

# Module 3: Preparation of Financial Statements of Not-for-Profit Organisations

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## 9. Meaning, Characteristics, and Accounting Records of NPOs

### 9.1 Meaning of Not-for-Profit Organisations (NPOs)

**Not-for-Profit Organisations (NPOs)** are institutions set up not to earn profit, but to render services to their members and to the public at large. These include schools, colleges, public hospitals, charitable trusts, sports clubs, libraries, and religious institutions.

Unlike regular business enterprises, their primary motive is **welfare and service**. Any excess of income over expenditure is called a "Surplus" (not profit) and is never distributed among its members as dividends. Instead, it is added to the Capital Fund to be utilized for the organization's future activities.

### 9.2 Characteristics of NPOs

- **Service Motive:** The core objective is providing service (education, healthcare, recreation) either free of cost or at highly subsidized rates.
- **Members, Not Owners:** These organizations are formed by individuals known as 'members'. They elect a managing committee to run the operations.
- **Source of Income:** Their major sources of income are subscriptions from members, donations, legacies, grants-in-aid, and income from investments.
- **Surplus/Deficit:** The financial result is expressed as a Surplus (Income > Expenditure) or Deficit (Expenditure > Income). It is not termed as Profit or Loss.
- **Capital Fund:** Instead of a Capital Account (as seen in sole proprietorships), NPOs maintain a **Capital Fund** or **General Fund**, which accumulates over the years.

### 9.3 Accounting Records Maintained by NPOs

Although NPOs are not profit-driven, they must maintain proper accounting records to ensure funds are utilized strictly for their stated objectives and to prevent misappropriation. The statutory records include:

1. **Cash Book:** To record all daily cash and bank receipts and payments.
2. **Members Register:** To keep a detailed record of members, their subscription dues, and arrears.

3. **Stock Register:** To track consumable items (e.g., sports equipment in a club, medicines in a hospital).
4. **Asset Register:** To maintain a record of all fixed assets owned by the institution.

At the end of the financial year, NPOs prepare three final financial statements:

### The Final Accounts of an NPO:

1. **Receipts and Payments Account** (Summary of Cash Book)
2. **Income and Expenditure Account** (Similar to P&L Account)
3. **Balance Sheet** (Statement of Assets and Liabilities)

## 10. Preparation of Receipts and Payments Account

### 10.1 Meaning and Nature

The **Receipts and Payments (R&P) Account** is a mere summary of the Cash Book for a given period. It is a **Real Account**. All cash and bank receipts are recorded on the Debit (Receipts) side, and all cash and bank payments are recorded on the Credit (Payments) side.

### 10.2 Features of Receipts and Payments Account

- **Opening and Closing Balances:** It begins with the opening balance of cash in hand/bank and ends with the closing balance.
- **No Distinction Between Capital and Revenue:** It records *all* cash flows, whether they are of a capital nature (e.g., Sale of Machinery) or revenue nature (e.g., Subscription received).
- **Ignores Accounting Periods:** It records actual cash received or paid during the year, regardless of whether it relates to the past year, current year, or future year.
- **No Non-Cash Items:** It strictly excludes non-cash items like depreciation, outstanding expenses, or accrued income. If cash didn't move, it is not recorded here.

#### FORMAT OF RECEIPTS AND PAYMENTS ACCOUNT

Receipts (Dr.)	Payments (Cr.)
To Balance b/d (Opening Cash/Bank)	By Salaries and Wages
To Subscriptions (Past, Present & Future)	By Rent, Rates & Taxes
To Entrance Fees	By Printing and Stationery
To General Donations	By Purchase of Fixed Assets (e.g., Furniture)

## Receipts (Dr.)

## Payments (Cr.)

To Sale of Old Newspapers

By Purchase of Investments / Books

To Specific Donations (e.g., Building Fund)

By Upkeep of Grounds / Sports Material

To Life Membership Fees

By Honorarium Paid

By **Balance c/d** (Closing Cash/Bank)

## 11. Preparation of Income and Expenditure Account

### 11.1 Meaning and Nature

The **Income and Expenditure (I&E) Account** is exactly equivalent to the Profit & Loss Account of a business enterprise. It is a **Nominal Account**. It is prepared to ascertain the Surplus or Deficit generated during the current accounting year.

### 11.2 Features of Income and Expenditure Account

- **Accrual Basis of Accounting:** It is prepared strictly on an accrual basis. Incomes earned and expenses incurred for the *current year only* are recorded, regardless of whether cash was actually received or paid.
- **Revenue Items Only:** It records only items of a revenue nature. Capital receipts (like Life Membership Fees) and capital payments (like Purchase of Land) are strictly excluded.
- **Current Year Focus:** Items relating to the previous year or future year are excluded.
- **Includes Non-Cash Items:** It includes non-cash expenses like Depreciation on assets, Bad Debts, and Provisions.
- **Closing Balance:** The balancing figure represents either **Surplus** (Excess of Income over Expenditure) or **Deficit** (Excess of Expenditure over Income), which is then transferred to the Capital Fund in the Balance Sheet.

#### **Exam Tip: R&P Account vs. I&E Account**

*University exams frequently ask for the distinction between these two accounts.*

*Remember: R&P is a **Real Account** based on a **Cash basis** (records everything). I&E is a **Nominal Account** based on an **Accrual basis** (records only current year revenue items).*

## FORMAT OF INCOME AND EXPENDITURE ACCOUNT

Expenditure (Dr.)	Income (Cr.)
To Salaries (Adjusted for O/s and Prepaid)	By Subscriptions (Adjusted for Current Year only)
To Rent & Taxes	By General Donations
To Printing & Stationery	By Entrance Fees / Admission Fees
To Honorarium	By Interest on Investments
To Depreciation on Assets	By Sale of Old Newspapers
To Loss on Sale of Fixed Assets	By Profit on Sale of Fixed Assets
<b>To Surplus</b> (Excess of Income over Exp.)	<b>By Deficit</b> (Excess of Exp. over Income)

## 12. Preparation of Balance Sheet & Treatment of Special Items

### 12.1 The Balance Sheet of an NPO

The Balance Sheet of an NPO is prepared similarly to that of a sole proprietorship, showing Assets on the right side and Liabilities on the left. However, instead of an owner's Capital Account, it features a **Capital Fund** (or General Fund).

**Capital Fund Calculation:** If the opening Capital Fund is not given in the problem, it must be calculated by preparing an *Opening Balance Sheet* (Assets at the beginning of the year – Liabilities at the beginning of the year = Opening Capital Fund).

### 12.2 Treatment of Peculiar Items in NPOs (Highly Examinable)

NPOs receive specific types of income that require special accounting treatment. The examiner tests whether you know to put them in the I&E Account or the Balance Sheet.

#### 1. Subscriptions (The Most Important Adjustment)

Subscription is the regular membership fee collected annually. It is the primary source of revenue income. However, the Receipts & Payments Account shows the *total cash received*, which may include arrears of the past year or advances for the future year.

**Rule for I&E Account:** We must calculate the subscription strictly pertaining to the *current year*.

Total Subscription Received during the year (as per R&P A/c)	<b>XXX</b>
<b>Add:</b> Subscription Outstanding at the <i>end</i> of the Current Year	XXX
<b>Add:</b> Subscription Received in Advance in the <i>Previous Year</i>	XXX
<b>Less:</b> Subscription Outstanding at the <i>beginning</i> of the Current Year	(XXX)
<b>Less:</b> Subscription Received in Advance for the <i>Future Year</i>	(XXX)
<b>= Subscription Income to be shown in I&amp;E Account (Credit Side)</b>	<b>XXXX</b>

## 2. Donations

- **General Donation:** Received without any specific condition attached. It is a revenue receipt and shown on the **Credit side of the I&E Account**.
- **Specific Donation:** Received for a specific purpose (e.g., Donation for Building, Donation for Library). It is a capital receipt and must be capitalized. It is shown directly on the **Liabilities side of the Balance Sheet**.

## 3. Fund Based Accounting (Special Funds)

Often, an NPO creates a specific fund (e.g., Tournament Fund, Prize Fund, Match Fund). Under Fund Based Accounting, all incomes and expenses related to that specific fund are NOT taken to the Income & Expenditure Account. Instead, they are adjusted directly in the **Balance Sheet**.

### Treatment on the Liabilities Side:

Tournament Fund (Opening Balance)

*Add:* Donations received for Tournament

*Add:* Interest received on Tournament Fund Investments

*Less:* Tournament Expenses incurred

**= Net Fund Balance (shown in outer column)**

*(Note: If expenses exceed the fund balance, the fund becomes zero, and the excess expense is debited to the I&E Account).*

## 4. Entrance Fees / Admission Fees

This is the fee paid by a member upon joining. There is academic debate on its treatment. Usually, unless the question specifically instructs to capitalize it, it is treated as a **Revenue Receipt** and credited to the **I&E Account**.

## 5. Life Membership Fees

Paid by a member once in a lifetime for a lifetime membership. Because it provides long-term benefit, it is a **Capital Receipt**. It is never credited to the I&E Account. It is added directly to the **Capital Fund** on the Liabilities side of the Balance Sheet.

## 6. Legacies

Amount received by an NPO as per the will of a deceased person. It is a non-recurring **Capital Receipt** and is added to the **Capital Fund** in the Balance Sheet. (If it is a very small amount, some institutions treat it as revenue, but capitalizing it is the safest academic standard).

## 7. Sale of Old Assets vs. Sale of Old Newspapers/Sports Materials

- **Sale of Fixed Asset:** The sale proceeds are deducted from the Asset in the Balance Sheet. Only the *Profit or Loss* on the sale is transferred to the I&E Account.
- **Sale of Old Newspapers / Consumables:** Treated as normal **Revenue Income** and credited to the I&E Account.

## Comprehensive Numerical Illustration

**Question:** From the following Receipts and Payments Account of Star Sports Club for the year ended 31st Dec 2023, prepare the Income and Expenditure Account and Balance Sheet.

Receipts	Payments
To Balance b/d (Opening Cash): 5,000	By Salaries: 8,000
To Subscriptions:	By Rent: 4,000
2022: 1,000	By Sports Equipment (Purchased 1-Jul-23): 10,000
2023: 20,000	By Printing & Stationery: 1,000
2024: 1,500	By Tournament Expenses: 3,000
To Donations (General): 4,000	By Balance c/d (Closing Cash): 11,000

Receipts	Payments
To Life Membership Fees: 3,000	
To Entrance Fees: 2,500	
<b>Total: 37,000</b>	<b>Total: 37,000</b>

**Additional Information:**

1. On 1st Jan 2023, the club possessed Sports Equipment worth ₹25,000 and Land worth ₹50,000.
2. Subscriptions outstanding for 2023 were ₹2,000.
3. Salaries outstanding at the end of the year were ₹1,000.
4. Depreciate Sports Equipment by 10% p.a.
5. Entrance fees are to be treated as revenue.

**Solution:**

**Step 1: Calculate Opening Capital Fund (Prepare Opening Balance Sheet as of 1 Jan 2023)**

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Fund (Balancing Figure)	81,000	Cash Balance (Opening R&P)	5,000
		Subscription O/s (Received later for 2022)	1,000
		Sports Equipment	25,000
		Land	50,000
<b>TOTAL</b>	<b>81,000</b>	<b>TOTAL</b>	<b>81,000</b>

**Step 2: Prepare Income & Expenditure Account for the year ended 31 Dec 2023**

Expenditure	Amount (₹)	Income	Amount (₹)
To Salaries	8,000	By Subscriptions (2023 only)	20,000
Add: Outstanding (Adj 3)	<u>1,000</u>	Add: Outstanding for 2023 (Adj 2)	<u>2,000</u>
	9,000		22,000
To Rent	4,000	By Donations (General)	4,000
To Printing & Stationery	1,000	By Entrance Fees (Adj 5)	2,500

Expenditure	Amount (₹)	Income	Amount (₹)
To Tournament Expenses	3,000		
<b>To Depreciation on Sports Equipment:</b>			
On Opening Bal (25,000 x 10%) = 2,500			
On Addition (10,000 x 10% x 6/12) = 500	3,000		
<b>To Surplus (Transferred to Cap Fund)</b>	<b>8,500</b>		
<b>TOTAL</b>	<b>28,500</b>	<b>TOTAL</b>	<b>28,500</b>

### Step 3: Prepare Closing Balance Sheet as on 31 Dec 2023

Liabilities	Amount (₹)	Assets	Amount (₹)
<b>Capital Fund</b> (from Step 1)	81,000	<b>Cash Balance</b> (Closing R&P)	11,000
Add: Life Membership Fees	3,000	<b>Subscription Outstanding</b> (2023)	2,000
Add: Surplus	<u>8,500</u>	<b>Land</b>	50,000
<i>Closing Capital Fund</i>	92,500	<b>Sports Equipment:</b> Opening: 25,000 Add: Purchases: 10,000 Less: Depreciation: (3,000)	32,000
<b>Outstanding Salaries</b>	1,000		
<b>Subscription Received in Advance</b> (for 2024)	1,500		
<b>TOTAL</b>	<b>95,000</b>	<b>TOTAL</b>	<b>95,000</b>

#### Exam Concept Check:

Notice how the **Life Membership Fee** bypassed the I&E Account entirely and went straight to the Capital Fund, whereas the **Entrance Fee** was treated as revenue. Also, observe the 6-month calculation for depreciation on the new sports equipment purchased mid-year.

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