3.2 NOT-FOR- PROFIT MAKING CONCERN

Preparation of Financial Statements of a Non-Trading Concern

Until now, we have seen accounting treatment for business transaction of business entities whose main objective is to earn profit. There are certain organisations that are not established for making profit but to provide some service. These services are generally given to members who make subscriptions to avail them. These are also called as non-trading entities. The examples of such organisations are:

- Gymkhana / sports clubs
- Educational institutions
- Public hospitals
- Libraries
- Cultural clubs like Rotary or Lions club
- Religious institutions
- Charitable trusts

These organisations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc. The accounting of such organisations is based on similar principles followed by the other organisations. Given the nature of these institutions, there are certain items of revenue and expenses that need special understanding so that accounting treatment could be correctly decided.

Special Items

There are certain items of revenue and expenses that are unique for the non-trading entities. They could be listed as:

Revenue items	Expenditure items
Donations	Upkeep of grounds
Entrance fees	Tournament expenses
Subscriptions	Prizes
Grants received Events	

Let us see what accounting treatment should be given to some of the special items.

(a) **Entrance Fees –** These are received at the time of admission of a new member and thus are onetime fees. They are non-recurring in nature. It could be either capitalized as they are non-recurring or taken as revenue as per the rules of the institution. There's a view that addition of member is an ongoing activity and thus every year the institute will get entrance fees. So it may be taken as a normal revenue receipt.

(b) **Donations –** They could be used for meeting capital or revenue expenses. If donations are received for a special purpose, the amount is credited to a fund from which the amounts are disbursed. The fund may be invested in specified securities. Income from such investments is credited to the fund Account only. Small donation amounts which are not earmarked for any specific purpose may be treated as revenue receipts.

(c) **Legacy –** Many times trusts are formed in the memory of certain persons by their will. In such case after the demise of the person, the funds pass on to the institution. Such legacies are of course one-time and therefore should be taken to the capital fund.

(d) **Endowments –** Sometimes, donations are also in the form of endowments to be used as per instructions of the donor. These are to be treated as capital receipts.

(e) **Life membership fees –** These could be taken as capital receipts and every year a charge is debited based on some logic. In other words, when received, it could be treated as deferred receipt in the balance sheet and every year a specific amount is credited to I & E Account.

(f) **Subscriptions –** These are annual receipts and therefore taken as revenue receipts. These must be recognized as revenue on the accrual concept.

These non-profit organisations prepare

Receipt and Payment Account – This is similar to cash book. Entries are made on cash basis and items pertaining to previous year or current year or subsequent years are also recorded. Receipts are shown on debit side and payments are shown on credit side. Capital as well as revenue items are entered in the R & P Account. This account is real account in nature. No provisions are recorded in this account. The account has an opening and a closing balance which is reflected as an asset in the balance sheet.

Features of receipts and payment account

1. It is an Account which contains all Cash and Bank transactions made by a nonprofit organization during a particular financial period.
2. It starts with the opening balances of Cash and Bank. All Cash Receipts both capital & revenue during the period are debited to it.
3. All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
4. While recording the Cash and Bank transactions all entries are made on Cash Basis.
5. It is a summary of Cash Book.
6. It follows Real Account.

Receipt and Payment Account
Receipt and Payment Account

Receipts	Amount(₹)	Payments	Amount(₹)
Starts with opening balance			
All receipts - capital or revenue		All payments - Capital or revenue	
May be related to any period previous, current or subsequent.		May be related to any period previous, current or subsequent.	
		Ends with closing balance	

Income and Expenditure account – This is similar to the Profit and loss Account and is prepared exactly based on same principles. As the name suggests only revenue items are recorded herein. Incomes are recorded on the credit side while the expenses on the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are pertaining to current period. Previous and subsequent year items are to be excluded. This account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called as deficit.

Features of Income and expenditure Account

1. It follows Nominal Account.
2. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
3. imilarly all revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital incomes and Expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Income and Expenditure Account

Expenses	Amount (₹)	Income	Amount (₹)
Only revenue expenses		Only revenue receipts	
Only related to current period.		Only related to current period	
Shows either surplus		Or shows deficit	

Balance Sheet – It is prepared as on the last day of the accounting period. It also has assets and liabilities and prepared based on accounting equation. But, there's no capital account. Instead there is a capital fund. The surplus or deficit from Income & Expenditure Account is adjusted against this capital fund at the end of the year.

Difference between Receipts and Payments Account and Income and Expenditure Account

	Receipts & Payments Account	Income & Expenditure Account
1	It is a summarized Cash Book	It closely resembles the Profit & Loss Account of a Trading concern.
2	Receipts are debited and Payments are credited.	Incomes are credited and Expenditures are debited.
3	Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
4	Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
5	It records both Capital and Revenue transactions.	It records Revenue transactions only.
6	It serves the purpose of a Real Account.	It serves the purpose of a Nominal Account.
7	It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
8	It does not record notional loss or noncash expenses like bad debts, depreciations etc.	It considers all such expenses for matching against revenues
9	Its closing balance is carried forward to the same account of the next accounting Period.	Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
10	It helps to prepare an Income & Expenditure Account.	It helps to prepare a Balance Sheet.

Difference between Profit and Loss Account and Income and Expenditure Account

	Profit and Loss Account	Income & Expenditure Account
1	It is prepared by business undertaking.	It is prepared by non-trading organizations.
2	The credit balance of Profit and Loss Account is known as "net profit" and added to opening capital.	Credit balance of Income and Expenditure Account is known as excess of income over expenditure or surplus and added to opening capital fund.
3	The debit balance of this Profit and Loss Account is known as "net loss" and deducted from opening capital.	Debit balance of this Income and Expenditure Account is known as "excess of expenditure over income' or deficit and deducted from opening capital fund.
4	To check correctness of accounts trial balance is prepared before preparing this account.	To check correctness of accounts, receipts and payments account is prepared before preparing this account.

Fund Asset Accounting and its peculiarities:

Following are the concepts of some funds which are generally maintained by organizations:

(i) **Capital Fund:** It is also called "General Fund" or "Accumulated Fund." It is actually the Capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually "Surplus" or "Deficit" during a period is added with or deducted from it. A portion of Capitalised incomes like donations may be added with it.

(ii) **Special Fund:** It may be created out of special donation or subscription or out of a portion of the "Surplus". For example a club may have a "Building Fund". It may be used for meeting some specific expenses or for acquiring an asset. If any income is derived out of investments made against this fund or if any profit or loss occurs due to sale of such investments, such income or profit or loss is transferred to this fund.

Other Treatments

(a) If the Special Fund is used to meet an expense

Special Fund A/c Dr.
To Bank A/c (amt. of expense)

The balance of the Fund is shown as a liability.
If the balance is transferred to Capital Fund, the entry will be—
Special Fund A/c Dr.
To Capital Fund A/c (Balance of Special Fund)

(b) If the Special Fund is used to purchase an asset

Asset A/c Dr.
To Bank A/c (Cost of the asset)
Special Fund A/c Dr.
To Capital Fund A/c (Special Fund closed)

(iii) Donations

(a) Donation received for a particular purpose should be credited to Special Fund. For example, Donation received for Building should be credited to Building Fund Account.

(b) For other donations received the by-laws or rules of the concern should be followed.

(c) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund. Recurring donations received should be credited to Income & Expenditure Account.

(d) Donation paid by the concern should be debited to Income & Expenditure Account.

(iv) Legacy received: It is to be directly added with Capital Fund after deduction of tax, (if any). It is a kind of donation received according to the will made by a deceased person.

(v) Entrance Fees or Admission Fees

(a) The rules or by-laws of the concern should be followed.

(b) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.

(c) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

(vi) Subscriptions

a) Annual subscriptions are credited to Income & Expenditure Account on accrual basis.

b) Life membership subscription is usually credited to a separate account shown as a liability.