made during the current accounting period.
7. Object	This account depicts the cash position of an NPO.	This account shows the net result in terms of surplus or deficits due to the business activities during the year.
8. Opening Balance	This account begins with the opening balance of cash in hand and cash at bank or overdraft.	Usually, it has no opening balance but sometimes surplus or deficits forwarded from the last accounting period (if not added to the Capital Fund) can be shown as the opening balance of this account.
9. Closing balance	The balancing figure of this account is expressed in terms of the closing balance of cash in hand and cash at bank or overdraft.	The balancing figure is expressed in terms of either surplus (if incomes > expenses) or deficit (if expenses > incomes).
10. Depreciation	It does not include non-cash items like depreciation, appreciation, etc.	It includes non-cash items like depreciation, bad-debts, provisions, etc. in order to ascertain the actual net profit or net loss.
11. Adjustment	Receipts and Payments during the year can be adjusted before preparation of the financial statements.	Adjustments regarding both cash and non-cash transactions can be made.
12. Transfer of Balance	The opening balance of this account is brought forward from the last year's Receipts and Payments Account and the closing balance of this account is carried forward to the subsequent year's Receipts and Payments Account and is shown in the Balance Sheet of the current accounting period.	If the closing balance of this account is surplus then it is added to the Capital Fund in the Balance Sheet. If the closing balance is deficit then it is deducted from the Capital Fund in the Balance Sheet.
13. System	It is prepared on cash basis.	It is prepared on accrual basis.

Some important definitions

i) Annual Subscription

a) Subscriptions received during an accounting year (whether related to the current year or previous and subsequent year) are shown on the debit side of the Receipts and Payments Account.

b) Subscription amount related to the current accounting year only, whether received or yet to be received are shown on the credit side of the Income and Expenditure Account.

c) Subscriptions received in advance for the subsequent year are shown on the Liabilities side of the Balance Sheet.

d) Subscriptions due but not received are shown in the Assets side of the Balance Sheet.

ii) Donation

There are two types of donations: General donations and specific donations

1. Specific donations

Specific donations are donations for a specific purpose

a) The amount received for specific donation is shown on the debit side of the Receipts and Payments Accounts.

b) The amount received for specific donation is shown on the Liabilities side of the Balance Sheet as it is used for the specific purpose for which it is received.

For example, Mr. X donated RS 50,000 to a charitable school in order to help school in buying new furniture. In this case, helping school to buy new furniture is the specific purpose of donation

2. General donations

Donations without a specific purpose are general donations. Such donations can be used by non-profit organizations for any purpose

Both specific and general Donations received during an accounting period are generally considered as income/revenue for that accounting period and they are shown in an income and expenditure account

iii) Sale of fixed assets

a) The amount received from the sale of fixed assets are recorded on the debit side of the Receipts and Payments Account.

b) Profit (or loss) on the sale of fixed assets is credited (or debited) to the Income and Expenditure Account.

c) The book-value of the fixed assets sold is deducted from its respective assets on the Assets side of the Balance Sheet.

iv) Sale of old periodicals

a) The amount received from the sale of old periodicals are shown on the debit side of the Receipts and Payments Account.

b) As the sale of old periodicals by any organization is considered as revenue receipts, so it is shown on the credit side of the Income and Expenditure Account.

v) Sale of sport Materials

a) The amount received from the sale of sport materials are debited to the Receipt and Payments Account.

b) As the sale of sport materials by any sport club is considered as revenue income, so it is shown on the credit side of the Income and Expenditure Account.

vi) Life Membership Fees

a) The amount paid by a person to become a member of an organization is called life membership fees. As this is a receipt for an NPO, so it is debited to the Receipt and Payment Account.

b) Life Membership fees is not recurring in nature and received once for a whole life from a member. Thus, as Life Membership Fees are capital receipts, so these are added to the Capital Fund on the Liabilities side of the Balance Sheet.

Vii) Entry fees

When a new member gets admission in a non-profit organization, the non-profit organization may require him/her to pay a certain amount of fee in order to be a member of non-profit organization Fee received in an accounting period is generally considered as revenue/income for that accounting period. Therefore, it is reported in an income and expenditure account

Viii) Legacy

Legacy is the property or money received by the non-profit organization as stated by the will of a deceased person. For example, Mr. Z declared in his will to donate his house and car to a non-profit organization.

IX) Honorarium

Honorarium is a payment to a person for his/her services that are generally supposed to be performed voluntarily. In other words, an honorarium is a payment to a person for his/her services which are customarily not required any fee or money to be paid. For example, a person (an outsider) got paid RS 500 (honorarium) for giving a good lecture to the students of a non-profit college

X) Endowment Fund

An endowment fund is an investment fund established by a foundation that makes consistent withdrawals from invested capital. The capital in endowment funds, often used by universities, nonprofit organizations, churches and hospitals, is generally utilized for specific needs or to further a company's operating process. Endowment funds are typically funded entirely by donations that are deductible for the donors.

What is subscription? How is it calculated?

Subscription is the main source of income for an NPO besides entrance fees, donations, grants, etc. Subscriptions refer to the amount of money paid by the members on periodic basis for keeping their membership with the organization alive. It is paid monthly, quarterly, half yearly or annually by the members. It is shown in the debit side of the Receipt and Payment Account with the total amount received during the year that may be related to the current period and to the previous and next accounting period. While calculating subscription for the current period, advance subscription received for the current period in the previous period and outstanding subscription for the current period are added to the subscription received during the current period. Whereas, on the other hand, advance subscription received for the next accounting period during the current period and outstanding subscription for the preceding period are deducted from the subscription received during the current period.

<u>Calculation of Subscription</u>

Subscription received during the year		***
Add: Subscription received (in advance) during previous year for current year	***	
Add: Subscription outstanding at the end of the year	***	
		***
Less: Subscription received in advance for the next year	***	
Less: Subscription outstanding for the previous year	***	***
## **Subscription shown in Income and Expenditure Account**		***

This subscription is related to the current accounting period and is shown in the Income side of the Income and Expenditure Account.

What is Capital Fund? How is it calculated?

Capital fund is the excess of NPOs' assets over its liabilities. In other words, the excess of assets over the liabilities for a profit earning organization is termed as capital and the same for an NPO is termed as capital fund. Any surplus or deficit ascertained from Income and Expenditure account is added to (deducted from) the capital fund. It is also termed as Accumulated Fund.

<u>Calculation of Capital Fund</u>

Capital Fund at the beginning of the year		**
Add: Surplus from Income and Expenditure Account	**	
Add: Subscription Amount (Capitalized amount)	**	
Add: Life membership fee.	**	**
Less: Deficit from Income and Expenditure Account		**
Capital Fund at the end of the year		***

<u>Calculation of Cost of consumable goods</u>

Total payment made during the year	**********	
Add: Opening stock of material	**********	
Add:- Advance made in beginning of year(Opening)	**********	
Add:- Creditors at the End of year (closing)	**********	
***********		
Less: Closing Stock of Material		********
Less: Advance made at the end of year (closing)		********
Less:- Creditors At the beginning of year(Opening)		*******
************		
Amount to be Shown in Income and Expenditure		

Calculation of Current revenue Expenditure

Total Expenses paid during the year	********
Add: outstanding Expenses at the end of year (closing)	********
Add: Prepaid Expenses at the beginning of year (opening) ******	*******
Less: outstanding Expenses at the beginning of year (opening) (******)	
Less: Prepaid Expenses at the end of year (closing) (******)	
Current year expenses debited to income & expenditure *******	