

CHAPTER 02**Difference between Commercial and Fund Accounting Systems**

02.01 Commercial organisations have accounting systems that measure product, division and company performance by profit and loss. Accounting in NGOs is also required to measure the incoming and outgoing funds, but NGOs have social and legal responsibilities that extend beyond spending their money wisely. Fund accounting systems help in meeting various social and legal responsibilities which normal accounting systems cannot. Some features of fund accounting are as under :

- Tracking and reporting accounting records separately for different funding sources, grants, programmes etc. and being able to allocate expenses across these groups of records
- Tracking and reporting across different time periods (frequently not on annual basis), which often may extend to multiple fiscal years
- Keeping funds separately according to donor's restrictions
- Measuring and analysing the success or failure of each programme or fund individually
- Tracking the ratio of overhead to programme expenses

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- Producing specialised and specific reports for internal and external purposes

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02.02 In commercial accounting financial statements are prepared with a specific purpose for each statement. A profit and loss account is prepared to ascertain the profit and loss during the year. If a company shows high profits then it reflects its success and if it shows losses, it reflects failure. The deficit or surplus in the profit and loss account is directly related with the success and failure of a commercial organisation. But in an NGO the excess or deficit in an income and expenditure account may not provide any meaningful indication of its success or failure. Suppose an NGO is showing very high income over expenditure, but such high surplus may reflect the inability to spend fund for charitable purposes. Therefore, something which is termed as a success in the commercial world may be treated as a failure in the NGO world.

02.03 Similarly, in the commercial world if the profit and loss account is showing losses it would surely be considered as a failure or negative sign. But if an NGO is showing excess of expenditure over income it may be a positive sign. The NGO might have done some exemplary work where some money from its past reserves were also spent. Or on the contrary due to mismanagement or inefficiencies the cost may have escalated resulting in excess of expenditure over income. Therefore, the deficit in the income and expenditure account cannot conclusively indicate anything about the work or activities of the NGO. It is necessary to obtain more precise and meticulous details of the income or expenditure in order to make any meaningful analysis.

02.04 The moot point is the meaninglessness of conventional accounting statements in context of an NGO. The income and expenditure account fails to provide any definite message about the quality and efficacy of the programmes.

02.05 Similarly, a balance sheet is prepared to signify the state of assets and liabilities at the end of the year. In the balance sheet of a commercial organisation the reader can find

- The quantum of external borrowings
- The ratio of equity to loans
- The unsecured and secured loans
- The creditors
- The debtors
- The current assets, etc.

02.06 Each one of the above can provide a definite insight about the health of a commercial organisation. But again in the case of an NGO it makes very little sense if we try to understand the health of the programme or project through a conventional balance sheet. We will not be able to know

- the closing balances of individual projects
- negative project balances, if any
- investments pertaining to specific funds
- project-wise assets details
- break-up of capital/endowment funds
- break-up of current restricted funds
- break-up of current unrestricted funds, etc.

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² From 'Understanding Social Accounting' by Dr. Badal Sengupta, Interface-Volume. IV, Issue III, published by FMSF, New Delhi

³ From 'Need for Social Accounting' by Sanjay Patra, Interface- Volume. IV, Issue III, published by FMSF, New Delhi.

2.07 The fundamental difference between an NGO and a commercial organisation is the differential approach towards finance and activities. A commercial organisation does activities to maximise its capital or profits. Therefore, all the energies of a commercial organisation are spent in maximising the profits. On the contrary, NGOs by their inherent constitution do not have any profit motive. All their energies are channelised in maximising the quality of the programme or activities irrespective of whether they are making profits or losses. The donors or the stakeholders will not appreciate if the NGO is amassing huge wealth or is making huge surpluses from its programme. The reader of the financial statements of an NGO is interested in understanding

- the level of competence and efficiency in management of financial resources
- whether the conditions attached to the grants have been complied with or not
- whether different funds coming from different sources have been properly invested and managed according to the conditions attached by the donors
- whether all endowments created are intact and are as per the norms laid down
- whether administrative expenditures are reasonable in comparison to programme expenses, etc.

2.08 The conventional accounting statements may not provide any meaningful insight into the above discussed issues. Therefore, it becomes necessary to maintain sub-system and specific details to generate the desired informations. Fund accounting is one such tool which helps in providing answers to many NGO specific queries. For instance, NGOs create endowments and corpus which may be from internal or external sources. If an endowment fund is created then it implies that certain amount of funds are blocked permanently or on long term

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basis for certain specific purpose of activities. Now, it becomes important that the NGO as well as the external stakeholders know about the management and methodology involved in such fund. Therefore, the NGO has to maintain separate details for investment, assets, cash and bank balances on account of this particular fund. Similarly, the NGO also has to separately maintain the detail of expenditures made on account of this fund. Fund accounting becomes necessary for maintaining specific fund or activity-wise detail.

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