

Accounting Framework for NPOs

Disclaimer: This document is intended solely for educational purposes. The content herein is subject to change based on evolving finance trends and any relevant rulings by the Government of India. Readers are advised to consult with qualified professionals for specific guidance related to their individual circumstances.

It is often argued that since profit is not the objective of NPOs, the accounting framework which is relevant for business entities is not appropriate for NPOs. With a view to recommend a suitable accounting system for NPOs, it would be imperative to understand the major ingredients of an accounting framework. An accounting framework primarily comprises the following:

(a) Elements of financial statements primarily comprising of income, expenses, assets and liabilities: The framework aims to identify the items that should be considered as income, expenses, assets and liabilities in NPOs, for the purpose of including the same in the financial statements by defining the aforesaid terms.

(b) Principles for recognition of items of income, expenses, assets and liabilities: These principles lay down the timing of recognition of the aforesaid items in the financial statements of NPOs. In other words, these principles lay down when an item of income, expense, asset or liability should be recognised in the financial statements.

(c) Principles of measurement of items of income, expenses, assets and liabilities: These principles lay down at what amount the aforesaid items should be recognised in the financial statements.

(d) Presentation and disclosure principles: These principles lay down the manner in which the financial statements are to be presented by NPOs and the disclosures to be made

therein.

There is no difference in the application of the recognition principles to business entities and NPOs. For example, the timing of the recognition of a grant as an income in the financial statements of an organisation does not depend upon the purpose for which the organisation exists. A grant is recognised as income in the financial statements, under accrual basis of accounting, when it becomes reasonably certain that the grant will be received and that the organisation will fulfil the conditions attached to it. Similarly, principles for recognition of other income, expenses, assets and liabilities would be the same for business entities and NPOs.

In so far as the measurement principles are concerned, the same are relevant to NPOs as they are to business entities. For example, depreciation on assets represents primarily the extent to which an asset is used during an accounting period by an organisation. Thus, whether an asset, such as a photocopying machine, is used by an NPO or by a business entity, the measure of charge by way of depreciation depends primarily upon the use of an asset rather than the purpose for which the organisation is run, i.e., for profit or not-for-profit motive. Accordingly, the measurement principles for other expenses, income, assets and liabilities are the same for business entities as well as NPOs. However, considering the nature of activities performed by these entities, in limited cases, measurement principles have been amended where considered appropriate.

In so far as presentation of financial statements is concerned, NPOs generally follow what is known as 'fund-based accounting' whereas the business entities do not follow this system. This is because NPOs may be funded by numerous grants, donations or similar contributions, which may or may not impose conditions on their usage. In other words, the use of some funds may be restricted by an outside agency such as a donor or self-imposed by the organisation. The restrictions can be temporary or permanent (e.g., in case of endowments). Certain contributions may not carry restrictions of usage, i.e., these are unrestricted.