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ACCOUNTING FOR NON-PROFIT ORGANISATIONS AND AN OVERVIEW OF GOVERNMENT ACCOUNTING SYSTEM

5.1 Accounting for Non-Profit Organisations:

5.1.1 Introduction

In the preceding chapter, we have discussed about the principles of accounting. Although the principles of accounting are common to profit-seeking and non-profit organizations, these are ordinarily generated keeping in mind the operations of profit-seeking organizations. There are certain special features of accounting for non-profit organizations, which we shall explain in this chapter.

The primary objectives of accounting are to maintain the records of income and expenditure and provide information to the management for planning and control. The primary purpose of accounting is to enable the management to maintain expenses within available revenue of that organization. The working of Panchayats is very much similar to that of non-profit organizations. Both are engaged in serving people without the objective of earning profit. So, the accounting system of non-profit organizations may be similar to that of Panchayats in many respects. That is why, we are discussing here in brief the basic concepts of the accounting of non-profit organizations.

The accounting and reporting practices of an organisation are very much influenced by the primacy of certain elements as essential foundation of accounting. However, the elements of the financial statements generally differ according to the methodologies used and the basic objective of the entity. In fact, at present there does not exist any universally accepted unified comprehensive accounting theory containing an exhaustive set of all possible principles that can meet the needs of all accounting entities. The principles and practices of accounting of profit-seeking organisations naturally differ, at least in certain
aspects, from those of non-profit organizations. The main objective of accounting of profit organizations is to find out the profit or loss during the period and the position of assets and liabilities at the end of the period. Whereas the principal purpose of accounting of non-profit-seeking organizations is to render an account of the ways in which the resources are accumulated and of the avenues of utilising such resources to carry out the organisation’s objectives and ultimately, to determine the net balance during the period. In case of non-profit organization, the focus is on the expenses and imposition of necessary budgetary or other methods of control so that expenses are within the estimated incomes. But, in case of profit-making organization focus is on the surplus generation by controlling expenses and enhancing sale. In the following pages, we shall make a brief discussion on the accounting principles and practices adopted by the non-profit organizations.

5.1.2 Basis of Accounting

The basis of accounting is the set of rules that determines when revenues, expenditures, expenses and transfers and related assets and liabilities are recognized in the accounts and reported in the financial statement.\(^{(2)}\) There are three methods, which are generally used to determine when various amounts are transacted and placed in the accounting records. They are (i) Cash Basis; (ii) Accrual Basis; (iii) Modified Accrual Basis.

(i) Cash basis of accounting is a system where only the cash transactions are taken into consideration. Many non-profit entities still adopt the cash basis of accounting because they often do not want to recognise income prior to the actual receipt of cash.\(^{(3)}\) It is easy to follow and record the transactions.

(ii) In accrual basis, it is the principle of accrual which constitutes the basis of recognition of revenues and expenses. Under this method, the financial position of an organization can be portrayed on a more realistic basis. Moreover, the matching principle is adopted here for reporting the various revenues and related expenses of such entities in their financial reporting.\(^{(4)}\)
(iii) The modified accrual basis of accounting is adopted by some non-profit organizations. In this method of accounting, incomes are recognized when they are received in cash but amounts payable are recorded as liabilities on accrual basis. This practice is a highly conservative one in that it makes a provision for liability, but does not recognize a promise for subscription or donation as gain until it is realized in cash.

5.1.3 Fund Accounting

The concept of Fund Accounting is based on the principle of segregating resources into a number of self-balancing sets of accounts on the basis of restrictions imposed by the contributors and governing bodies. The term 'fund' refers to a sum of money or other resources segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations, restrictions, or limitations and constituting an independent fiscal and accounting entity. Generally, most of the non-profit organizations follow the concept of fund accounting in view of the cherished belief that this method of accounting is the most appropriate one in exercising the stewardship control over funds. Earlier, various funds were treated as completely separate accounting entities and were represented separately in the Balance Sheet for different funds. Now-a-days, most of the non-profit-seeking organizations follow the method of eliminating the several funds and combining and consolidating them in a restricted number. The funds under the broad headings are:

(a) **Unrestricted Operating Fund**: The income under this fund can be used in any manner, and at any time to achieve the desired objective of the organization.

(b) **Current Restricted Operation Fund**: Here, the resources available to the organization can be expended for specific operating purposes only.

(c) **Fixed Assets Fund**: The fund is restricted by the authority to be used only for the additions to fixed assets. Depreciation may be provided on such assets and in that case, the depreciation is charged to this fund account.
(d) **Endowment Fund**: The interest accrued from this fund, keeping the principal preserved, can be utilised for restricted or for general purposes.

(e) **Expendable and Non-expendable Fund**: Where the entire resources of expendable funds may be expended for current operation, the principal under the non-expendable funds must be maintained intact.

(f) **Reserve Fund**: This fund is created primarily out of short-term income and can be categorized into general funds and specific or special purpose funds.

(g) **Working Capital Fund**: This fund is formed by contributors or transfer from other funds and can be utilised for purchase of assets or for repayment of loan.

(h) **Capital Project Fund**: This fund is created through the issue of special bonds and receipts of grants from government for specific capital project.

### 5.1.4 Accounting for Fixed Assets

As fixed assets play a vital role in the functioning of a non-profit organization, accounting for fixed assets forms an important part of accounting literature. Accounting for fixed assets is necessary for representing in the balance sheet the value of resources available to the entity, and secondly for recovering from the sales revenue the consumed portion of the assets by way of changing depreciation. Generally, three alternatives are used by the non-profit organizations for accounting for fixed assets. They are: (i) Immediate write off; (ii) Capitalisation of fixed assets; (iii) Write off and capitalisation.

### 5.1.5 Accounting for Depreciation

In fact, depreciation is the distribution of the cost of an asset over its estimated life. It is charged on the assets to reflect the fair value of the asset on the financial position statement. In non-profit organizations, where profit is not a major concern, depreciation is not charged to the income and expenditure account (Statement of Revenue and Expenses). Apart from that, there is no obligation to amortise or write off the cost of the investment over its estimated life. However, the generally accepted accounting principles are in
favour of charging depreciation on the fixed assets of non-profit organizations on the following grounds:-

- The net revenue earned during a specific period cannot reflect the true picture unless depreciation is taken into account.
- It helps in measuring the actual cost of services rendered or goods purchased.
- Where the non-profit organizations are under legal obligation to pay income tax to government, depreciation should be taken into consideration as an item of expenses to reduce tax liability.

The system of accounting for depreciation, in case of non-profit organizations, when applied, should be similar to what is followed in profit-seeking organizations. If the costs of fixed assets are capitalised and the depreciation is not charged for the year in the accounting statement, the balance sheet figures will be overstated. Hence, it is better to charge depreciation in accounting of non-profit organizations.

5.1.6 Financial Reporting

The financial reporting of an organization should be such as to provide satisfactory information appropriate for fair disclosure and should be most suitable to the organization's need, in conformity with its objectives and constituents. The following three statements are generally used by the non-profit organizations for their financial reporting:-

- Balance Sheet.
- Statement of Activity.
- Statement of Changes in Financial Position.

The balance sheet of a non-profit organization reflects the financial position of the organization by showing the assets, liabilities and fund balances at the end of the accounting period. The balance sheet generally contains resources, obligations and residual claims.
Through the statement of activity, the non-profit organizations show the result of all the financial activities from the beginning to the end of an accounting period. This statement is also named as statement of support, revenue and expenses, capital additions or simply statement of changes in fund balance. The income and expenditure account, as practised by the non-profit organizations in India and U.K., is similar to this statement. Since these entities are not for earning profit, the account is maintained to determine the surplus generated or deficit incurred during an accounting period.

The statement of changes in financial position provides the interested persons with information about the changes in fund balance, including a summary of available resources and their use during the period. The non-profit organizations in India provide such information through the receipts and payments account showing the receipts as debit entries and payments as credit entries in the statement. Finally, the closing balance represents the cash and bank balances at the year end.

5.1.7 Using Financial Reports

Various people are interested in the information portrayed in the financial reports of the non-profit organizations. The following groups are especially interested in the financial reports.

✓ Resource Providers: Resource providers comprise those who are directly indemnified for providing money and wealth to the entities. They include contributors, suppliers, members and the employees of the organization. They may be interested in information as a basis for appraising how well the entity has met each objective. If these people are not satisfied with appropriate information on how the resources are utilized, then the future contribution and services on their part may become uncertain. In case of Gram Panchayats, the main resource providers are Government, elected persons and other employees of Gram Panchayats. In this case, money and materials are not only the resources, time, labour and skill are also treated as resources.
Constituents: Constituents refer to those who are benefited by the services rendered by the non-profit organizations. In case of some non-profit organizations, constituents include resource providers. However, in some organizations, resource providers are separated from the service beneficiaries. These constituents are interested in the availability of desired services and value on providing such satisfactory services. In case of Gram Panchayats, the constituents are rural people. They must have to know the effectiveness of Gram Panchayats.

Granting Agencies: The granting agencies are also concerned with the financial report of the non-profit organizations. The inflow of resources of such entities generally comprise contributions, grants from local government and payment from third parties. Sometimes grants may be used according to the restrictions imposed by the funding agencies. The non-profit organizations generally follow the accounting principles based on the stewardship accounting concept and provide the most acknowledged report.

5.1.8 Conclusion

The accounting and reporting practices of any organization, whether profit-seeking or not, are very much influenced by its objectives. The financial statement of a profit-seeking organization generally reveals the profit earned or loss incurred during a particular period of time, whereas the report published by the non-profit organizations portrays the various sources of funds and how the resources have been utilised according to the restrictions imposed by the funding authorities. But, there are some areas which are not exposed in the traditional accounting reporting of the non-profit organizations. They are:

(i) The volume of services rendered by the entity to the society.
(ii) The sacrifices made by the working force of the organization to generate such services.
(iii) The value of the people to the organization.
(iv) The social contribution made by the organization.
5.2 Government Accounting

5.2.1 Introduction

For the purpose of evaluation of Panchayat accounting and control system, we must have a knowledge about the Government accounting system. The basic principles of government accounting are usually followed in Panchayat accounting. Panchayat also utilize the funds contributed by the funded authorities and public. A brief study of the features, objectives and procedures of Government accounting, therefore, will help us to understand the present accounting system of Panchayats.

5.2.2 General Structure of the Financial administration in India

From January 26, 1950, the day of commencement of the Constitution, India has been constituted by its people into a Sovereign Democratic Republic and is a Union of States. The executive power of the Union vests in the hands of the President whereas that of a State in the hands of a Governor.

Every union territory is administered by the President acting to such extent as he thinks fit, through an administrator, appointed by him. The initial responsibility for the administration of each department of Government activities in the Union, an Union Territory or a State is laid down on the head of the department concerned, who is controlled and guided in this respect by the Government to which he is subject. In financial matters, each head of a department is thus responsible for the collection of revenue and for the control of expenditure pertaining to his department, the receipt and disbursement of which are effected at various places and through various persons.

5.2.3 Treasuries
All the States are divided into a number of districts at the headquarters of which there is a Government Treasury along with one or more sub-treasuries. The State treasuries are controlled by the respective State Governments whereas Union Territories are controlled by the Central Government. The treasuries are the units of the fiscal system and the points at which the public accounts start. The Union Government and the State Government have their own rules which are known as Treasury Rules in order to regulate the workings of treasuries. The collector of the district is in general charge of the treasury with the Treasury Officer. Generally, a treasury is divided into two departments, viz., (i) for cash, stamps, opium under the charge of the treasurer; and (ii) for all other accounts under the charge of the Accountant. When anyone has a payment to make to the government, he presents the money with a challan at a treasury and receives a receipt for it. On the contrary, when one has a payment to receive from Government, he presents at a treasury a receipted bill, or a cheque issued in favour by a competent officer and obtains payment of it.

The treasury is conducted by the Reserve Bank of India at every place where it has an office or branch of its own or of the State Bank of India as its agent. The Union and the State Government keep their own separate accounts with the Reserve Bank of India. Therefore, the bank is to deal with two groups of accounts, viz. (i) with the Union, and (ii) with the States. Any kind of adjustment between Union and State Government are to be adjusted by the Reserve Bank of India. The treasury system is being increasingly phased out in this country and the vacuum is being filled up by the State Bank or by State associated banks.(8)

5.2.4 Important features of Governing Account

The Government Accounting system has some features of its own. Out of them, we are discussing here, the most important ones.

(1) Accounting Methods: The first point to note is that government accounts are mostly kept on a cash basis. The reason for this can be well comprehended from the nature of government functions. A government has to
decide upon its range of activities first and then decide how to get the money for it—through taxation, borrowing or deficit financing. Thus, the government decides the size of the coat first and then proceeds to gather the necessary cloth through methods so chosen as to put the least burden on the community. Imposition of 'least burden' is the first directive principle of government finance.

Besides the State, of whom government is an agency, is regarded as a vast benefit club. Necessarily, it does not have a profit motive except in public-commercial enterprises. Even in some of these enterprises, it may run services or produce goods at a loss for promoting the welfare of the people. Hence, the saying, "It may pay a government to run a service at a loss." (9)

Since profit motive is absent, the Profit and Loss Account is not prepared for the government. It is thus not important for the government authorities to know how much they are likely to accrue in the future. What is important for them is to ascertain how much cash they may draw upon for the socially oriented activities of the government. Thus, cash basis of accounting becomes the norm for government finance.

(2) Financial Statements: In case of government accounting, most of the transactions are recorded on the single entry basis. The following two statements are generally prepared:

(a) Government Account—to show the net result of all incomes and expenditures including expenditure on capital account; and
(b) Statement of Balancing Accounts—to show whether the government owes or has to receive money.

(3) Classification of Account Heads: In case of government accounting, the classification of account is very wide. It comprises broadly three categories of accounts, each category is sub-divided into major heads of account. Also, major heads are further sub-divided into minor heads and so on. This process is continued till the preparation of detailed heads of account. The three main accounts are:
(i) Consolidated Fund;
(ii) Contingency Fund; and
(iii) Public Accounts.

The consolidated fund is again classified into: (i) Revenue and Expenditure Heads; (ii) Capital Receipts and Disbursement Heads; and (iii) Public Debt and Loans and Advances. Public Account is also divided into: (i) Debt and Deposit Division; and (ii) Remittance Division.

5.2.5 Objectives of Governing Accounting

Accounting is very important in a democracy where people have a right to know how government finances are being managed by their representatives. This knowledge enables them to have faith in their representatives or substitute them by new ones. There are objectives of government accounting which enable it in helping the people in this respect.

Information about Revenue

Revenue of the government has a bearing on the pockets of the people. So, the pockets should be touched only to the extent welfare is promoted. Whether this rule is being observed is indicated by the accountant's analysis and collection.

Government revenues are classified into (a) tax revenues and (b) non-tax revenues. Information about both the types has to be sufficient to enable the government to decide which way to stretch its arms next year or withdraw them to the needed extent. It has to meet the people's directive; and the directive is for general well-being. By providing information about revenue in detail, government accounting enables the people to form their idea about the directive to be given.

Information about Expenditure

After revenue information, government accounting seeks to provide information on different expenditures. This is rather mandatory in nature in view of the fact that expenditure sanctioning authorities like the legislature have a right and
really want to know whether expenditures have been made as per sanctions. It is to be noted that expenditures of public money raised through taxation and borrowings etc. is sanctioned by the representatives of the people who compose the legislature.

**Information about Loans and Deposits**

Public money consists of loans, deposits and other receipts besides tax revenue. Public borrowing is inevitable. Likewise, governments also lend money to different parties, individual or otherwise. These loans and deposits must be fully displayed in government accounting so as to provide information to the legislature who authorises the raising of money through this method.

**Information about Cash Availability**

Finances are raised through taxation and borrowing and other methods throughout the year, while expenditures are also incurred throughout the year. Thus, there may exist a gap between cash receipts and cash availability at any given time. Those who are authorised to make expenditures must be made aware of this. So, it is the function of the government accounts to provide information about this.

**5.2.6 Procedure of Government Accounting**

The form, in which government accounts are to be kept is decided by the President in consultation with the Comptroller of Auditor General of India. The pattern has to be uniform both for the centre and states.

The constitution of India provides that an Annual Financial Statement, popularly called the budget, is to be laid before Parliament in the case of the centre, and in the case of states, before their respective legislatures. This has to be passed by them before the next fiscal year (1st April of the Current year to 31st March of the next calendar year). The ‘appropriations’ and ‘demands for grant’ are separately shown. The appropriations include expenditure charged on Consolidated Fund as salaries of President, Speaker, the Governors and the like. These are not subject to votes.(10) But, the demands for grant are to be voted.
The accounts of the Government in India are kept in the following three parts:

Part I Consolidated Fund

Part II Contingency Fund

Part III Public Account

CONSOLIDATED FUND

There is a consolidated fund both for the centre and each of the states. It is a broad head sub-divided into the following:

i. Revenue and Expenditure Heads;
ii. Capital Receipts and Disbursement Heads; and
iii. Public Debt and Loans and Advances.

Revenue and Expenditure Heads:

Under this head, all receipts from taxes and other sources and all expenditures therefrom are recorded. When the receipts and expenditures do not balance, the division exhibits either deficit or surplus during the year concerned. The following heads comprise the revenue receipts:

- tax revenues: all taxes on income and expenditure on property, on capital transactions and on commodities and services; and
- non-tax revenues: all interest receipts, dividends and profits, changes for fiscal services and grant-in-aid and contributions.

On the expenditure side, the classification is as follows:

(i) General Services: General Services comprise administrative services, defence services and servicing of loans and debts.

(ii) Social Services: Social Services head consist of education, sports and games, health and family welfare, information and broadcasting and also
arts and culture. These services are basically intended to improve the quality of social life.

(iii) Economic Services: Economic Services consist of those, which facilitate production or provide infrastructure for it. Agriculture and allied activities, power generation, transport and communication come under this head.

(iv) Grant-in-aid and Contributions: All grant-in-aid and contributions are made from the consolidated fund. It is more important for the centre than for the states because the states do not defray much expenditure as grant-in-aid though they make some contributions now and then.

**Capital Receipts and Disbursement Heads**

Under this head, all capital receipts and capital expenditures are recorded. Capital receipts are receipts of a capital nature, i.e., sums received all at once such as from discarded assets like plants and machinery. Capital expenditures consist of those long-run costs incurred either for increasing tangible capital assets or for reducing recurring liabilities thereon.

**Public Debt and Loans and Advances**

Public debt is a broad category as it includes all loans raised by the government from the public, and all loans and advances taken by it from the central bank and other statutory authorities. Necessarily, it consists of all loans raised, taken and granted as also all advances obtained and granted. Since, they are all loans, they are concerned with repayment or recovery, as the case may be.

**CONTINGENCY FUND**

This fund is for meeting contingencies like earthquakes, floods, foreign aggression, etc. This fund is at the disposal of the President in respect in respect of the Centre, and of the Governor in a State. These functionaries are authorised to expend from the fund concerned to meet contingencies pending final authorisation by the legislature concerned. Necessarily, this final authorisation is in the nature of a post mortem approval or compulsory ex-post facto legislation.

**PUBLIC ACCOUNT**
Like any individual a government has to have its own account, which is called Public Account. It consists of money raised through loans, advances and deposits for which the government undertakes the liability of refunding at some future date. It is in no way related to the capital division of the consolidated fund. It consists of all monies received by or on behalf of the government outside of the consolidated fund. This account consists of two main divisions: (i) debt and deposit division; and (ii) remittance division.

5.2.7 Conclusion

The working of Panchayats is very much similar to the working of Non-profit organizations. Both are engaged in serving people without the objective of earning profit. The accounting of non-profit organizations is based on the concept of fund. Different types of funds are maintained in these organizations. When the money is received, it is treated as a source of fund and is credited to the particular fund account. On the other hand, when the money is spent, it is treated as use of that fund and is debited to the particular fund account. Similarly, the Panchayats have different source of income—tax revenue, non-tax revenue, grant-in-aid etc. Various types of government schemes are being assigned to the Panchayats from time to time for the development of rural people. So, separate funds are to be maintained to operate the scheme. In suggesting the accounting system of Panchayats, it should be kept in mind. The Panchayats are also known as Local self-government. Thus, there is a similarity between Panchayat accounting and Government accounting. Like government, Panchayats also utilize the funds contributed by the funded authorities and the public. For the purpose of suggesting a better system for Panchayat accounting, we must have a knowledge about government accounting system. The objective of government accounting is to enable the people informed about revenue, expenditure, loans and deposits, and cash availability, which is very similar to Panchayat accounting. The Government accounting is based on fund concept. This may be successfully applied in Panchayat accounting.
References:


9. A.Mukherjee and M.Hanif, ibid, P-871.
