Fund based accounting

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NPOs frequently receive grants/donations and other forms of revenue the use of which may be either unrestricted or subject to the restrictions imposed by the contributors, i.e., such funds can only be used for specific purposes and, therefore, are not available for an NPO's general purposes. Further, there might also be legal/ other binding restrictions on NPOs to use certain specific amounts only for specified purposes or NPOs may also, on their own, earmark certain unrestricted funds for specific purposes. For the purpose of appropriate presentation and disclosure of these funds in the financial statements, it is necessary to understand their nature and characteristics, which is described below:

1. *Unrestricted funds:* Unrestricted funds refer to funds contributed to an NPO with no specific restrictions. The obligation of an NPO while accepting an unrestricted donation or grant is to ensure its usage for the general purposes of the NPO. All incomes (donations, legacies, investment income, fees, etc.) not subject to external restrictions are part of unrestricted funds. The unrestricted funds can be further classified into three categories viz., corpus, designated funds and general fund.
    1. Corpus: Corpus refers to the funds contributed by founders/promoters generally to start the NPO. They are non- reducible funds which can, however, be increased by additional contribution by the founders/ promoters in furtherance of the objects of the NPO. These funds need to be distinguished from funds which are in the nature of founders'/promoters' contribution, which are grants given by contributors other than founders/promoters with reference to the total investment in an undertaking or by way of contribution towards outlay. No repayment is ordinarily expected of such grants.

    2. Designated funds: Designated funds are unrestricted funds which have been set aside by the trustees/ management of an NPO for specific purposes or to meet future commitments. Unlike restricted funds, any designations are self-imposed and are not normally legally binding. The NPO can lift the designation whenever it wishes and reallocate the funds to some other designated purpose.
    3. General fund: Unrestricted funds other than ‘designated funds’ and ‘corpuses’ are part of the ‘General Fund’.
2. *Restricted funds:* Restricted funds are subject to certain conditions and obligations set out by the contributors and agreed to by the NPO when accepting the contributions. The restriction may apply to the use of the monies received or income earned from the investment of such monies or both. Funds, the use of which is subject to legal restrictions are also considered as restricted funds.

Endowment funds are another form of restricted funds. Endowment funds are those funds which have been received with a stipulation from the contributor/donor that the amount received should not be used for any purpose. Only the income earned from these funds can be used either for general purposes of the NPO or for specific purposes, depending on the terms of the contribution made. Usually, the amount received is invested outside the NPO as per the terms of the contribution, if any.

Designated funds are created by appropriation of the surplus for the year for meeting a revenue expenditure or capital expenditure in future. When revenue expenditure is incurred with respect to a designated fund, the same is debited to the income and expenditure account. A corresponding amount is transferred from the concerned designated fund account to the credit of the income and expenditure account after determining the surplus/deficit for the year since the purpose of the designated fund is over to that extent. Where the designated fund has been created for meeting a capital expenditure, the relevant asset account is debited by the amount of such capital expenditure and a corresponding amount is transferred from the concerned designated fund account to the credit of the income and expenditure account after determining surplus/deficit for the year. In respect of the assets, e.g., a building, being constructed by an NPO, on completion of the same, the entire balance, if any, of the relevant designated fund is transferred to the credit of

the income and expenditure account after determining the surplus/ deficit for the year.

In case an NPO holds specific investments against the designated funds, income earned, if any, on such investments, is credited to the income and expenditure account for the year in which the income is earned. An equivalent amount may be transferred to the concerned designated fund account after determining the surplus/deficit for the year as per the policy of the NPO.

All items of revenue and expenses that do not relate to any designated fund or restricted funds are reflected in the 'General Fund'. The surplus/ deficit for the year after appropriations is transferred and disclosed as surplus/deficit as a part of 'General Fund' in the balance sheet. Apart from such surplus/deficit, the 'General Fund' also includes the following which are separately disclosed in the balance sheet:

3. Grants related to a non-depreciable asset. (See Grants and Donations- Recognition and Measurement)
4. Grants of the nature of founders'/promoters' contribution. (See Grants and Donations – Recognition and Measurement)

Restricted funds, that represent the contributions received the use of which is restricted by the contributors, are credited to a separate fund account when the amount is received and reflected separately in the balance sheet. Such funds may be received for meeting revenue expenditure or capital expenditure. Where the fund is meant for meeting revenue expenditure, upon incurrence of such expenditure, the same is charged to the income and expenditure account ('Restricted Funds' column); a corresponding amount is transferred from the concerned restricted fund account to the credit of the income and expenditure account ('Restricted Funds' column). Where the fund is meant for meeting capital expenditure, upon incurrence of the expenditure, the relevant asset account is debited which is depreciated as per AS 10. Thereafter, the concerned restricted fund account is treated as deferred income, to the extent of the cost of the asset, and is transferred to the credit of the Income and Expenditure Account in proportion to the depreciation charged every year (both the income so transferred and the depreciation should be shown in the 'Restricted Funds' column). The unamortised balance of deferred income would continue to form part of the restricted fund. Any excess of the balance of the concerned restricted fund account over and above the cost of the asset may have to be refunded to the donor. In case the donor does not require the same to be refunded, it is treated as income and credited to the income and expenditure account pertaining to the relevant year (as 'General Fund'). Where the restricted fund is in respect of a non-

depreciable asset, the concerned restricted fund account is transferred to the ‘Capital Reserve’ in the balance sheet when the asset is acquired.

The restricted funds will normally carry a stipulation as to the use of income earned on investments made out of the contributions received. If the terms stipulate that the income earned should be used for the same purpose for which the contribution was made, the income earned should be credited to the concerned restricted fund account. Where the terms stipulate a general use of the income earned, the same should be credited to the income and expenditure account (as ‘General Fund’) of the year in which the income is so earned.

With regard to endowment funds, the income earned from investments of these funds is recognised in the income and expenditure account only to the extent of the expenditure incurred for the relevant purpose. Both the income and the expense should be shown in the ‘Restricted Funds’ column. Any excess of the income not recognised as aforesaid would continue to remain part of the concerned fund.

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