

# **Accounting for Government and Non-profit Organisations**

## **Unit - V**

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**COURSE CODE – Acct 327**

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# Unit 5

## CONTENTS:

- **Financial Control in Non Profit Organizations (NPOs):**
- Meaning and concept of financial control,
- classification of revenue and expenditure

# **Financial Control definition**

## **Financial Control definition :**

“The management of a firm's costs and expenses in relation to budgeted amounts” is called financial control

# Meaning of Financial Control

Financial control is usually when someone has money (large or moderate sums) and they control their partner with that money. For instance, if a man works and controls the money in the family he can tell the wife what to spend and what not to spend and may even go along (as her shadow) to see she gets a good deal and he'll pay for it if he thinks she should have it. I've seen people that don't even know how to use the ATM machine, write out a check or even go into a bank and deposit money or withdraw it. Some people feel that money of any kind leads to a sense of control. Why shouldn't some people feel this way when we all know money is what makes the world go round.

# Revenue

## Meaning:

In business, **revenues** or **revenue** is income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

For non-profit organization, annual revenue may be referred to as **gross receipts**. This revenue includes donations from individuals and corporations, support from government agencies, income from activities related to the organization's mission, and income from fundraising activities, membership dues, and financial investments such as stock shares in companies.

# Revenue Conti...

- In general usage, revenue is income received by an organization in the form of cash or cash equivalents. Sales revenue or revenues is income received from selling goods or services over a period of time. Tax revenue is income that a government receives from taxpayers.
- In more formal usage, revenue is a calculation or estimation of periodic income based on a particular standard accounting practices or the rules established by a government or government agency.

# Revenue Expenditure

## Meaning:

Revenue expenditure is a reserve of money used by an establishment to acquire or upgrade physical assets. Revenue expenditure is beneficial for the current business year.

# Meaning and Definition Expenditure

## Meaning of expenditure:

- outgo: money paid out; an amount spent
- expending: the act of spending money for goods or services
- consumption: the act of consuming something
- Payment of cash or transfer of property or services for the purpose of acquiring an asset or service.
- Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets

## Expenditure Conti...

- The actual spending of money as distinguished from its appropriation. The two are rarely identical in any fiscal year. Expenditures may represent money appropriated in previous years.
- Any payment, distribution, purchase, loan, advance, deposit, gift of money or anything of value, or any transfer of funds between political committees, made to support or oppose a candidate or proposition. The definition also includes an electioneering communication.
- A disbursement or liability incurred for the acquisition of a good or service. (Compare with Expense.)

# Capital Expenditure

- A capital expenditure is incurred when a business spends money either to buy fixed assets or to add to the value of an existing fixed asset with a useful life that extends beyond the accounting period generally of one year.
- To acquire or upgrade physical assets such as equipment, property, or industrial buildings.
- In accounting, a capital expenditure is added to an asset account ("capitalized"), thus increasing the asset's basis (the cost or value of an asset as adjusted for tax purposes).

# Capital Expenditure      Conti...

## **IF THE AMOUNTS SPENT ON THE FOLLOWING, WILL BE CONSIDERED AS CAPITAL EXPENDITURES:**

- Acquiring fixed assets
- Fixing problems with an asset that existed prior to acquisition
- Preparing an asset to be used in business
- Legal costs of establishing or maintaining one's right of ownership in a piece of property
- Restoring property or adapting it to a new or different use
- Starting a new business

# Explanation Capital Expenditure

- **What Does *Capital Expenditure* - Mean?**  
Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. This type of outlay is made by companies to maintain or increase the scope of their operations. These expenditures can include everything from repairing a roof to building a brand new factory.
- **Explains *Capital Expenditure* -**  
The amount of capital expenditures a company is likely to have depends on the industry it occupies. Some of the most capital intensive industries include oil, telecom and utilities.

In terms of accounting, an expense is considered to be a capital expenditure when the asset is a newly purchased capital asset or an investment that improves the useful life of an existing capital asset. If an expense is a capital expenditure, it needs to be capitalized; this requires the company to spread the cost of the expenditure over the useful life of the asset. If, however, the expense is one that maintains the asset at its current condition, the cost is deducted fully in the year of the expense.

# Difference Between Revenue Expenditure and Capital Expenditure

Capital expenditures are those expenditures that are incurred to improve the **revenue** earning capacity of fixed assets. Fixed assets are those assets that cannot be replaced unless the company goes into liquidation. For example plant & Machinery, Building, Furniture etc. Hence whenever an expense is incurred the benefit of which can be enjoyed not only in the present year but future years as well, we term it as a capital expenditure. Revenue expenditure on the other hand are all those expenditures the benefit of which can be derived in the present year only. It is an expense incurred with respect to the present year.

# Quiz No - 5

1. Entrance fees will be considered generally:
  - a) Capitalized
  - b) Taken as income
  - c) Treated as liability
  
2. The outflow of funds for acquiring current assets is nature of capital expenditure? Is the statement true or false?
  - a) True
  - b) False
  
3. What do you mean by voluntary organization:
  - (a) Meant for social services, (b) Association of person
  - (c) Colleges and Universities, (d) All of the above
  
4. Government university to report state appropriation as
  - (a) Operating revenue, b) Non Operating revenue, c) Non capital revenue,
  - (d) Special revenue
  
5. Which of the following expenses would least likely be a line item on the statement of activities of a not for profit college.
  - (a) Instruction, b) Salaries & wages, c) auxiliary enterprises, d) Student services
  
6. Which one is not part of Non Profit Organization:
  - (a) Nonprofit institutions of higher education. (b) Hospitals and other health care providers.
  - (c) Voluntary health and welfare organizations (d) Private company
  
7. Tuition fees collected from students is considered is as: Select right answer
  - (a) Revenue (b) Assets (c) Liability

True and false:

8. Revenue expenditure is the expenses of long term.

a) True, b) False

9. Acquiring fixed is of \$ 5000 is revenue expenditure.

a) True, b) False

10. Classification of expenditures can be done only by only one way.

a) False, b) True

11. The absence of profit motive, is the nature of Not for Profit Organization?

(a) True (b) False

# Revenue & Expenditure

Classification of Expenditures:

a) By Fund b) By Source

## **By Fund**

- Function or Program
- Organization Unit
- Activity
- Character (Current, Capital, Debt Service)
- Object

# Classification of Revenues and Estimated Revenues

- By Fund
- By Source
  - Taxes (Ad-valorem and self-assessing)
  - Special Assessments
  - Licenses and Permits
  - Intergovernmental Revenues
  - Charges for Services
  - Fines and Forfeits
  - Miscellaneous Revenues

# Object Classification Budget

- Traditional and most common
- Facilitates control

## **Drawbacks:**

- Discourages planning
- Promotes bottom-up budgeting than top-down budgeting
- Overwhelms top-level decision-makers with details
- Limits post-budget evaluation

# Key Phases of Budget Cycle

- Preparation
- Legislative adoption and executive approval
- Execution
- Reporting and auditing

# Cash Basis Budgeting

- Budgeting principles are established by individual governments or organizations and not by GASB nor FASB.
- Although GASB recommends the use of modified accrual basis in preparing the annual budgets, many governments adopt cash basis or modified cash basis.

# Cash Basis Budgeting

Governments using cash basis:

- Assign revenues and expenditures to the period during which the cash is expected to be received or disbursed.
- Treat encumbrances equivalent of actual purchases.
- Recognize taxes and other revenues in the year in which they are due and **not** in the year in which they are expected to be collected.

# Cash Basis

## Disadvantages:

- May distort the economic impact of planned fiscal activities.
- May be unbalanced as to economic costs and revenues.
- It may give an appearance of a budget that has achieved interperiod equity when it really has not.
- Makes it easier to transfer resources from a fund that has a budget surplus to one that needs extra resources.
- Complicates financial accounting and reporting.

# Recording Budgets

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- Estimated revenues (DB) – Actual Revenues (CR) = Revenue to be recognized
- Appropriations (CR)-Actual expenditures (DR) = Balance available for expenditure
- Refer to pgs. 98-104 for budgeting entries.

# Practical Problem

**Exe:** A government health care district incorporates its budget in its accounting system and encumbers all commitments. Prior to the start of the year, the governing board adopted a budget in which agency revenues were estimated at \$5,600 and expenditures of \$5,550 were appropriated. Record the budget using only the control accounts.

A: Estimated revenues	\$5,600	
Appropriations		\$5,550
Fund balance		50

# Encumbrance

- Prevents overspending the budget
- Entry to record encumbrance is made when purchase order is issued, a contract is signed, or a commitment is made.
- Entry that records encumbrance reduces the budget available for expenditure.
- Outstanding commitments are reported on the entity's fund balance sheet.

# Budgetary Accounts

- Purpose: Used to record the budgetary inflows and outflows estimated or authorized in the annual budget
- Accounts:
  - Estimated Revenues, Estimated Other Financing Sources
  - Appropriations, Estimated Other Financing Uses

# Budgetary and Operating Statement Accounts (cont'd)

- Revenues and Other Financing Sources increase fund balance when closed. Both are recognized on the Modified Accrual basis--when measurable and available to pay current period obligations.
- Expenditures and Other Financing Uses decrease fund balance when closed. Both are recognized on the Modified Accrual basis--when incurred, if expected to be repaid from currently available resources of the fund.

# Budgetary and Operating Statement Accounts (cont'd)

- An appropriation is a legal authorization granted by the legislative body to incur liabilities for purposes specified in the appropriation act or ordinance.
- An encumbrance is an estimated amount recorded for purchase orders, contracts, or other expected expenditures chargeable to an appropriation.

# Budgetary Control — Expenditures

- Budgetary control of expenditures is achieved by:
  - ensuring that a valid appropriation exists prior to recording an encumbrance or expenditure, and
  - periodically comparing encumbrances and expenditures to appropriations.
- Comparison is enhanced by using a common classification scheme for appropriations, encumbrances, and expenditures

# Budgetary Control — Expenditures (cont'd)

- Accounting Control over Expenditures
  - Three control accounts (Appropriations, Encumbrances, and Expenditures) are used to control similarly named columns in the detail budget accounts in the subsidiary ledger
  - The sum of the Appropriations, Encumbrances, and Expenditure account balances of the subsidiary ledger must equal the general ledger control account balance

# Practical Question of Budgetary Journal Entries

<b><u>Budget Approved on 1-1-2009:</u></b>	<b><u>Dr.</u></b>	<b><u>Cr.</u></b>
Estimated Revenues	500,000	
Appropriations		450,000
Fund Balance		50,000
<b><u>Revenues Ledger:</u></b>		
Taxes	300,000	
Licenses and Permits	50,000	
Intergovernmental Revenues	50,000	
Charges for Services	50,000	
Fines and Forfeits	25,000	
Miscellaneous Revenues	25,000	
<b><u>Appropriations Ledger:</u></b>		
General Government		120,000
Public Safety		150,000
Public Works		100,000
Culture and Recreations		80,000

# Subsidiary Ledgers for Budgetary Control

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## Revenue Subsidiary Ledger

Acct No. XXX

Account Name: Charges for Services

Estimated

Actual

Revenues

Revenues

Balance

Date	Explanation	Folio	DR	CR	DR (CR)
1-1-2009	Budget authority	GJ71	50,000		50,000
1-31-2009	Various items	CR82		4,000	46,000
2-28-2009	Various items	CR87		5,000	41,000

# Practical of Budgetary Control

Exe: City Clerk's office orders a new FAX machine on January 2, 2009 which had a list price in the vendor's catalog of \$500.

## Entry in the General Fund General Journal:

	<u>Dr.</u>	<u>Cr.</u>
Encumbrances--2009	\$500	
Reserve for Encumb.--2009		500

# Questions

**Exe:** During the year, the district collected \$5800 in fees, grants, taxes, and other revenues. Prepare journal entries.

A: Cash	\$5800	
Revenues		5800

**Exe:** It ordered goods and services for \$3000.

A: Encumbrances	\$3000	
Reserve for encumbrances		3000

# Cont'd

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**Exe:** During the year it received and paid for \$2800 of goods and services that had been previously encumbered. It expects to receive the remaining \$200 in the following year.

A: Expenditures	\$2800	
Cash		2800
Reserve for encumbrances	\$2800	
Encumbrances		2800

**Exe:** It incurred \$2500 in other expenditures for goods and services that had not been encumbered.

A: Expenditures	\$2500	
Cash		2500

(cont'd)

**Exe-5** Prepare end of year closing entries.

<b>A: Revenues</b>	<b>\$5800</b>	
Estimated revenues		5600
Fund balance		200
<b>Appropriations</b>	<b>\$5550</b>	
Expenditures		5300
Encumbrances		200
Fund balance		50

# Summary

- The General Fund and special revenue funds usually require a legally adopted budget before the government can collect revenues from taxes and other sources and incur expenditures.
- Severe penalties may exist for failure to comply with the budget, so it is imperative that the accounting system facilitate accounting for the budget as well as all other operating transactions.

# Quiz No - 5

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4. Government university to report state appropriation as
  - (a) Operating revenue, b) Non Operating revenue, c) Non capital revenue,
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5. Which of the following expenses would least likely be a line item on the statement of activities of a not for profit college.
  - (a) Instruction, b) Salaries & wages, c) auxiliary enterprises, d) Student services
  
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  - (a) Nonprofit institutions of higher education. (b) Hospitals and other health care providers.
  - (c) Voluntary health and welfare organizations (d) Private company
  
7. Tuition fees collected from students is considered is as: Select right answer
  - (a) Revenue (b) Assets (c) Liability

True and false:

8. Revenue expenditure is the expenses of long term.

a) True, b) False

9. Acquiring fixed is of \$ 5000 is revenue expenditure.

a) True, b) False

10. Classification of expenditures can be done only by only one way.

a) False, b) True

11. The absence of profit motive, is the nature of Not for Profit Organization?

(a) True (b) False

# HOME ASSIGNMENT

**Q-1.**

**What's The Difference Between Revenue Expenditure And Capital Expenditure?**

**Q-2.**

**Explain The Meaning And Concept Of Financial Control**

# Questions

Q-1 A government health care district incorporates its budget in its accounting system and encumbers all commitments. Prior to the start of the year, the governing board adopted a budget in which agency revenues were estimated at \$8,600 and expenditures of \$8,550 were appropriated. Record the budget using only the control accounts.

A: Estimated revenues	\$8,600	
Appropriations		\$8,550
Fund balance		50

# Questions

Q-2. City Clerk's office orders a new FAX machine on January 2, 2009 which had a list price in the vendor's catalog of \$500.

## Entry in the General Fund General Journal:

	<u>Dr.</u>	<u>Cr.</u>
Encumbrances--2009	\$500	
Reserve for Encumb.--2009		500

# Questions

Q-3. During the year, the district collected \$5800 in fees, grants, taxes, and other revenues. Prepare journal entries.

A: Cash	\$5800	
Revenues		5800

Q-4. It ordered goods and services for \$3000.

A: Encumbrances	\$3000	
Reserve for encumbrances		3000

# Cont'd

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**Q-5:** During the year it received and paid for \$2800 of goods and services that had been previously encumbered. It expects to receive the remaining \$200 in the following year.

A: Expenditures	\$2800	
Cash		2800
Reserve for encumbrances	\$2800	
Encumbrances		2800

**Q-6:** It incurred \$2500 in other expenditures for goods and services that had not been encumbered.

A: Expenditures	\$2500	
Cash		2500

**Q-7:** Prepare end of year closing entries.

<b>A: Revenues</b>	<b>\$5800</b>	
Estimated revenues		5600
Fund balance		200

<b>Appropriations</b>	<b>\$5550</b>	
Expenditures		5300
Encumbrances		200
Fund balance		50

## Questions

Q-8. A religious Trust having total expenditure is \$ 80000 for the financial year ending 31<sup>st</sup> December, 2009, while the total subscription received during the same financial year is \$ 74600. At the end of the financial year what is the surplus amount.

Cash                   \$ 80000

Subscription                   \$ 80000

Expenditure                   \$ 80000

    Cash                                   74600

    Surplus                               \$ 5400

Ans. \$ 5400

# Questions

True and false:

Q. Acquiring fixed is of \$ 5000 is revenue expenditure.

a) True, b) False

Q. Revenue expenditure is the expenses of long term.

a) True, b) False

Q. Classification of expenditures can be done only by only one way.

a) False, b) True

Very short answer type question:

Q. What do you mean by Financial control?

Q. Define and explain the differences between revenue and expenditure for non profit organization

Q. Differentiate the nature of Capital expenditure and revenue expenditure.

## Model Question - Quizzes

1. Explain the terms

- a) **GASB**
- b) **FASB**

2. The term independent sector refers to: Opt only one;

- a) **States that have opted not to receive fund govt. funds**
- b) **Not for profit Organization**
- c) **University that are not affiliated with particular Govt. Unit**

3. The term funds refers to:

- a) **Only cash**
- b) **All Assets**
- c) **Retained Earning**
- d) **Money save and kept for special purposes**

4. The \$8,000 bill was paid, whether, it's sources of application of fund?

- a) application of fund
- b) sources of fund

Fill in the blanks:

5. **International Financial Reporting Standards (IFRS)** are Standards, Interpretations and the Framework adopted by the .....IASB.....

Depict True OR False:

6. Statement of retained earning is not the part of Financial Statement;

- i) True
- ii) **False**

## Model Question - Quizzes

Q.7 Which one is not part of Non Profit Organization:

- a) Nonprofit institutions of higher education, B) Hospitals and other health care providers.
- c) Voluntary health and welfare organizations, d) Other nongovernment non-business organizations,
- e) Private company

Q 8. Tuition fees collected from students is considered is as: Select right answer

- a) Revenue
- b) Assets
- c) Liability

Q 9. Entrance fees will be considered generally:

- a) Capitalized
- b) Taken as income
- c) Treated as liability

Q 10. The outflow of funds for acquiring current assets is nature of capital expenditure? Is the statement true or false?

- a) True
- b) False

# Model Question For Mid-Term I&II

**Total Questions = 8**

**Maximum Marks : 5 × 3= 15**

All question carry equal marks. Attempt any five question.

## **Objective Type Question:**

Q 1. The primary objective of a not for profit organization:

- a) Maximize revenue, b) Maximize expenditure,
- c) Provide services to constituent, d) All of the above

Q 2. When used in fund accounting, the term ‘ ‘ Fund’ ’ refers to:

- a) A sum of money designated for special purposes
- b) A liability to other governmental units.
- c) The equity of a municipality in its own assets.
- d) A fiscal and accounting entity having a set of self balancing

## **True and false:**

Q 3. Acquiring fixed is of \$ 5000 is revenue expenditure.

- a) True, b) False

Q 4. Revenue expenditure is the expenses of long term.

- a)True, b) False

## **Very Short answer question:**

Q 5. What do you mean by non profit organization?

Q 6. How fund arises? Give one example

# Mode Questions Cont...

## **Practical questions:**

- Q 7. The budget authorized the transfer of \$50,000 from the Water Fund to the General Fund. Interest due for the year on the \$1,000,000, 8% bond issue for the Civic Center is approved for transfer from the General Fund to the Debt Service Fund.
- Q 8. The annual property tax levy of 10% on assessed valuation (\$11,000,000) is billed to property owners. Two percent is estimated to be uncollectible. Pass accounting entries.

# Model Question For Final Semester Exam

**Total Questions = 8**

**Maximum Marks : 5 × 8 = 40**

All question carry equal marks. Attempt any five question.

## **Practical questions:**

Q 1. A well-known celebrity sponsored a telethon for the Help for the Blind Foundation on November 1, 2008. Pledges in the amount of \$1,000,000 were called in. Using similar telethon campaigns as a basis, it is estimated that 25% of the pledges will be uncollectible. During 2009, \$700,000 of contributions from these pledges were collected. The remainder were uncollectible.

Required: Identify the appropriate fund(s) and prepare the journal entries necessary in 2008 and 2009 to record these transactions.

Q 2. The budget authorized the transfer of \$50,000 from the Water Fund to the General Fund. Interest due for the year on the \$1,000,000, 8% bond issue for the Civic Center is approved for transfer from the General Fund to the Debt Service Fund.

Q 3. The annual property tax levy of 10% on assessed valuation (\$11,000,000) is billed to property owners. Two percent is estimated to be uncollectible. Pass accounting entries.

## **Q 4. True and false:**

i) Acquiring fixed is of \$ 5000 is revenue expenditure.

a) True, b) False

ii) Revenue expenditure is the expenses of long term.

a)True, b) False

# Model Question For Final Semester Exam

## Cont...

### **Q 5. Objective Type Question:**

- i) The primary objective of a not for profit organization:
- a) Maximize revenue, b) Maximize expenditure,
  - c) Provide services to constituent, d) All of the above
- ii) When used in fund accounting, the term ‘ Fund’ refers to:
- a) A sum of money designated for special purposes
  - b) A liability to other governmental units.
  - c) The equity of a municipality in its own assets.
  - d) A fiscal and accounting entity having a set of self balancing

**Q 6.** The \$8,000 bill was paid, whether, it's sources of application of fund?

- a) application of fund
- b) sources of fund

### **Very Short answer question:**

**Q 7.** What do you mean by non profit organization? Explain in two sentences.

**Q 8.** How fund arises? Give one example

# Mini Project During the Semester

*Title: What is the nature of revenue, in not for profit organizations how it will be recognized? When the it will be incurred, explain with example.*