Financial statements

> 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.

The accounting process in an organisation culminates in the preparation of its financial statements. Financial statements are intended to reflect the operating results during a given period and the state of affairs at a particular date in a clear and comprehensive manner. The basic financial statements relevant to an NPO are income and expenditure account and balance sheet and notes, other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with such statements. In addition, NPOs should also prepare a cash flow statement in accordance with Accounting Standard (AS) 3, Cash Flow Statements where applicable. Financial statements do not, however, include reports by the governing body, for example, the trustees, statements by the Chairman, discussion and analysis by management and similar reports that may be included in a financial or annual report.

Income and expenditure account is a nominal account which is prepared by an NPO in lieu of a profit and loss account. An income and expenditure account should contain all revenue, gains and other income and expenses and losses incurred by an NPO during an accounting period. The net result, i.e., the difference between revenues and expenses is depicted in the form of surplus, i.e., excess of income over expenditure, or deficit, i.e., excess of expenditure over income for the period. For the preparation of income and expenditure account only revenue items are taken into consideration and capital items are totally excluded. Incomes received in advance and prepaid expenses at the end of the accounting period are also excluded while preparing this account and are disclosed as a liability and an asset, respectively, in the balance sheet. These are included as incomes and expenses in the accounting periods to which they relate.

Since the purpose of fund based accounting in an NPO, discussed in detail hereinafter, is to present income and expense in respect of restricted funds as distinguished from unrestricted fund, it is recommended that the income and expenditure account should have three columns, namely,

1. ‘Unrestricted Funds’, in NPOs generally consists of General Fund or otherwise known as Capital Fund’;
2. ‘Restricted Funds’; and
3. ‘Total’ column reflecting aggregate income and expenses of ‘Unrestricted Funds’ and ‘Restricted Funds’.

The NPOs can further classify the ‘Unrestricted Funds’ column in the Income and Expenditure Account into ‘General Funds’ and ‘Designated Funds’.

NPOs reflect restricted and unrestricted funds separately in their financial statements. Restricted funds are those designated for utilisation for specific purposes either by donors or by NPO and such funds should be utilised only for those specific purposes. On the other hand, unrestricted funds are those which can be spent at the discretion of the NPO but within the defined objectives of such NPO.

NPOs should not present the balance sheet in multi-columnar form. An integrated balance sheet for the NPO as a whole should be presented. In the balance sheet, assets and liabilities should not be set-off against each other, even though these may be related to the same programme/project. Rather these should be disclosed separately. Movement and balance of various funds should be distinctly disclosed in the balance sheet under their respective category.

In the preparation and presentation of financial statements, the overall consideration should be that they give a true and fair view of the state of affairs of the NPO and of the surplus or deficit as reflected in the balance sheet and the income and expenditure account, respectively. The financial statements should disclose every material transaction, including transactions of an exceptional and extraordinary nature. The financial statements should be prepared in conformity with relevant statutory requirements, the Accounting Standards and other recognised accounting principles and practices.

As explained in earlier paragraphs, NPOs incorporated under section 8 of the Companies Act, 2013, are governed by the provisions of the said Act. Under the Act, these NPOs are required to follow the Accounting Standards notified by the MCA and to prepare balance sheet and statement of profit and loss account (income and expenditure account in case of companies not carrying business for profit) in the formats set out in Schedule III to the Act, or as near thereto as circumstances admit. NPOs which are not registered under the Companies Act but the statute which governs them prescribes a format for the purpose of preparation of the financial statements, should prepare the financial statements in accordance with the requirements of the said statute. The Accounting Standards should also be followed by such NPOs as are already discussed in this Technical Guide. For use by NPOs, which are not governed by any statute or for which the governing statute does not prescribe any formats, formats of financial statements are given hereinafter. It may be emphasised that an NPO may modify the formats appropriately keeping in view the nature of activities, requirements of donor agencies, etc. The formats should be viewed as laying down the minimum requirements that NPOs should present in their financial statements. Those NPOs which wish to present more detailed information are encouraged to do so.

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