

AccountAble™

Understanding the Receipts and Payments Account Issue # 87; Jan-03; Released: Jul - 03

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What is a Receipts & Payments Account?

NGOs are required each year to prepare a summary of their cash book. This summary shows all the money that they received during the year. It also shows the payments that were made. This is called the Receipts & Payments Account.

Utility

Some people think that the Receipts and Payments Account is a left-over from the time of cash accounting. This is not quite correct. The Receipts and Payments Account has several advantages. This is more so in the case of non-profit sector:

1. Trustees and other laypersons find the Receipts and Payments Account easier to understand.
2. This Account discloses all loan transactions, even those which have been squared-off during the year.
3. Some accountants do not disclose revenue Grants in the Income and Expenditure Account. In such cases, the true Income of the Non-profit can be known only from the Receipts & Payments Account.
4. Manipulation of financial statements has become very common these

days. It is, however, not easy to manipulate the Receipts and Payments Account¹ and the Income and Expenditure Account *together*.

Receipts vs. Income

All receipts are not income. For example, money received from sale of fixed assets, loans taken, advances from customers, etc. are not income.

Similarly, all income may not be received

The Peacemaker

Payment is a noun. It comes from the verb pay. And where does pay come from? It's been used in English for more than 800 years.

It seems that the original root of pay was the Latin word *pax*. *Pax* means peace (as in *Pax Romana*). One of the Latin forms of *pax* was *pacare*, which meant pacify. The idea was that you could pacify an angry creditor by paying him. Just as a mother pacifies her child by giving her or him a pacifier.



The French changed *pacare* to *payer*. From there, it reached English in the 12th century as *pay*. It was often used in the sense of 'pacifying' people till the 16th century. After that, this meaning died out. For the last 500 years, *payment* has been used only to mean 'the act of giving money'.

And we all know, what a great peacemaker that can be!

¹ In recognition of this fact, corporate reporting requirements have now changed to include cash flow statements also.

during the year. This happens if the organisation follows accrual accounting². For example, money for credit sales may be received in the next year. Similarly, interest earned on fixed deposits may be received later.

Payments vs. Expenditure

Using the same logic, all payments are not expenditure. For example, money paid for purchase of fixed assets, loans re-paid or given to others, advances to contractors, etc. are not expenditure.

In some cases, an expense may occur but may be paid later. For example, you may have organized a *mela* in Feb '02, but the bill of the tent house may be paid later in April '02.

In this case, if you are following accrual accounting, then this will be shown as an expense in 2001-02, and as a payment in 2002-03.

Left or right?

In the Income & Expenditure Account, Income items show up on the right side. And expense items show up on the left.

Income & Expenditure Account (partial)	
Expenditure	Income
Program expenses 45,000	Grants received 50,000
Other expenses 4,000	Donation recd. 5,000
	Interest income 230

In the Receipts & Payments account, this is reversed. Receipts show up on the left, and payments appear on the right.

Receipts & Payments Account (partial)	
Receipts	Payments
Grants received 50,000	Program expenses 45,000
Donation recd. 5,000	Other expenses 4,000
Interest income 230	

What is the reason for this?

Firstly, debits are always shown on the left, and credits are shown on the right.

Secondly, Income & Expenditure is a nominal account. So it follows the rule:

² See 'Basis of Accounting' in AccountAble 59.

Debit all expenses and losses, credit all incomes and gains.

On the other hand, Receipts & Payments Account is not really an account. It is a summary of the cash book. And in the cash book, Receipts are shown on the left, and payments are shown on the right³. Therefore, the Receipts & Payments Account follows the same pattern.

Common issues

Before discussing the methods of making a Receipts and Payments Account, let us deal with some commonly confused issues:

Loan transactions

The Receipts & Payments Account should show all cash and bank transactions. This includes loans given or received. It even includes those loans that were given out and received back during the same year.

Unfortunately, many accountants simply prepare the Receipts and Payments Account from the Balance Sheet and the Income & Expenditure Account. As a result, transactions settled during the year do not show up at all. This is not a good practice and should be avoided.

Mr. Clever's Loan Account

We can understand the reason for this through an example. Let us assume that Mr. Clever is the trustee of Wealthy Trust. On 1st April '00, he took a loan of Rs.5,00,000 from the Trust. On 31st March '01, he returned the entire Rs.5,00,000. The loan was interest-free.



Then again on 1st April '01, he took another loan of Rs.5,00,000. He returned this loan also on 31st March '02.

His account looks like the following:

³ Can you figure out why?

Loan Account of Mr. Clever, Trustee				
Date	Narration	Debit	Credit	Balance
1-4-00	Loan taken	5,00,000		5,00,000
31-3-01	Loan re-returned		5,00,000	0
1-4-01	Loan taken	5,00,000		5,00,000
31-3-02	Loan re-returned		5,00,000	0

In both years, the loan has been squared-off within the financial year. Should this loan be shown in the Receipts and Payments Account?

Some people do not show the above in the Receipts and Payments Account. However, in such a case, the auditor can not really say that the Receipts & Payments Account shows all the receipts and all the payments made during the year. Reason? Two transactions are missing from the Receipts & Payments Account.

Our view is that the Receipts & Payments Account of Wealthy Trust should look like the following in both the years:

Receipts & Payments Account of Wealthy Trust (partial)			
Receipts		Payments	
Loan returned by Mr. Clever, Trustee	5,00,000	Loan given to Mr. Clever, Trustee	5,00,000

Advances for expenses

During the year many staff members may be given advances for expenses. For example, people are given advance for traveling, for organizing events, for purchasing stationery, etc. Should all these be shown in the Receipts and Payments Account?

This is a difficult question. If we do not show these advances, then some people may feel that we are suppressing information. But if we show these, then the Receipts and Payments Account will become hopelessly cluttered.

There are two ways to deal with this. One is to take a decision that all routine advances settled during the year will not be shown in the Receipts and Payments Account. However, this can be disclosed in

the Receipts and Payments Account by giving a note.

Second option would be to show all advances given on the payments side as one line item 'Advances for Expenses'. On the receipts side, a corresponding one line item can be shown as 'Settlement of Advances for Expenses'. This may look like below:

FCRA Receipts & Payments Account (partial)			
Receipts		Payments	
Settlement of Advances for Expenses	40,224	Advances for Expenses	46,250

Why is there a difference of Rs.6,026 between the two sides? This represents advances given to staff, for which bills have not been submitted by the end of the year.

Accrued Expenses / Income

What happens to expenses or income, which have accrued during the year but not paid or received so far? These should not be shown in the Receipts and Payments Account of this year. These will be shown in the next year when the actual cash payments or receipts occur.

Cash or Bank?

For making the Receipts and Payments Account, cash and bank transactions are treated as being the same. Therefore, deposit or withdrawal of cash from bank account⁴ is not shown as a receipt or payment.

However, if you invest your money in bank fixed deposits, this will be shown as payment item in the Receipts and Payments Account. Similarly, encashment of fixed deposited will be shown as a separate item of receipt.

Level of Detail



Receipts and Payments Account is a summary of the cash and bank book. This means that all items of one type can be added together and shown as a

⁴ Sometimes called 'cash-bank contra'

single line item. For example, salary is paid twelve times a year. However, we need not show 12 entries for salary. We can show just one entry 'salary paid' in the Receipts and Payments Account.

However, can we add up all our expenses⁵ and show these as one item, say 'rural development'? No. This will give very little information. The basic purpose⁶ of preparing a Receipts and Payments Account will be defeated.

We should therefore, try to give reasonable level of detail⁷ in the Receipts and Payments Account.

Using Trial balance figures

Most accountants use a shortcut to make the Receipts and Payments Account. They pick up most of the income / expense figures from the trial balance. Then they derive other figures⁸ of receipts / payments by using opening and closing balances of various accounts⁹.

This can work if the organisation is following cash basis of accounting. In case, the organisation follows accrual basis or mixed basis, then this shortcut can give wrong results.

Depreciation

Depreciation is not a cash payment. It is an estimated charge towards wear and tear of fixed assets. Therefore, depreciation never appears in the Receipts and Payments Account.

Computerised Accounts

What is the command for making a Receipts and Payments Account if your accounts are computerized? We do not know

⁵ Including salary, rent, fuel, etc.

⁶ That is, financial disclosure

⁷ For more in this, see 'Level of Detail' in AccountAble 72

⁸ Non-revenue items such as loans, purchase of fixed assets, etc.

⁹ This often means that some transactions do not get reported in Receipts and Payments Account, particularly where loan account had been squared-off during the year.

of any accounting software, which can generate a proper Receipts and Payments Account automatically. This may be because the software is unable to link up an advance with its settlement.

Local Contribution and FCRA

Does your FCRA funded project require local contribution also? Be careful how you account for it. Any local contribution, whether cash or in kind, cannot be brought into FCRA account books.

This should be accounted in the General or Indian cash book and posted to another sub-ledger maintained for concerned project. Please note that this sub-ledger is part of the Indian set of books and is different from the FCRA project ledger.

Also do not include this local contribution in the FCRA Receipts and Payments Account when you file your FC-3. If you do, you may get a notice from FCRA 'for mixing up local and FCRA funds'.

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