AccountAble

Income & Expenditure | Issue 38 for September 1997

As the development sector grows, size and complexity of NGOs is also growing. To handle the large amount of funds, both the NGOs and the funding agencies need a better understanding of financial statements. This will help them raise and answer questions.

In a previous issue, we discussed the Balance Sheet. The Balance Sheet shows how wealthy (or bankrupt) a person or organization is. It is a status report and shows where the organization has reached on a particular date.

Here we deal with the Income & Expenditure Account.

Income & Expenditure Account is like an activity report — it shows what you did in one year. Mostly this account is prepared for a year though it can be prepared for a longer or shorter period also. It shows all the income for the year on one side (the 'auspicious' right hand side) and all the expenditure on the other side (the 'evil' left hand side).
The difference between the two sides is shown as 'surplus' or 'deficit'. If the right side (income) is more, you get a surplus. If the left side (expenditure) is more, it means you spent more than you earned — the result is a 'deficit'.

How can I spend more than I earned?

This is not difficult at all — see how easily the Government has been doing it for 50 years. You do this mainly by:

- borrowing money from others. The loans will not show up on the Income side — these are shown as liabilities.
- spending stored surplus related to an earlier year. This adjustment will also show up in the Balance Sheet.

What can the Income & Expenditure Account tell us?

For a good analyst, a decently prepared Income & Expenditure account is better than an annual narrative report. It can tell you:

- how much the NGO received from different sources: grants, donations, interest, other income.
- how did it spend the money: salaries, travel, physical program work.

And when you compare two or three accounts, you will know:

- whether the income of the NGO is rising or stagnating.
- whether it has been able to spend the money it receives.
- which type of expenses are growing at a higher rate than others.

With these figures, you can raise some relevant questions:

- Is it practical to raise such large amount of donations from villagers or from small towns?
- What are the expenses incurred against other income from consultancy, training etc.?
- Why is the pattern of expenditure changing?
- Whether activities given in the narrative report tie up with the Income & Expenditure Account?

Is it different from the Receipts & Payment Account?

The Receipts & Payments Account shows all receipts, including donations, grants, loans taken, sale of assets, recovery of staff advances. In the Income & Expenditure, loans, sale of assets, recovery of staff advances etc. is not shown.
Similarly, repayment of loans, purchase of fixed assets etc. is shown in the Receipts & Payments Account, but not in the Income & Expenditure Account.
Receipts & Payment Account is like a summary of the cash and bank book — it starts and ends with cash and bank balances. It can not tell you whether there is a surplus or deficit.

Why is that important?

You may be spending more than you earn by borrowing money. In the long run, this will get you into serious financial problems. The Receipts & Payments account does not distinguish between 'income' and 'loans' etc. The Income & Expenditure account can tell you whether you are breaking even each year or not. In any case, you need to know the figure of surplus or deficit to prepare your Balance Sheet.

(Continued on page 2)

...Surplus

(Continued from page 1)

What happens to the surplus?
The surplus is transferred to the Balance Sheet and carried forward to the next year. In most cases, the surplus shows up due to wrong accounting policies. It represents unspent grants which will be spent next year. There are really very few NGOs who will have a genuine surplus. These NGOs may be doing public fund-raising or may be running some income generation activity, where they earn a profit.

Is 'profit' different from 'surplus'?
The word 'profit' is used for commercial organizations. 'Surplus' is used for non-profit bodies. Surplus is also sometimes called 'excess of income over expenditure'. The main difference between 'profit' and 'surplus' appears to be that you are not free to distribute the surplus among the members of the NGO. Even the profit earned in income generation activities can not be given to the members of the NGO — it must be used for the organization's objectives.

Can we transfer surplus to General Fund?
In most cases the surplus includes unspent grants. This part of the surplus can not be transferred to General Fund without the concerned Agency's permission. However, general donations from public or other similar income (interest etc.) can be transferred to General Fund or some other specific fund.

What about transfers to Corpus?
The entire surplus can not be transferred to the Corpus. Some part of the surplus will represent amounts received for purchase of fixed assets. This can be transferred to 'corpus' or 'Fixed Assets Fund' when the assets are purchased. This provides a balancing effect on the liabilities side. If you receive a specific grant for your corpus, this can be transferred to the corpus. Donations from general public can be transferred to corpus, unless the donor has given some other instructions.

Are grants 'income'?
Some people say that grants are received for specific purposes and represent a liability. These should not be taken to Income & Expenditure Account but directly to the Liabilities side of the Balance Sheet. Unfortunately, this results in a distorted view. Even in case of NGOs receiving and spending crores as grants, the Income & Expenditure Account may show very little income or expenditure.
Another view is to treat such grants as 'conditional income'. This would mean that these become the organization's income if these are spent properly. That is to say, these are spent according to the terms and conditions of the grant. In such case, the entire grant is shown as income and a provision is made for unspent grant at the end of the year. This presents a picture which is closer to reality.

What is a consolidated Income & Expenditure Account?
NGOs often prepare separate Income & Expenditure Account for each funding agency. This reflects the transactions related to that particular project. However, they also need to prepare a consolidated Income & Expenditure Account showing transactions related to all projects (FCRA or Indian) as also the General section. This is a compulsory requirement under Income Tax, Societies Act , as also Bombay Public Trust Act.

What is depreciation?
When you build or purchase a fixed asset, it will last you for several years. A jeep may be useful for 5-10 years, a good building will last you for 90-100 years. When you charge depreciation, you write off a proportionate amount each year. The jeep may be written off over 10 years by charging 10% depreciation each year; the building will be written off over 100 years by charging a lower rate.

Who pays for depreciation — the NGO or the funding agency?
Neither the funding agency nor the NGO pays for depreciation in a direct sense. Indirectly, the funding agencies or donors pay for it in most of the cases. This happens when they give grants to purchase assets as new or replacement.

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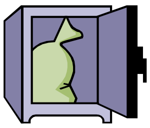
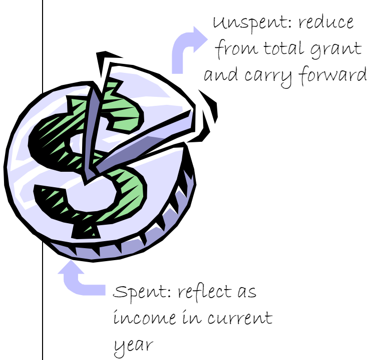


A wealthy Wall Street financier was famous for his numerical skills — he could take in the most complicated balance sheet at one glance. Trained as an accountant, he would come to his office every day, open a safe behind his desk, take out a piece of tightly rolled paper, look at it, then place it back in the safe.
When the financier died, his executive assistant was naturally very interested to know what was written on that slip of paper. He gained access to the safe, took out the paper, and unrolled it. Written in the financier's own handwriting were these words: 'Debit is on the left, Credit is on the right.'

—The Guinness Book of Humorous Anecdotes by Nigel Rees



Details are given in schedules like this.

Schedule B: Grants	
Hivos	230,465
CRY	364,964
CAPART	482,928
ActionAid	328,227
CSWB	200,000
Oxfam America	314,086
Total	**1,920,670**

Income & Expenditure Account of Lok Jagran Manch for year ended on 31st March 1997

Expenditure	Amount (Rs.)	Income	Amount (Rs.)
Watershed program (sch. C)	830,471	Grants (schedule B)	1,920,670
Education program (sch. D)	665,340	Community Contribution:	
Credit program (sch. E)	41,274	— in kind	230,710
Emergency Relief (sch. F)	530,223	— in cash	4,360
Institutional Expenses (sch. G)	149,878	Donations	12,451
Depreciation (sch. A)	19,952	Bank Interest	23,852
Audit Fees	4,500	Income from investments	100,045
Surplus carried to Balance Sheet	50,450		
Total	**2,292,088**	**Total**	**2,292,088**

Horizontal format

Horizontal or Vertical?

Horizontal Format: Most NGOs prepare the Income & Expenditure account in horizontal format. Income is kept on the right hand side and expenditure on the left hand side. In this, it is similar to the Profit & Loss Account prepared by commercial organizations.

Using Schedules: But there the similarity ends. NGO tend to put all the line items on the main Income & Expenditure Account, instead of classifying these into schedules. This makes the accounts very difficult to understand. Use of schedules could solve this problem.

Classifying account-heads: Secondly, there is no standard basis of classifying account-heads — it follows the agency budgets. Similar expenditure may be classified differently under two different agency budgets. This causes confusion and makes comparisons difficult. In the present situation, there appears to be no real solution for this.

Vertical Format: When the Income & Expenditure Account is prepared vertically, Income items go on top. Below these the Expenditure items are shown. Total expenditure, when subtracted from Total Income gives you the surplus or deficit.

There is no major advantage in the vertical Income & Expenditure Account except that it is easier to type and file, and shows total income and expenditure clearly.

Notes to Accounts: These provide explanations or clarification regarding accounting policies etc. This helps people understand your Income & Expenditure Account better. These can be given with the horizontal format as well.

Income & Expenditure Account of Lok Jagran Manch for year ended on 31st March 1997

	Amount (Rs.)
Income:	
Grants (schedule B)	1,920,670
Community Contribution:	
— in kind	230,710
— in cash	4,360
Donations	12,451
Bank Interest	23,852
Interest / dividend on investments	100,045
Total Income	**2,292,088**
Expenditure:	
Watershed program (sch. C)	830,471
Education program (sch. D)	665,340
Credit program (sch. E)	41,274
Emergency Relief (sch. F)	530,223
Institutional Expenses (sch. G)	149,878
Depreciation (sch. A)	19,952
Audit Fees	4,500
Total Expenditure	**2,241,638**
Surplus (carried to Balance Sheet)	50,450
Notes to Accounts : Schedule H	

Vertical format

Your views, comments and questions are welcome. Please send these to:

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...Depreciation

(Continued from page 2)

Should NGOs charge depreciation?

It is very difficult to work out a proper rate of depreciation. Commercial concerns charge depreciation because a) it is required for calculating taxable profit; b) it is compulsory for companies if they want to declare dividend; c) it is recommended by most accounting bodies so that a reserve for replacement of the asset is created.

The first two reasons are not relevant for NGOs. They get a 100% tax write-off in the year they purchase an asset. They do not declare dividend either. Moreover, most assets are created out of grants. When the asset becomes worn out, a fresh grant is sought for replacement.

The ICAI has made AS - 6 on Depreciation Accounting compulsory for from 1st April 1995. This applies to all NGOs which have any business or commerical type activities (see AccountAid Kit # 6).

For other NGOs, it is up to them whether they charge depreciation or not. If they wish to charge depreciation, they can use the rates given in Income Tax act or Companies Act (see chart alongside).

Asset	**Companies Act**		**I. Tax**
	SLM %	*WDV %*	*WDV*
Office Building	1.63	5	10
Residential building	1.63	5	5
General Equipment	5.15	15	25
Cars / jeeps	7.07	20	20
Tractors	11.31	30	25
Bus / truck	11.31	30	25
Other vehicles	7.07	20	25
Computers	16.21	40	25
Furniture	3.34	10	10
School furniture	5.15	15	15

SLM: Straight Line Method
WDV: Written Down Value

Depreciation rates

The rates shown here are taken from the Companies Act and the Income Tax Act. In these Acts, many more rates are specified — for accurate information you should consult your auditors.

WDV or SLM?

These indicate the method of calculating depreciation: SLM means straight line method. Here the rate is applied to original cost of the asset each year. If an asset is worth Rs.10,000 and the SLM rate is 10%, then the depreciator each year will be 10% of 10,000 or Rs.1,000 each year.

WDV means written down value method. Here the rate is applied is applied to the net balance of an asset. If the asset is worth Rs.30,000, and depreciation rate is 10%, then in the first year, depreciation will be Rs.3,000. In the second year, it will be Rs.2,700 [(Rs. 30,000-Rs.3,000) x 10%]. In the third year, deprecation will be Rs. 2,430 [(Rs.30,000-3,000-2,700) x 10%].

Format: Gujarat & Maharashtra

A special format has been given under the Bombay Public Trust Act. This format gives minimum disclosure requirements. This has to be used by all NGOs registered under BPT Act (the Act applies to Gujarat and Maharashtra only).

References:

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- *How to Read A Balance Sheet*: 1st Indian Edn 1989.; ILO programmed book; Pub.: Oxford & IBH Publishing Co. P. Ltd.; Rs.66
- *Finance Sense - An easy guide for Non-Finance Executives*; 1993; Author: P. Chandra; Pub: Tata McGraw Hill, N. Delhi; Rs.96
- *Introduction to Financial Accounting*; 5th edition; Authors: Horngren, Sundem & Elliott; Pub: Prentice-Hall International; US $ 25