Basis of Accounting adopted by NPOs

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1. The commonly prevailing basis of accounting are:

- cash basis of accounting; and
- accrual basis of accounting.

2. Under the cash basis of accounting, transactions are recorded when the related cash receipts or cash payments take place. Thus, the revenue of NPOs, such as donations, grants, etc. are recognised when funds are actually received. Similarly, expenses on acquisition and maintenance of assets used for rendering services as well as for employee remuneration and other items are recorded when the related payments are made. The end product of the cash basis of accounting is a statement of receipts and payments that classifies cash receipts and cash payments under different heads. A statement of assets and liabilities may or may not be prepared.
3. Accrual basis of accounting is the method of recording transactions by which revenue, expenses, assets and liabilities are recognized in the accounts in the period in which they accrue. The accrual basis of accounting includes considerations relating to deferral, allocations, depreciation and amortisation. This basis is also referred to as ‘Mercantile Basis/system of Accounting’.
4. Accrual basis of accounting attempts to record the financial effects of the transactions and other events of an enterprise in the period in which they occur rather than recording them in the period(s) in which cash is received or paid. Accrual basis recognises that the

economic events that affect an enterprise’s performance often do not coincide with the cash receipts and payments. The goal of accrual basis of accounting is to relate the accomplishments (measured in the form of revenue) and the efforts (measured in terms of costs) so that the reported net income measures an enterprise’s performance during a period rather than merely listing its cash receipts and payments. Apart from income measurement, accrual basis of accounting recognises assets, liabilities or components of revenue and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in future.

5. In cash-based accounting, no account is taken of whether the asset is still in use, has reached the end of its useful life, or has been sold. Thus, cash based information fails to show a comparable statement of the financial position and performance for the accounting period. A cash-based system does not provide information about total costs of an organisation’s activities. On the other hand, an accrual system of accounting offers the opportunity to the organisation to improve management of assets and provides useful information about the realistic amount of organisation’s liabilities, relating to both debts and other obligations such as employee entitlements.
6. NPOs registered under the Companies Act, 2013, are required to maintain their books of account according to accrual basis as mandated in section 128(1) of the said Act. If the books are not kept on accrual basis, it shall be deemed that proper books of account are not kept as per the provisions of the aforesaid section.
7. Accrual is the scientific basis of accounting and has conceptual superiority over the cash basis of accounting. It is, therefore, recommended that all NPOs, including non-corporate NPOs, should maintain their books of account on an accrual basis.

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