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M. Com. Part-II

Semester-IV :

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Advanced Accountancy Paper-XIII

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Preface

It gives me immense pleasure to bring forward this self learning material (SLM) for Advanced Accountancy Paper XIII for the students of M. Com. II. As per the order and guidelines of the Government of Maharashtra, National Education Policy 2020 is implemented for all the post graduate programmes of Shivaji University from the Academic Year 2023-24. Continuing the implementation of NEP 2020 for the academic year 2024-25, syllabus of various papers under various major courses for M. Com. II are set considering the guidelines given in the NEP Document and Government Resolution in this regard and introduced from June 2024.

The subject Advanced Accountancy occupies an important place in the content of Commerce and Management Education. Its importance has been arduously recognised by all types of business organisations in private and public sector and even, non-business organisations. Considering the need of the hour some units were need to be accommodated in the curriculum of the Accountancy. Accordingly, the Board of Studies in Accountancy drafted the syllabus of the subject incorporating Human Resource Accounting, Royalty Accounts, Contract Accounting and Accounts of Non-Government Organisation (NGO). This book brings out theoretical and practical knowledge in these areas.

The main feature of this syllabus is that, it brought the Accounts of Non-Government Organisation (NGO) first time in the curriculum. Though thousands of NGOs are working all over the country and they are maintaining their accounts, it was not included in any of the curriculum of under graduate or post graduate programmes of the university so far. As the information of the Accounts of NGO is not available in many of the books on Accounting, it provides opportunity to the teachers and students to visit the NGOs and gain the practical knowledge rightly from the active NGOs.

I am thankful to all the authors who have contributed to this SLM. I strongly appreciate the sincere efforts taken by the authors to enrich the quality of the concerned units. Because, this course is firstly introduced in the syllabus of the M. Com. Programme. I express my deep sense of gratitude to Hon. Vice Chancellor Prof. (Dr.) D. T. Shirke, Hon. Pro-Vice Chancellor Prof. (Dr.) P. S. Patil, Hon. Dean of the Faculty of Commerce and Management Prof. (Dr.) S. S. Mahajan and Registrar Dr. V. N. Shinde for their supreme support, guidance and encouragement. I especially thanks to the Director, Distance and Online Education Centre for his keen interest in developing quality study material, cooperation and assistance to produce the learning material. I am also thankful to Dr. Sushant Mane, Mrs. Kapade and other concerned staff of CDOE who worked continuously for preparation and publication of this learning material.

All your suggestions will be welcomed for the further improvement of the book.

Thank you all.

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Advanced Accountancy Paper-XIII
M. Com. II

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M. Com Part-II

Semester IV

ADVANCED ACCOUNTANCY PAPER-XIII

INDEX

Each Unit begins with the section objectives -

Objectives are directive and indicative of :

1. what has been presented in the unit and
2. what is expected from you
3. what you are expected to know pertaining to the specific unit, once you have completed working on the unit.

The self check exercises with possible answers will help you understand the unit in the right perspective. Go through the possible answers only after you write your answers. These exercises are not to be submitted to us for evaluation. They have been provided to you as study tools to keep you in the right track as you study the unit.

Dear Students

The SIM is simply a supporting material for the study of this paper. It is also advised to see the new syllabus 2024-25 and study the reference books & other related material for the detailed study of the paper.

Unit-1

Human Resource Accounting

Index :

1.0 Objective

After Studying this Unit you will be able to :

1. Understand concept of Human Resource Accounting.
2. Understand the importance of Human Resource Accounting in organisation.
3. Visit to business organisation and discuss with Human Resource Manager.

1.1 Introduction

Ensuring the growth and development of any organization, it is important to enhance the efficiency of its people from the right perspective. Without human resources, other resources cannot be operationally effective. The overall health of the organization is reflected in human behavior variables such as group loyalty, skill, motivation, and the capacity for effective interaction, communication, and decision-making. Organizations require resources like men, materials, machines, money, and methods. These resources are broadly categorized into two groups: animate and inanimate (human and physical) resources. Human resources, or men, are considered animate resources. The other resources -materials, machines, money, and methods are regarded as inanimate or physical resources.

For example, in a manufacturing company, the human resources include factory workers, engineers, and managers who operate and oversee the production process. The inanimate resources include the raw materials used to make products, the machinery that assembles the goods, the capital invested in the company, and the methods or processes employed to ensure efficient production and quality control.

The success of an organization depends on how effectively human resources utilize limited physical resources. Physical resources alone cannot function; they require activation by human resources. Therefore, the efficient and effective use of inanimate resources is largely dependent on the quality, caliber, skills, perception, and character of the people (human resources) working within the organization. At the macro level, human resources encompass the collective skills, creative abilities, innovative thinking, insight, imagination, knowledge, and experience of all individuals. An organization with abundant physical resources can still fail miserably without the qualified human resources to manage its operations. Thus, the significance of human resources cannot be overlooked. For a long period, the importance of human resource was not taken care of seriously by the top management of organizations. Therefore, at this stage, it becomes very important to pay due attention on the proper development of such an important resource of an organization. Let us now concentrate our discussion on the historical development of the Human Resource Accounting.

1.2 Presentation of Subject Matter

Section – 1.

1.2.1 Historical development of HRA

The systematic study of Human Resource Accounting (HRA) began in the 1960s, as described by Eric G. Flamholtz in 1999. He outlines the development of HRA in five stages:

First Stage (1960-66): During this time, academic interest in HRA started to grow. Researchers borrowed concepts from other fields like economic theories of capital, psychological theories on leadership effectiveness, and the new idea of human resources as distinct from personnel management or human relations. They also looked at measuring corporate goodwill.

Second Stage (1966-71): This period focused on creating and testing different HRA models. These models included both the costs and the monetary and non-monetary value of human resources. The goal was to develop tools that organizations could use to better assess and manage their human resources as valuable assets.

Third Stage (1971-76): Research in HRA rapidly increased during this period, with a focus on how HRA could be applied in business organizations. Significant contributions were made by R.G. Barry Corporation in 1971.

Fourth Stage (1976-80): Interest in HRA declined during this period. The issues that needed to be explored became more complex and required deeper empirical research, which organizations were not willing to fund.

Fifth stage (1980 onwards): Interest in HRA revived suddenly as developed economies shifted from manufacturing to service industries. Organizations realized the importance of their human assets. Since the success and profitability of companies were seen to depend more on intellectual assets than physical ones, there was a growing need for more accurate ways to measure HR costs, investments, and value.

1.2.2 Meaning and Definition of Human Resource Accounting (HRA)

The concept of human resource accounting can be better understood through some key definitions by experts in the field.

1. American Association of Accountants (1973)

(AAA) defines HRA as follows: "HRA is a process of identifying and measuring data about human resources and communicating this information to interested parties"

2. Eric Flamholtz (1974)

"Accounting for people as an organizational resource. It involves measuring the costs incurred by organizations to recruit, select, hire, train, and develop human assets"

3. Stephen Knauf (1983)

"HRA is the measurement and quantification of human organizational inputs such as recruiting, training, experience and commitment"

4. Palanivelu, R.P (2007)

"Human Resource Accounting involves measuring the costs incurred by business firms and other organizations to recruit, select, hire, train and develop human assets. It also involves measuring the economic value of people to the organization".

5. The American Accounting Society Committee on Human Resource Accounting

"Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties." In simple terms, it is an extension of the accounting principles of matching costs and revenues and of organizing data to communicate relevant information in financial terms.

6. Mr. Woodruff Jr. Vice President of R. G. Batty Corporation

"Human Resource Accounting is an attempt to identify and report investments made in human resources of an organization that are presently not accounted for in conventional accounting practice. Basically it is an information system that tells the management what changes over time are occurring to the human resources of the business.”

Imagine a company invests Rs.10,00,000 in training its employees over a year. In traditional accounting, this investment might not be recorded as a valuable asset. However, Human Resource Accounting would track this investment and report on how the training improves employee skills and productivity. For example, if the training leads to a 15% increase in sales revenue, Human Resource Accounting would helps show how the training has added value to the company’s human resources.

Thus, human resources accounting may be defined as, “a process of accounting which identifies, quantifies and measures human resources for the use of management to cope up with the changes in its quantum and quality so that equilibrium could be achieved in between the required resources and the provided human resources”

In short, human resource accounting is the art of valuing, recording and presenting systematically the worth of human resources in the books of account of an organization. This definition brings out the following important characteristic features of human resource accounting: 1. Valuation of human resources 2. Recording the valuation in the books of account 3. Disclosure of the information in the financial statements of the business.

Check your progress-1

1. Multiple Choice questions

1. ……….. stage of HRA development saw the involvement of R.G. Barry Corporation in making significant contributions.

   a) First Stage (1960-66) b) Second Stage (1966-71)

   c) Third Stage (1971-76) d) Fourth Stage (1976-80)

2. ……………. organization defined HRA as “a process of identifying and measuring data about human resources and communicating this information to interested parties”?

   a) American Association of Accountants b) Eric Flamholtz

   c) R. G. Barry Corporation d) Palanivelu, R.P

2. Fill in the blanks

1. During the _______ stage of HRA development (1966-71), researchers focused on creating and testing different HRA models, which included both the costs and the _______ value of human resources.
2. The American Association of Accountants (AAA) defined HRA in 1973 as a process of ________ and ________ data about human resources and communicating this information to interested parties.

3. State True or False

1. Human Resource Accounting involves recording the valuation of human resources in the books of account and disclosing this information in the financial statements of the business.
2. The systematic study of Human Resource Accounting (HRA) began in the 1970s.

Section – 2

1.2.3 Objectives of Human Resource Accounting (HRA)

Human resources play a significant role and the return on investment is directly or indirectly related to it. Sometimes, human resources have a positive value whereas at other times they may have consciousness or awareness about the human resources which could be the basic objective of valuing human resources. Another purpose of HRA is to improve the quality of financial decisions both internally and externally concerning an organisation. HRA system provides the data necessary to convert the 'qualitative' decision making inherent in the management of human resources into a somewhat quantitative framework.

1. Provide information for Management Decision:

Human Resource Accounting (HRA) provides essential cost and value information, enabling management to make well-informed decisions regarding various aspects of human resource management, such as acquisition, allocation, development, and maintenance. By accurately measuring and reporting the costs associated with HR activities, HRA ensures that resources are utilized efficiently and effectively. For instance, when considering training programs, HRA can reveal the true costs of internal training versus hiring externally. This detailed financial insight helps managers decide whether investing in internal training programs will be more cost-effective and beneficial in the long run compared to the expenses and potential risks associated with hiring new employees. Additionally, HRA helps in assessing the value added by training programs, such as improved employee performance and retention, which further guides strategic HR decisions. This comprehensive approach ensures that HR initiatives align with the organization's financial goals and long-term strategic objectives, ultimately leading to better resource management and enhanced organizational performance.

2. Effective Monitoring of human resources:

HRA allows for the effective monitoring of human resources by tracking how these resources are utilized within the organization. This includes evaluating the efficiency and productivity of employees, ensuring that they are contributing effectively to the organization’s goals. For instance, tracking employee performance metrics can highlight areas where additional training or support is needed.

Imagine a large technology company that uses HRA to monitor its human resources. They implement a system to track employee performance metrics such as sales targets achieved, project completion rates, customer satisfaction ratings, and attendance records. Through this system, they analyze the efficiency and productivity of each employee and team. During the analysis, they notice that a particular team consistently meets their sales targets but has lower customer satisfaction ratings compared to other teams. This discrepancy prompts further investigation. Upon reviewing the HRA data, they find that the team lacks training in handling customer inquiries effectively, which impacts their ability to maintain high customer satisfaction. Based on this insight from HRA, the company decides to implement additional training sessions focused on customer service skills for the team. They monitor the team's performance metrics after the training sessions and observe an improvement in customer satisfaction ratings, leading to better overall team productivity and performance.

3. Helps in Human Asset Controlling:

Human Resource Accounting (HRA) establishes a structured method for controlling human assets by determining whether these assets are being appreciated (value increasing), depleted (value decreasing), or conserved (maintained value). Appreciating human assets involves investing in professional development, career advancement, and recognition programs to enhance their skills, motivation, and satisfaction, thereby increasing their value to the organization. Depletion of human assets occurs when factors such as employee suffer exhaustion, job dissatisfaction, and skill obsolescence reduce their effectiveness and contribution. Conserving human assets involves maintaining their current value through regular assessments, support systems, and engagement strategies, ensuring they remain productive and satisfied. Regular assessments are crucial for identifying and addressing issues such as burnout or dissatisfaction early on, enabling timely interventions that promote a healthy, engaged, and continuously valuable workforce. Effective asset control in HRA thus plays a vital role in ensuring that employees contribute positively to the organization's success while maintaining their well-being and professional growth.

For example, a tech company conducts regular employee surveys and performance reviews to monitor its human assets. Through these assessments, they discover that many software developers are experiencing burnout due to excessive workloads and tight project deadlines. To address this, the company decides to implement several measures:

- **Workload Redistribution**: They hire additional developers to balance the workload more evenly across the team.
- **Professional Development**: They offer training programs on time management and stress reduction techniques.
- **Recognition and Rewards**: They introduce a recognition program to celebrate and reward high-performing employees, providing bonuses and public acknowledgment of their efforts.

These initiatives lead to reduced burnout, improved job satisfaction, and increased productivity among the developers. As a result, the value of these human assets appreciates, contributing positively to the organization's overall performance and success.

4. Enhancing Quality of Financial Decisions:

Human Resource Accounting (HRA) enhances the quality of financial decisions by supplying detailed data about the organization's human resources. This comprehensive information is crucial for making informed internal management decisions and for transparent external reporting to stakeholders. By integrating human resource data into financial statements, organizations can present a more accurate and holistic view of their overall value, including intangible assets such as employee skills, experience, and productivity. This leads to better resource allocation, investment in employee development, and strategic planning. For instance, an organization might use HRA data to identify high-performing departments with significant employee contributions and allocate additional funds for further training and development in those areas. Conversely, they may identify areas with high turnover rates and invest in initiatives to improve employee retention. By presenting this data in financial statements, stakeholders gain a clearer understanding of the organization's true value and potential for future growth.

Example: A large manufacturing company integrates HRA into its financial reporting. The company collects and analyzes data on employee training, performance, retention rates, and overall satisfaction. This data reveals that the sales department has significantly increased its performance and revenue after participating in specialized training programs. Recognizing the success, the company decides to allocate more budget towards expanding these training programs to other departments. Additionally, the company notes a high turnover rate in the customer service department, prompting an investment in employee engagement and retention initiatives. By including this human resource information in their financial statements, the company provides stakeholders with a comprehensive view of how investments in human capital contribute to financial performance, leading to more informed and confident investment decisions.

5. Provide Quantitative Framework of HRM:

Human Resource Accounting (HRA) converts qualitative aspects of human resource management into a quantitative framework, allowing organizations to measure and analyze subjective factors such as employee satisfaction, morale, and engagement. By translating these subjective factors into measurable data, organizations can make more objective, data-driven decisions. This process involves creating metrics and scales to quantify these factors, which can then be incorporated into financial analysis and reporting. Quantifying qualitative data provides a clearer picture of the relationship between human resource practices and organizational performance, enabling better strategic planning and resource allocation.

Example: A retail company conducts regular employee engagement surveys to gauge satisfaction, motivation, and morale. The survey results are scored on a scale from 1 to 10, with higher scores indicating higher levels of engagement. The company finds that departments with average engagement scores above 8 have 20% higher productivity and 30% lower turnover rates compared to departments with scores below 5.

By converting the survey results into quantitative data, the company can directly link engagement levels to productivity and retention metrics. This information is used to make strategic decisions, such as increasing investment in employee development programs and enhancing workplace conditions in departments with lower engagement scores. Additionally, the quantified data is included in the company's financial reports, providing stakeholders with a comprehensive understanding of how employee engagement impacts overall financial performance. This quantitative framework thus enables the company to objectively assess the effectiveness of its human resource initiatives and make informed decisions to improve organizational outcomes.

6. Provide details for Long-term Cost and Benefit Analysis:

Human Resource Accounting (HRA) aids top management in understanding the long-term cost and benefit implications of their HR decisions, fostering the development of more sustainable business strategies. By providing detailed insights into the financial impact of various HR initiatives, HRA ensures that management considers both immediate and future consequences. This holistic view helps prevent decisions that may enhance short-term profitability at the expense of long-term sustainability. For instance, while cutting training programs might reduce costs in the short term, it could result in a less skilled workforce over time, leading to decreased productivity, higher turnover rates, and ultimately greater costs associated with hiring and retraining new employees.

Example: A manufacturing company is considering cost-cutting measures to improve its quarterly financial results. One proposed measure is to reduce the budget for employee training programs. HRA provides the company with a comprehensive analysis showing that while cutting the training budget would save Rs 5,00,000 this year, it would likely result in a 15% decline in employee productivity and a 20% increase in turnover within the next three years.

Further, the analysis reveals that hiring and training new employees to replace those who leave could cost the company an additional Rs 15,00,000 over the same period. HRA also highlights the benefits of maintaining the training programs, such as improved employee skills, higher job satisfaction, and better overall performance, which contribute to long-term profitability and competitive advantage. With this information, senior management decides to maintain the training programs despite the immediate cost. This decision, guided by HRA's long-term cost and benefit analysis, helps the company ensure sustainable growth and avoid the hidden costs and risks associated with short-term savings. By prioritizing long-term strategic planning, the company can foster a more skilled and loyal workforce, ultimately leading to higher productivity and profitability.

7. Provides information for the efficient and effective management of human resources

Human Resource Accounting (HRA) provides vital information for the efficient and effective management of human resources. This involves a comprehensive approach to acquiring, developing, allocating, conserving, utilizing, evaluating, and rewarding employees. By leveraging HRA, organizations can ensure that their human resources are optimally utilized to achieve maximum contribution to organizational success. Efficient management of these HR functions helps in making informed decisions that enhance employee performance, satisfaction, and retention, ultimately leading to improved organizational outcomes.

Example: A technology company utilizes HRA to optimize its training programs. The company conducts a detailed analysis of the costs associated with its training initiatives and compares them with subsequent performance improvements. The analysis reveals that while the initial cost of advanced software training is high, employees who undergo the training show a 25% increase in productivity and a 15% reduction in error rates. With this data, the company can make more informed decisions about its training budget. For instance, they might decide to reallocate funds from less effective training programs to the advanced software training, thereby maximizing the return on investment in employee development. Additionally, the HRA analysis highlights which departments benefit the most from specific training programs, enabling targeted training investments that yield the highest performance improvements.

By using HRA to manage these HR functions efficiently, the company ensures that its human resources are well-developed, effectively utilized, and appropriately rewarded. This comprehensive approach not only improves individual employee performance but also enhances overall organizational productivity and success. Efficient management through HRA thus facilitates better strategic planning and resource allocation, contributing to long-term organizational growth and sustainability.

8. Evaluation of Transformational Process:

Human Resource Accounting (HRA) evaluates the key transformational processes that convert raw human inputs into productive outputs. This involves assessing how effectively an organization transforms individual and group potential into tangible outcomes, such as goods and services. By analyzing these processes, HRA provides insights into areas where improvements can be made to enhance productivity and efficiency. This objective is crucial for understanding and optimizing the entire employee lifecycle, from recruitment and onboarding to full productivity and beyond.

Example: On boarding Process Evaluation

Consider a financial services company that aims to improve its onboarding process to ensure new hires quickly become productive team members. Using HRA, the company evaluates its current onboarding program by tracking several key metrics:

i) Time to Productivity: The company measures the average time it takes for new hires to reach full productivity. This includes the duration from their start date to when they consistently meet performance targets.

ii) Training Effectiveness: The company assesses the effectiveness of its training programs by comparing the performance of new hires who completed the training with those who did not. Metrics such as task completion rates, accuracy, and customer satisfaction scores are analyzed.

iii) Retention Rates: HRA tracks the retention rates of new hires within the first year. High turnover rates during this period can indicate issues with the onboarding process or initial job expectations.

iv) Employee Feedback: The company collects feedback from new hires about their onboarding experience, including the clarity of job roles, the helpfulness of training materials, and the overall support received from the team and management.

Based on the HRA evaluation, the company identifies several areas for improvement:

- Enhanced Training Modules: The analysis shows that new hires who received additional hands-on training performed better and reached productivity faster. The company decides to expand its training modules to include more practical exercises and real-world scenarios.
- Mentorship Programs: Feedback from new hires indicates that having a dedicated mentor significantly improves their onboarding experience. The company implements a mentorship program where each new hire is paired with an experienced employee who provides guidance and support.
- Streamlined Processes: HRA reveals that certain administrative tasks during onboarding are time-consuming and redundant. The company streamlines these processes by automating paperwork and simplifying procedures, reducing the time new hires spend on administrative tasks.
- Continuous Monitoring: The company establishes a system for ongoing monitoring and evaluation of new hires' progress, ensuring that any issues are addressed promptly and that the onboarding process remains effective.

By using HRA to evaluate and optimize its onboarding process, the financial services company improves the efficiency of transforming new hires into fully productive team members. This not only enhances overall productivity but also increases job satisfaction and retention rates, contributing to the organization's long-term success. HRA's evaluation of transformational processes enables organizations to identify strengths and weaknesses in converting human potential into productive outputs. By making data-driven improvements to these processes, organizations can enhance efficiency, productivity, and employee satisfaction, ultimately leading to better organizational performance.

9. Enhance Investment Decision Making:

Human Resource Accounting (HRA) enhances investment decision-making by providing a comprehensive and accurate account of an organization’s total worth, which includes its human resources. By offering insights into the value generated by the workforce, HRA helps investors assess the sustainability and growth potential of an organization. This detailed evaluation of human capital, such as employee skills, experience, motivation, and development, allows investors to make more informed decisions about where to allocate their resources. Organizations with a well-trained, highly motivated workforce are often perceived as more secure and promising investments due to their potential for sustained performance and growth.

Example: Evaluating a Tech Company's Workforce

Consider an investor evaluating two tech companies, Company A and Company B, for potential investment. Both companies have similar financial statements, but Company A uses HRA to provide additional insights into its workforce.

Company A: Detailed HRA Report

1. **Employee Training and Development:**
    - Company A reports that it invests $2 million annually in employee training and development programs.
    - The HRA analysis shows that employees who undergo these training programs improve their productivity by 30% and contribute to a 15% increase in innovative projects and patents.
2. **Employee Satisfaction and Retention:**
    - Employee satisfaction surveys indicate a high level of job satisfaction, with an average score of 8.5 out of 10.
    - The turnover rate is low at 5%, significantly below the industry average of 15%.
    - The HRA data attributes this to comprehensive onboarding processes, ongoing career development opportunities, and a positive workplace culture.
3. **Performance and Motivation:**
    - Company A's HRA metrics show that highly motivated employees consistently exceed performance targets, leading to a 20% higher revenue growth compared to industry peers.

- The company has a robust performance evaluation and reward system that recognizes and incentivizes top performers.

Company B: Traditional Financial Report

- Company B provides standard financial metrics but lacks detailed information on its workforce.
- There is no specific data on training investments, employee satisfaction, retention rates, or the impact of human resources on performance and innovation.

Investor Decision

With the HRA insights from Company A, the investor can see a clear picture of how the company's investment in its workforce translates into tangible business outcomes. The high level of employee satisfaction and low turnover rate suggest a stable and engaged workforce, which is crucial for long-term sustainability. The increased productivity and innovation stemming from the training programs indicate strong growth potential. Moreover, the detailed performance and motivation metrics demonstrate that Company A effectively leverages its human capital to drive business success.

In contrast, the lack of detailed workforce information from Company B leaves the investor uncertain about the company's human resource strategies and their impact on performance.

As a result, the investor is more likely to view Company A as a secure and promising investment due to its comprehensive approach to managing and valuing its human resources. This transparency and focus on human capital provide confidence in the company's ability to sustain growth and adapt to future challenges. HRA enables investors to make well-informed decisions by providing a complete picture of an organization's total worth, including its human resources. By highlighting the value generated by the workforce, HRA offers critical insights into an organization's sustainability and growth potential, making it a valuable tool for investors seeking secure and profitable investment opportunities.

10. Assessing Performance of HR functions:

Human Resource Accounting (HRA) plays a pivotal role in assessing the performance of the HR function and its impact on the overall organizational performance. This alignment is essential for ensuring that HR activities are in sync with business objectives and contribute meaningfully to the organization's success. For example, consider an organization that implements an employee engagement initiative aimed at improving job satisfaction and reducing turnover rates. By utilizing HRA, the company can quantify the financial impact of this initiative.

Initially, HRA tracks key metrics such as employee satisfaction scores, turnover rates, and productivity levels before and after the implementation of the engagement program. Suppose the company observes a significant decrease in turnover rates from 15% to 10% and an increase in productivity by 20% post-implementation. HRA translates these improvements into financial terms, such as cost savings from reduced recruitment and training expenses due to lower turnover and increased revenue from higher productivity.

By presenting these quantifiable results, HRA justifies the investment in the engagement initiative, demonstrating its positive impact on the organization's bottom line. This detailed analysis helps HR managers and executives make informed decisions about continuing or expanding such initiatives, ultimately aligning HR activities with strategic business goals and contributing to overall organizational success.

11. Avoid Short-term Profit Decisions:

Human Resource Accounting (HRA) aims to guide management away from short-term profit decisions that could harm long-term organizational health. One critical aspect involves avoiding decisions like hiring young, high-salary employees solely to meet immediate needs. While this might address short-term demands, it can lead to demotivation among existing staff due to perceived unfairness in salary disparities. This, in turn, could reduce overall productivity and foster an unhealthy work environment.

For example, a company facing a sudden surge in workload might opt to hire fresh graduates at high salaries to quickly fill the gaps. However, existing employees who have been with the company for years might feel undervalued and demotivated, especially if they perceive that the newcomers are receiving disproportionately higher compensation. This could lead to decreased morale, higher turnover rates among experienced staff, and ultimately, reduced productivity and organizational cohesion over the long term.

By employing HRA principles, such as considering the long-term costs and benefits of hiring decisions, companies can better balance short-term needs with maintaining a fair and motivating work environment. This approach helps in fostering a sustainable workforce strategy that aligns with both short-term operational needs and long-term organizational goals.

1.2.4 Need for Human Resource Accounting (HRA):

The need for Human Resource Accounting (HRA) has emerged from the increasing importance of human relations management within organizations. Behavioral scientists and management experts have emphasized several key reasons for the valuation of human assets. Traditionally, conventional accounting practices fail to provide any information about the human resources employed in an organization, despite the fact that without people, financial and physical resources cannot function effectively. Moreover, expenses related to human resources—such as recruitment, training, and development—are often charged directly to current revenue rather than being treated as investments to be amortized over time. This approach distorts the magnitude of net income and complicates the assessment of a firm's value, making interfirm comparisons difficult. Additionally, the productivity and profitability of an organization largely depend on the contribution of its human assets. Two firms with identical physical assets operating in the same market may yield different returns due to differences in the quality of their human resources. Ignoring the value of human assets makes it challenging to accurately determine the total valuation of a firm. Furthermore, if the value of human resources is not duly reported in financial statements, such as the profit and loss account or balance sheet, the critical role that management plays in developing and leveraging human capital cannot be fully appreciated. Finally, under conventional accounting, expenses related to recruitment, training, and development are treated as immediate costs and written off against revenue, when in fact, they should be regarded as long-term investments, providing benefits over time. These insights underscore the necessity of adopting Human Resource Accounting to ensure a more accurate and comprehensive valuation of an organization's true worth.

1. **Lack of Information on Human Resources:**

Under conventional accounting, no information is made available about the human resources employed in an organization. This absence of data means that the value and contribution of employees are not reflected in the financial statements. Without recognizing human resources, the financial and physical resources cannot be operationally effective. For example, a company's balance sheet might show significant investments in machinery and infrastructure, but without skilled and motivated employees to operate and maintain these assets, the company's operations could fail. Therefore, understanding and accounting for the human resources provide a more comprehensive picture of the organization's true value and operational capabilities.

2. **Unclear Net Income Due to Expense Treatment:**

In conventional accounting, expenses related to the human organization, such as salaries, recruitment, and training, are charged to current revenue instead of being treated as investments that should be amortized over time. This treatment distorts the magnitude of net income, as the costs are immediately expensed rather than spread over the period during which the benefits are realized. For instance, if a company invests heavily in employee training in one year, the expenses will be recorded in that year, leading to a lower net income. However, the benefits of this training, such as increased productivity and improved skills, will accrue over several years. By treating these expenses as investments, the financial statements would more accurately reflect the company's true profitability and facilitate better interfirm comparisons.

3. **Impact of Human Assets on Productivity and Profitability:**

The productivity and profitability of a firm largely depend on the contribution of its human assets. Two firms with identical physical assets and operating in the same market may have different returns due to differences in their human assets. For example, one firm may have more experienced and highly skilled employees, leading to higher efficiency and innovation, while the other may have a less skilled workforce, resulting in lower productivity. If the value of human assets is ignored, it becomes difficult to accurately assess the total valuation of the firm. Recognizing and accounting for human resources provide insight into the differences in performance between similar firms and highlight the critical role of employees in driving success.

4. Incomplete Management Reporting:

If the value of human resources is not duly reported in the profit and loss account and balance sheet, the important act of managing human assets cannot be fully perceived. For instance, if a company spends significantly on employee development programs but this investment is not reflected in the financial statements, stakeholders may not appreciate the company's efforts in enhancing its human capital. Properly reporting the value of human resources enables management to showcase their commitment to developing and maintaining a skilled and motivated workforce, which is essential for long-term success. It also aids in making informed decisions about hiring, training, and retaining employees.

5. Misclassification of Human Resource Expenses:

In conventional accounting, expenses on recruitment, training, and other human resource activities are treated as current expenses and written off against revenue. However, these expenses should be treated as investments, since their benefits extend over a period of time. For example, investing in an intensive training program for employees may lead to improved productivity, higher job satisfaction, and reduced turnover in the future. By treating these expenses as investments and amortizing them over their useful life, the financial statements would more accurately reflect the long-term benefits and provide a better understanding of the organization's commitment to human resource development.

The need for Human Resource Accounting (HRA) arises from the limitations of conventional accounting in recognizing and valuing human resources. HRA addresses the lack of information on human assets, corrects the distortion of net income due to expense treatment, highlights the impact of human resources on productivity and profitability, ensures comprehensive management reporting, and properly classifies human resource expenses as investments. By incorporating HRA, organizations can provide a more accurate and complete picture of their financial health and operational effectiveness, ultimately supporting better decision-making and enhancing stakeholder confidence.

1.2.5 Scope of Human Resource Accounting (HRA)

The scope of Human Resource Accounting (HRA) is extensive and multifaceted, encompassing the identification, measurement, and reporting of the value of human resources within an organization. HRA involves evaluating the costs associated with hiring, training, and developing employees, and treating these expenditures as long-term investments rather than mere expenses. It extends to the assessment of the return on investment (ROI) that human capital generates, aiding in strategic decision-making regarding resource allocation, workforce optimization, and talent management. Furthermore, HRA plays a crucial role in integrating human capital valuation with traditional financial reporting, offering a more comprehensive view of an organization's overall value by recognizing the significant impact of human resources on productivity and profitability. By including both internal factors, such as employee performance and development, and external factors, such as market trends and technological advancements, HRA provides a holistic approach to managing and valuing human assets. This comprehensive scope not only enhances financial reporting but also supports better management decisions, ultimately contributing to the long-term success and competitiveness of the organization.

1. **Information about Employment, Allocation, and Utilization of Human Resources:**

HRA provides detailed information that management uses in effectively employing, allocating, and utilizing human resources. This includes understanding the strengths and weaknesses of employees, which helps in placing the right person in the right job, thus maximizing productivity. Imagine a tech company that uses HRA to assess the skills and experience of its employees. The data shows that certain employees have advanced skills in software development. The company uses this information to assign these employees to critical projects, ensuring that their expertise is utilized effectively and enhancing overall productivity.

2. **Decision-Making for Transfers, Promotions, Training, and Retrenchment:**

With HRA, management can make informed decisions regarding employee transfers, promotions, training needs, and retrenchment. For instance, HRA data can highlight which employees have the potential for promotion or which ones might benefit from additional training. *Example:* A retail company reviews HRA data and notices that an employee has consistently exceeded sales targets and demonstrated leadership skills. This information helps the management decide to promote the employee to a managerial position. Additionally, if another employee's performance is lacking, the data might indicate a need for further training or development.

3. Planning of Physical Assets vis-a-vis Human Resources:

HRA serves as a basis for planning physical assets in relation to human resources. By understanding the value and potential of human assets, organizations can make more informed decisions about investing in physical assets to support their workforce.

4. Evaluation of Education and Training Expenditures:

HRA helps in assessing the costs incurred for employee education and training against the benefits derived. This evaluation can justify investments in employee development by showing how training programs contribute to the firm's overall performance.

5. Identifying Causes of High Labor Turnover:

HRA assists in pinpointing the reasons behind high labor turnover at different levels within the organization. By identifying these causes, management can take preventive measures to reduce turnover, such as improving working conditions or employee satisfaction.

6. Analyzing Low Return on Investment:

HRA helps in diagnosing the reasons for low return on investment, which may be due to improper or under-utilization of either physical or human resources. Understanding these issues allows management to address and optimize the use of both types of assets.

7. Assessing Organizational Strength:

HRA provides insights into the internal strength of an organization by evaluating its human resources. This information is crucial for management to navigate through adverse and favorable circumstances, ensuring long-term stability and growth.

8. Information for Long-Term Investment Decisions:

HRA provides valuable data for investors interested in making long-term investments in the firm. By presenting a clear picture of the organization's human capital, investors can make more informed decisions regarding their investments.

9. Enhancing Employee Performance and Bargaining Power:

HRA helps employees understand their contribution to the firm's success relative to the costs incurred by the firm for their development. This understanding can motivate employees to improve their performance and enhance their bargaining power in the organization.

By encompassing these areas, HRA provides a comprehensive framework for evaluating and managing human resources effectively, thus contributing to the overall success and sustainability of the organization.

Check your progress – 2

1. Multiple Choice questions

1. ……….. HRA objective focuses on tracking the utilization of human resources to improve efficiency and productivity

   a) Human Asset Control b) Effective Monitoring

   c) Investment Decision Making d) Performance Measurement

2. ……… objective of Human Resource Accounting (HRA) involves converting subjective factors like employee satisfaction into measurable data?

   a) Management Decision Support

   b) Effective Monitoring

   c) Provide Quantitative Framework of HRM

   d) Human Asset Control

3. ……… of the following is a reason for the need for Human Resource Accounting (HRA).

   a) Conventional accounting provides detailed information on human resources.

b) Human Resource Accounting helps in accurately reflecting the value of human assets in financial statements.

c) Conventional accounting treats recruitment expenses as long-term investments.

d) Human Resource Accounting reduces the importance of human resources in organizational success.

4. In conventional accounting, expenses related to employee recruitment and training treated…………………

a) As long-term investments amortized over time.

b) As immediate costs written off against current revenue.

c) As part of physical asset valuation.

d) As capital expenditures.

2. Fill in the blanks

1. HRA provides data to convert qualitative decision-making into a somewhat _______ framework, enhancing the quality of financial decisions both internally and externally**.**

2. In Human Resource Accounting (HRA), the objective of _______ is to assess how effectively an organization transforms individual and group potential into tangible outcomes.

3. Under conventional accounting, expenses related to human resources are __________ to current revenue rather than being treated as investments to be amortized over time.

4. The scope of Human Resource Accounting (HRA) includes evaluating costs associated with hiring, training, and developing employees, and treating these expenditures as __________ rather than mere expenses.

3. State True or False

1. Human Resource Accounting (HRA) helps in assessing the value added by training programs, such as improved employee performance and retention.

2. Human Resource Accounting (HRA) can help avoid short-term profit decisions that may harm long-term organizational health.
3. Under conventional accounting practices, expenses related to recruitment, training, and development are treated as long-term investments rather than immediate costs.
4. Human Resource Accounting (HRA) helps in evaluating the return on investment (ROI) that human capital generates, thus aiding in strategic decision-making.

Section – 3

1.2.6 Approaches or Methods for valuation of Human Resources

The accountants and finance professionals have suggested various methods for measuring the value of human resources utilized in an organisation. These, for the convenience of readers, may be broadly classified into two categories: Monetary Methods, and Non-Monetary Methods: We shall discuss these separately one by one.

Monetary Methods

These methods are based on cost or economic value of human resources. Under these methods human resources of an organisation are translated into a common denominator, i.e., money on which organisational decisions are taken. Following are the important monetary methods used for measuring human values in an organisation.

1. Historical Cost Method:

The Historical Cost Method**,** developed by Rensis Likert, is a way of valuing human resources by capitalizing all the actual costs incurred by an organization in acquiring and developing its employees. These costs include expenses related to recruitment, selection, hiring, training, and familiarization. Once these costs are capitalized, they are treated as an asset and are amortized over the expected service life of the employee in the organization.

For example, if a company spends 10,000 on recruiting, training, and familiarizing an employee, and the expected service period of that employee is 10 years, then 1,000 would be amortized each year over that period. This amortized amount would be charged to the profit and loss account annually. If the employee leaves the organization before the expected 10-year period, say after 5 years, the remaining unamortized amount of $5,000 would be written off in the year the employee leaves.

The primary advantage of this method is that it allows organizations to reflect the value of their human resources on their balance sheets, similar to other tangible assets. However, a significant drawback is that it may result in under-valuation, as it equates human resources with physical assets, ignoring the potential growth in the employee's value or the contributions they might make to the organization over time.

2. Replacement Cost Method:

The Replacement Cost Method is a human resource valuation approach that estimates the cost of replacing an existing employee with another who can provide equivalent services. This method considers various costs associated with replacing an employee, including recruitment, selection, training, and development costs. Additionally, it factors in the opportunity cost incurred during the time it takes for the new recruit to reach the efficiency level of the employee being replaced.

For instance, imagine an organization needs to replace a skilled manager who has been with the company for several years. The replacement cost would include the expenses involved in recruiting a suitable candidate, the training and development required to bring the new manager up to speed, and the cost of the productivity loss during the transition period. If these combined costs amount to 50,000, that figure represents the replacement cost of the existing manager.

This method is particularly useful for human resource planning, as it provides management with insights into the potential future costs of acquiring new employees. However, it contrasts with the Historical Cost Method, as the replacement cost can vary significantly depending on the specific circumstances. Additionally, this method has some drawbacks; for example, an organization might not find a direct replacement with the same value as the current employee, or the management may not want to replace the current employee due to their unique contributions, which could be more valuable than their estimated replacement cost.

3. Opportunity Cost Method:

The Opportunity Cost Method is used to assign a value to employees who possess rare and highly sought-after skills, making them scarce in the labor market.

In this method, managers who need such employees place offer prices on them, effectively competing to acquire these valuable resources. The organization that ultimately secures the employee does so by offering the highest offer price, which then represents the investment made in that employee. This offer price is typically determined by capitalizing on the actual or expected earnings that the employee is anticipated to generate for the organization.

For example, consider a highly skilled data scientist with expertise in a niche area like artificial intelligence. Several companies may be interested in hiring this individual due to the scarcity of such expertise in the market. Each company would offer a bid price based on what they believe the data scientist's skills could contribute to their organization in terms of revenue or cost savings. The company that offers the highest bid secures the data scientist, and this bid price becomes the opportunity cost or the value that the company places on the employee.

A key drawback of the Opportunity Cost Method is the lack of a clear, justified criterion for determining the offer amount. Since the offer price is often based on subjective estimates of the employee's potential contribution, it can vary widely, leading to inconsistencies in valuation. Moreover, this method only applies to employees with rare and highly specialized skills; employees who are easily replaceable or widely available in the market would not have an opportunity cost associated with them.

4. Asset Multiplier Method:

The Asset Multiplier Method is a human resource valuation approach that recognizes the indirect relationship between the costs incurred on an employee and their actual value to the organization. This method acknowledges that an employee's value is influenced by various factors, such as their motivation, working conditions, and overall attitude towards their work and the organization. Therefore, instead of directly linking costs to value, the method classifies employees into broad categories based on their roles and responsibilities, such as top management, middle management, supervisory management, and operative and clerical staff.

In this method, the total salary bill for each of these categories is multiplied by a specific multiplier to determine the value of that category of employees to the organization at a given point in time. The multiplier serves as a tool to connect the personal worth of employees with the organization's total asset values. The rationale behind using a multiplier is to match the value of human assets with the organization's goodwill. For example, if the total salary bill for the top management category is 1 million, and the multiplier for this category is set at 3, the calculated value of top management as an asset would be 3 million.

The multiplier is a critical factor in this method, and it must be carefully determined to accurately reflect the employees' value. If the calculated value of human assets does not align with the organization's goodwill, it may indicate an inaccuracy in the chosen multiplier, which would then need to be adjusted accordingly.

The Asset Multiplier Method provides a more nuanced approach to valuing human resources by considering the broader context of an employee's contribution rather than just their cost. However, its effectiveness hinges on the accurate determination of the multiplier, which can be subjective and complex, requiring a deep understanding of the organization's dynamics and the specific roles of its employees.

5. Economic Value Method:

The **Economic Value Method** values human assets by estimating the future contributions that employees are expected to make to the organization until their retirement. This method involves projecting the payments that will be made to employees over their remaining service period, including salaries, allowances, benefits, and other compensation. These projected payments represent the expected economic contribution of the employees to the organization.

Once the total future payments are estimated, they are then discounted to their present value. Discounting is necessary because the value of money changes over time; a dollar today is worth more than a dollar in the future. By discounting the future payments, the organization can determine the present economic value of each employee or group of employees.

For example, if an organization estimates that it will pay an employee 100,000 annually in salary and benefits for the next 10 years until retirement, the total future payments amount to 1 million. However, by applying a discount rate to account for the time value of money, the organization may determine that the present economic value of these future payments is, say, 800,000. This 800,000 represents the current value of the employee's economic contribution to the organization.

The Economic Value Method provides a forward-looking approach to human resource valuation, focusing on the future contributions of employees rather than past costs. However, this method relies heavily on accurate projections of future payments and the appropriate selection of a discount rate, both of which can be complex and subject to uncertainty. Additionally, it assumes that the value of an employee is solely based on their economic contributions, potentially overlooking other qualitative factors that may be important to the organization.

This model can be expressed in the following formula:

$$vr = \frac{T\Sigma E(t)}{r-r(1+r)}$$

Where,

vr = the human capital value of an individual r years old

E (t) = the individual's annual earnings upto retirement, represented by the earnings profile.

r =discount rate i.e., cost of captial.

T = retirement age.

The drawback of this method is that the under or over-fixation of salary may affect equating the total earnings to the human capital.

Non-Monetary Methods

Taking note of the changes in the effectiveness of individuals, groups and the organisation from time to time, the behavioural scientists have developed some non-monetary methods in HRA. The important ones are discussed here:

1. Expected Realisable Value Method:

The Expected Realisable Value Method is a non-monetary approach to valuing human resources by assessing the potential future contributions and value of employees based on behavioral and psychological measures. Rather than focusing solely on financial metrics, this method evaluates various aspects of an employee's performance, potential, and overall fit within the organization.

For instance, the productivity of an employee can be quantified using objective indices such as the number of units produced, sales generated, or tasks completed. Additionally, managerial assessments can provide insights into an employee's effectiveness and contribution to team goals. Beyond productivity, psychometric tests can be employed to gauge an employee's promotability or transferability within the organization, helping to identify those who are likely to excel in higher or different roles.

Moreover, attitude surveys can be conducted to assess employees' levels of satisfaction, motivation, and commitment. For example, if an employee shows high levels of job satisfaction and motivation in these surveys, it suggests they are likely to continue contributing positively to the organization. These insights can help management estimate the "realizable" value of the employee, considering their potential for growth, adaptability, and long-term contribution.

By integrating these behavioral and psychological evaluations, the Expected Realisable Value Method offers a holistic view of an employee's worth, taking into account not just their current performance but also their future potential and alignment with the organization's goals. This method is particularly valuable in human resource planning and development, as it emphasizes the importance of employee behavior, attitudes, and potential over purely financial considerations. However, it also requires careful and accurate measurement, as subjective evaluations can introduce bias or inconsistency.

2. Discounted Net Present Value of Future Earnings:

The Discounted Net Present Value of Future Earnings method, developed by Rensis Likert, evaluates the value of human resources by examining the relationship between three key variables: causal, intermediate, and output. This method posits that the effectiveness of human capital can be understood by analyzing how these variables interact and influence each other within an organization.

1. **Causal Variables:** These are the factors that originate from leadership style and behavior. For example, a manager who adopts a supportive and participative leadership style is more likely to create a positive work environment. This leadership approach can foster open communication, trust, and collaboration among employees.
2. **Intermediate Variables:** These variables are directly influenced by the causal variables and include employee morale, motivation, job satisfaction, and commitment to the organization. For instance, when employees feel supported and valued by their leaders, their morale and motivation tend to increase. High

levels of commitment and satisfaction typically follow, as employees are more engaged and dedicated to their work.

3. **Output Variables:** These are the tangible results that arise from the changes in intermediate variables. They include measurable outcomes such as production levels, sales, profitability, and overall organizational performance. For example, a motivated and committed workforce, driven by effective leadership, is likely to achieve higher productivity and better financial results, such as increased sales and profits.

In this method, the expected future earnings or contributions of employees are projected based on the positive effects of causal and intermediate variables on output variables. These future earnings are then discounted to their present value, taking into account the time value of money. The resulting figure represents the current economic value of the human resources within the organization.

For example, if an organization sees a significant boost in employee morale and motivation due to a new leadership initiative, it might project that this will lead to a 10% increase in productivity over the next five years. The additional revenue generated by this increase in productivity is estimated and then discounted to its present value, giving the organization a quantifiable measure of the value added by its human resources.

This method provides a comprehensive view of how leadership and employee behavior contribute to the organization's success, linking intangible factors like morale and motivation to concrete financial outcomes. It helps organizations understand the true value of their human resources, not just in terms of current contributions but also in terms of potential future earnings.

1.2.7 Merits/Advantages of Human Resource Accounting

Human Resource Accounting (HRA) offers numerous benefits that significantly enhance organizational management and decision-making. Firstly, it allows companies to ascertain the investment made in their employees and estimate the expected return from this investment, providing a clear understanding of the financial impact of their human capital. By calculating the ratio of human capital to non-human capital, HRA also helps organizations gauge their degree of labor intensity, which is crucial for understanding operational dynamics. Furthermore, HRA provides a solid foundation for planning physical assets in relation to human resources, ensuring that both are aligned for optimal efficiency.

Investors, particularly those interested in the service sector, benefit from the valuable information that HRA provides, as it offers insights into the long-term value of a company's human assets. Additionally, by disclosing the value of human resources, HRA aids in the accurate interpretation of return on capital employed, offering a more comprehensive view of organizational performance. Managerial decision-making is also improved through HRA, as it provides data-driven insights into workforce management and resource allocation.

The recognition of human resources as valuable assets through HRA helps prevent their misuse by superiors and management, promoting ethical treatment and better management practices. Moreover, HRA facilitates the efficient utilization of human resources and highlights the detrimental effects of labor unrest on workforce quality. By valuing human talent, devotion, and skills, HRA can boost employee morale and, consequently, productivity. Finally, HRA assists management in implementing effective wage and salary administration methods, ensuring that compensation strategies are aligned with the true value of human resources. Together, these merits make HRA an indispensable tool for modern organizations aiming to optimize their human capital and achieve sustained success.

1. Information for Decision-Making on Human Capital

Human Resource Accounting (HRA) provides detailed information about the human capital within an organization, including the value and performance of employees. This information is crucial for managers when making strategic decisions, such as whether to hire new employees or promote existing ones, transfer employees to different roles, or decide on retention and retrenchment strategies. For example, if HRA data shows that promoting an existing employee would be more cost-effective and beneficial for the company than hiring someone new, management can make an informed decision accordingly.

2. Identifying Strengths and Weaknesses of Employees

HRA helps in identifying the strengths and weaknesses of employees. By quantifying and analyzing the contributions of employees, it provides insights into which employees are performing well and which may need additional training or support. This information is invaluable for recruitment planning, helping management determine whether to bring in new talent or focus on developing the existing workforce. For example, if HRA reveals a shortage of skilled employees in a particular department, the organization can either hire new employees or upskill the current ones to fill the gap.

3. Evaluation of HR Policies and Practices

HRA facilitates the evaluation of the effectiveness of HR policies and practices by providing data-driven insights. For instance, if the cost of training programs is high, HRA can help determine whether these programs are yielding a good return on investment over time. Additionally, if a company is spending significantly on recruitment for a specific category of employees, HRA can indicate whether the existing compensation plan is competitive enough or if adjustments are needed. Furthermore, HRA also serves as a feedback mechanism for managers, allowing them to assess the impact of their decisions on human resource costs and overall employee performance.

4. Enhancing Investor Confidence

HRA provides valuable information for both current and potential investors by offering insights into the value and effectiveness of the human resources employed by a company. This information is particularly useful when comparing companies that offer similar financial returns. For example, if two companies provide the same rate of return on capital employed, the one with better-managed and more valuable human resources (as revealed by HRA) may be a more attractive investment. Investors can use this information to make more informed decisions, as HRA offers a more accurate accounting method for assessing the true return on total resources, including human capital.

5. Cost Control and Profitability Improvement

HRA enables management to control various human resource costs, such as recruitment, training, and compensation. By providing a detailed analysis of these costs, HRA helps identify areas where expenses can be reduced or better managed. This, in turn, can lead to improved profitability for the organization. For example, if HRA shows that the cost of turnover is high due to inadequate employee retention strategies, management can take steps to improve retention, thereby reducing turnover costs and increasing overall profitability.

6. Better Human Resources Planning

Human Resource Accounting (HRA) enables organizations to improve their human resources planning by systematically recording and analyzing employee data. With HRA, every detail about an employee, including their skills, experience, performance, and potential, is documented. This comprehensive data allows organizations to make more informed decisions about workforce management. For example, by understanding the strengths and weaknesses of their workforce, companies can develop targeted training programs, optimize team composition, and create succession plans that align with business objectives. Moreover, by monitoring workforce trends over time, HRA helps organizations anticipate future needs and adjust their strategies accordingly, leading to better resource allocation and improved overall productivity.

7. Proper Utilization of Human Resources

HRA provides organizations with a clear understanding of the costs associated with their human resources, as well as the value that employees bring to the company. By quantifying the economic value of employees and their contributions to organizational goals, HRA helps management make better decisions regarding the deployment and utilization of human resources. For instance, if an analysis reveals that certain employees or teams are underutilized, the organization can take steps to reassign tasks or provide additional training to maximize their potential. This ensures that the right people are in the right roles at the right time, leading to more efficient operations and the achievement of strategic objectives.

8. Increases Employee Motivation

One of the key benefits of HRA is its ability to enhance employee motivation. By recognizing and quantifying the value of each employee's contribution, HRA helps organizations design compensation and reward systems that are aligned with individual performance. When employees see that their efforts are being recognized and valued, they are more likely to feel appreciated and motivated to perform at their best. Additionally, transparent communication about how employee contributions are measured and rewarded can foster a culture of trust and engagement within the organization. As a result, motivated employees are more likely to be productive, innovative, and committed to achieving the company's goals.

9. Designs Training and Development Programs

HRA plays a crucial role in the design and implementation of effective training and development programs. By maintaining detailed records of employee strengths, weaknesses, and performance over time, HRA provides valuable insights into areas where additional training may be needed. For example, if HRA data reveals that certain employees lack specific skills that are critical to the organization's success, targeted training programs can be developed to address these gaps. Furthermore, HRA can help organizations track the effectiveness of training initiatives by monitoring changes in employee performance and productivity after the training has been completed. This ensures that training resources are invested wisely and that employees are continuously developing the skills needed to contribute to the organization's long-term success.

10. Formulates Better Personnel Policies

HRA provides the data necessary for formulating and refining personnel policies that are aligned with the organization's strategic objectives. By analyzing HRA data, management can identify trends and patterns related to employee behavior, performance, and satisfaction. This information can be used to develop policies related to promotions, transfers, work conditions, and job satisfaction. For instance, if HRA data indicates high employee turnover in a particular department, the organization might investigate the root causes and implement policies to improve retention, such as enhancing working conditions or offering more competitive compensation. Similarly, HRA can help organizations develop fair and transparent promotion criteria based on objective performance data, leading to increased employee satisfaction and loyalty.

11. Attracts the Best Human Resources

HRA contributes to building a strong employer brand, which is essential for attracting top talent. By demonstrating a commitment to valuing and investing in employees, organizations can enhance their reputation as an employer of choice. The transparency and fairness associated with HRA, along with the benefits it provides in terms of training, development, and career growth, can make the organization more appealing to skilled professionals. Additionally, HRA helps companies create a competitive advantage by retaining their best employees, as the organization's positive image and the opportunities for growth and development attract and retain high-performing individuals. As a result, the organization can maintain a strong and capable workforce that drives business success.

12. Communicates Information to Investors

HRA provides investors with valuable insights into the organization's human capital, which is often a key driver of business success. By quantifying the skills, knowledge, and productivity of employees, HRA allows investors to assess the organization's potential for future growth. This information is crucial for making informed investment decisions, as it provides a clearer picture of the organization's intangible assets. For example, a company with a highly skilled and productive workforce may be seen as having a competitive edge, which can positively influence investor confidence. Additionally, HRA can demonstrate how investments in employee development translate into improved performance and profitability, further enhancing the company's attractiveness to investors.

13. Improves Financial Reporting

HRA contributes to more accurate and comprehensive financial reporting by incorporating the value of human capital into the organization's financial statements. Traditional financial accounting often overlooks the value of employees as assets, focusing instead on tangible assets like property and equipment. However, HRA recognizes that employees are a critical component of the organization's value and should be accounted for accordingly. By providing a more complete view of the organization's assets and liabilities, HRA helps stakeholders, including investors, lenders, and regulators, make more informed decisions. Accurate financial reporting that includes the value of human capital also helps organizations better understand the true drivers of their financial performance, leading to more effective management and strategic planning.

1.2.8 Limitation of Human Resource Accounting

Human Resource Accounting (HRA), while offering numerous benefits, also faces several significant limitations that hinder its effectiveness and widespread adoption. One of the primary challenges is the lack of a universally accepted valuation method, leading to disagreements among firms regarding the most ideal approach. This is compounded by the absence of standardized procedures, resulting in firms only providing HRA information as supplementary to traditional accounting reports. Unlike conventional accounting, which operates under widely accepted standards, HRA lacks such uniformity, making it difficult to establish consistent practices across organizations.

All existing methods for valuing human assets are based on assumptions that may not hold true, such as the belief that employees will remain with the same organization until retirement, which is often unrealistic. Moreover, the notion that human resources do not depreciate and instead always appreciate is not universally applicable, as some firms may experience the opposite. Estimating the lifespan of human resources is inherently uncertain, rendering the valuation process speculative and, at times, unrealistic.

The absence of clear and specific guidelines for determining the cost and value of human resources further complicates the implementation of HRA. The methods currently in use have notable drawbacks, and the uncertainty surrounding the future existence of human resources makes their valuation even more challenging. Additionally, the possibility of employees being assigned low valuations can lead to discouragement, negatively impacting their performance and creating a self-fulfilling cycle of reduced competency.

Another significant limitation is the lack of empirical evidence supporting the hypothesis that HRA effectively facilitates the management of human resources, leaving its practical benefits in question. The issue of how to appropriately include the value of human resources in financial statements remains unresolved, with no consensus among accounting professionals. Furthermore, since human resources cannot be owned, retained, or utilized in the same way as physical assets, treating them as assets in the strict sense poses a conceptual challenge for management.

Lastly, there is a constant fear of opposition from trade unions, as placing a monetary value on employees might lead to demands for rewards and compensation based on such valuations. These limitations underscore the complexities and challenges inherent in implementing HRA, making it a contentious and evolving field in accounting and management.

1. Subjectivity and Lack of Standardization

Human Resource Accounting (HRA) is often criticized for the subjectivity involved in valuing human capital. Unlike physical assets like machinery or buildings, which have clear and tangible measures of value, human resources are intangible and their value is much harder to quantify. Assessing the value of an employee's skills, knowledge, and experience is inherently subjective, as it involves making judgments about their expertise and potential impact on the organization. For example, two managers might have different opinions on the value of the same employee based on their perceptions of the employee’s contributions. This subjectivity is compounded by the lack of standardized methodologies for HRA. Without clear guidelines or universally accepted standards, different organizations may use different methods to value their human resources, leading to inconsistencies and discrepancies. These variations make it difficult to compare human capital valuations across companies or industries, which can undermine the reliability and credibility of HRA. To address these challenges, organizations can work towards greater objectivity by establishing clear criteria for valuing human capital and minimizing reliance on individual judgments. Additionally, developing standardized frameworks for HRA across industries could help reduce inconsistencies and improve the reliability of human capital measurements.

2. Difficulty in Measuring Human Capital

Measuring human capital is a complex task due to the intangible nature of employee contributions. Traditional accounting methods are designed to measure tangible assets like equipment and inventory, which can be easily quantified. However, human capital, which includes elements like skills, experience, creativity, and innovation, is much harder to measure in concrete terms. The challenge lies in identifying relevant metrics that can accurately capture the value of these intangible contributions. Even when appropriate metrics are identified, the process of collecting accurate data can be difficult. Much of the data related to human capital, such as employee engagement or potential, is qualitative rather than quantitative, making it harder to measure objectively. The difficulty in measurement can lead to flawed or incomplete assessments of human capital, which in turn can result in suboptimal decisions regarding resource allocation or talent management. To mitigate these challenges, organizations should carefully define metrics that align with their strategic goals and continuously refine their measurement techniques. Using a combination of quantitative and qualitative data can provide a more holistic view of human capital, and collaboration with experts can ensure that organizations stay up-to-date with best practices.

3. Lack of agreement on Valuation Methods

A significant limitation of HRA is the lack of a universally accepted method for valuing human capital. Various approaches exist, but there is no single method that is widely recognized or adopted across all organizations. This lack of consensus means that different companies may use different methodologies to value their human resources, leading to inconsistencies in how human capital is reported and interpreted. This inconsistency poses challenges for comparing human capital valuations across organizations or industries. Without a standardized approach, it is difficult to ensure that the value of human resources is measured and reported in a consistent and comparable manner. This lack of comparability can undermine the reliability and effectiveness of HRA as a tool for strategic decision-making. To address this limitation, organizations can engage in research to identify the most effective valuation methods and work towards greater transparency in their valuation practices. Collaboration with industry stakeholders to develop standardized frameworks for HRA can also help improve the accuracy, reliability, and comparability of human capital measurements.

4. Ignoring External Factors

Human Resource Accounting often focuses primarily on internal factors, such as employee skills and performance, while overlooking the impact of external factors on the value of human capital. External factors like economic conditions, market trends, technological advancements, and changes in industry regulations can significantly influence the value and relevance of an organization's human resources. For example, a sudden technological advancement might render certain skills obsolete, reducing the value of employees who possess those skills. Similarly, changes in economic conditions or market demands can affect the marketability of certain types of human capital. By not accounting for these external factors, HRA may provide an incomplete or even misleading assessment of the true value of human resources. To address this limitation, organizations should integrate external factors into their HRA processes. This involves monitoring industry trends, economic conditions, and technological advancements to understand how they might impact the value of human capital. By staying informed about these external influences, organizations can adapt their talent management strategies, invest in relevant training and development programs, and ensure that their workforce remains aligned with changing market demands. Additionally, cross-functional collaboration between HR, strategy, marketing, and finance departments can help organizations develop a more comprehensive understanding of how external factors affect human capital and make more informed decisions.

5. Inadequate Integration with Financial Reporting

Another limitation of HRA is its inadequate integration with traditional financial reporting. While HRA focuses on valuing human capital, this information is often not effectively linked with the organization's financial statements. Financial reporting typically emphasizes tangible assets and monetary transactions, providing a snapshot of the company's financial position. However, human capital, being an intangible asset, is not consistently reflected in financial statements, leading to a gap in reporting. This limitation can result in an incomplete representation of an organization's true value and potential. Stakeholders, such as investors or regulators, may not fully understand the impact of human resources on the financial health and future prospects of the company if this information is not integrated into financial reporting. This gap can hinder decision-making and obscure the true drivers of organizational performance. To address this limitation, organizations should work towards better integrating HRA with financial reporting. This can be achieved by developing appropriate measurement techniques and reporting frameworks that allow for the inclusion of human capital in financial statements. One potential approach is the concept of "intellectual capital reporting," which aims to capture and present information related to intangible assets, including human capital, in financial reports. By incorporating relevant metrics and valuation methods into financial reporting, organizations can provide stakeholders with a more comprehensive understanding of their value and the contributions of their human resources. Collaboration between HR and finance departments is essential in bridging the gap between HRA and financial reporting, ensuring that human capital is recognized as a critical asset in the organization's overall financial health.

Check your progress – 3

1. Multiple Choice questions.

1. ……….. method determines the value of an employee by projecting future earnings and discounting them to their present value?

   a) Asset Multiplier Method b) Economic Value Method

c) Expected Realisable Value Method

d) Discounted Net Present Value of Future Earnings

2. ……………… of the following is a benefit of Human Resource Accounting (HRA).

a) It helps in valuing tangible assets like machinery.

b) It allows companies to assess the financial impact of their human capital.

c) It eliminates the need for traditional financial reporting.

d) It standardizes the valuation of human resources across all industries.

3. One of the limitations of Human Resource Accounting (HRA) is:

a) It provides standardized procedures accepted globally.

b) It offers universally accepted valuation methods.

c) It faces subjectivity in valuing human resources.

d) It focuses exclusively on external factors affecting human capital.

2. Fill in blanks

1. The __________ Method values human resources by capitalizing on the actual costs incurred in acquiring and developing employees and amortizing these costs over the expected service life of the employee.
2. Human Resource Accounting (HRA) enables management to control various human resource costs, such as __________, __________, and compensation.
3. The lack of __________ and __________ are significant limitations of Human Resource Accounting (HRA).

3. State True or False

1. The Expected Realisable Value Method evaluates employees based solely on their financial contributions to the organization.
2. Human Resource Accounting (HRA) helps organizations in making data-driven decisions regarding workforce management and resource allocation.

3. There is a universally accepted method for valuing human resources in Human Resource Accounting (HRA).

1.3 Summary

Human Resource Accounting (HRA) is essential for quantifying and communicating the value of a company's human capital, much like financial accounting does for physical and financial assets. The primary purpose of HRA is to provide management and stakeholders with insights into the costs and value associated with the organization's workforce. This includes the costs of recruiting, training, and developing employees, as well as the value they bring through their skills, experience, and productivity. By recognizing human resources as an asset rather than just an expense, HRA helps organizations make informed decisions regarding investments in employee development, retention strategies, and overall workforce management. Moreover, it enhances transparency in financial reporting, allowing investors and other stakeholders to better understand the long-term impact of human capital on organizational performance. Ultimately, HRA contributes to better planning, budgeting, and performance evaluation, aligning human resource strategies with the organization's financial goals.

Human Resource Accounting (HRA) plays a pivotal role in modern business management by bridging the gap between human resource management and financial accounting. Its primary purpose is to accurately reflect the value of a company's human resources, which are often the most critical assets yet are traditionally underrepresented in financial statements. HRA provides a framework for evaluating the investments made in employees, such as hiring, training, and development, against the economic benefits they generate over time. This approach enables organizations to assess the return on investment in human capital, guiding more effective resource allocation and strategic planning.

The importance of HRA extends to enhancing decision-making processes. By quantifying the value of human resources, HRA enables managers to make more informed decisions about workforce management, including recruitment, compensation, and development programs. It also supports the optimization of labor costs and helps in identifying areas where efficiency can be improved. For external stakeholders, such as investors and regulators, HRA offers a clearer picture of an organization's intangible assets, contributing to more accurate company valuations and better risk assessments. HRA fosters a culture of accountability and recognition within the organization. By acknowledging the economic value of employees, companies can cultivate a more engaged and motivated workforce. This recognition can also drive better performance, as employees who feel valued are likely to be more committed to the organization's success. In a broader context, HRA aligns human resource management with the overall strategic goals of the organization, ensuring that human capital is leveraged effectively to achieve long-term growth and sustainability.

1.4 Terms to Remember

- Abundant - existing in very large quantities; more than enough
- Equilibrium - a state of balance
- Obsolescence - the process of becoming obsolete or outdated and no longer used.
- Distorts - to change something and show it falsely
- Magnitude - the great size or importance of something
- Monetary - connected with money
- Asset Multiplier - This method is based on the assumption that there is no direct relationship between cost incurred on an employee and his value for the organisation

1.5 Answers to check your progress

Check your progress – 1

1. Multiple Choice questions

1. c) Third Stage (1971-76)

2. a)American Association of Accountants

2. Fill in the blanks

1. second, monetary and non-monetary
2. identifying, measuring

3. State True or False

1. True
2. False *(It began in the 1960s, as described by Eric G. Flamholtz.)*

Check your progress – 2

1. Multiple Choice questions

1. b) Effective Monitoring
2. c) Provide Quantitative Framework of HRM
3. b) Human Resource Accounting helps in accurately reflecting the value of human assets in financial statements.
4. b) As immediate costs written off against current revenue.

2. Fill in the blanks

1. quantitative
2. Transformational Process Evaluation
3. charged
4. long-term investments

3. State True or False

1. True   2. True   3. False   4. True

Check your progress – 3

1. Multiple Choice questions.

1. b) Economic Value Method
2. b) It allows companies to assess the financial impact of their human capital.
3. c) It faces subjectivity in valuing human resource

2. Fill in blanks

1. Historical Cost
2. recruitment, training
3. standardization, consensus

3. State True or False

1. False   2. True   3. False

1.6 Exercise

1. State the concept on objectives of Human Resource Accounting?
2. Explain methods of valuation of Human Resources.
3. Explain need of Human Resource Accounting?
4. State merits and limitations of Human Resource Accounting?

1.7 Reference for further study

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Unit-2

Royalty Accounts

Index :

2.0 Objectives :

After studying this unit students can able to understood :

- the Royalty accounting used specially for mining, writing books, patents
- parties involved in Royalties agreement
- different terms used in Royalties
- How these transactions are recorded in the books can be learned.

2.1 Introduction:

Certain person or parties or group of person possesses an exclusive right on a particular thing. Landlord has an exclusive right over a mine, a patent holder has exclusive right on his patent, singer has an exclusive right on his voice, author has an exclusive right on his book writing. The person having such type of exclusive right has transfer such right to other person or group of person instead of selling such right one can transfer it to some other party and earn certain income thereon. This transfer is made in exchange of certain amount which is termed as royalty.

Royalty is a periodical payment, based on output or sale, required to be paid by one person to another in consideration of some special rights acquired e.g. the right to exploit a mine or colliery to publish a book or to manufacture an article under a patent. Royalties arises with the agreement between two parties one is the owner of the asset or the person who has rights over the asset. Other is the person who acquired the right of using it for payment of a Royalty. The person who makes the payment to the owner of the asset in exchange for the right to use his asset is known as 'lessee' and the owner of the asset as lessor or landlord. The lessee making the payment of royalty treats it as ordinary business expenditure and debits Royalty Account.

Royalty Account is a nominal account and is closed at the end of every Accounting year by transferring it to profit and loss Account. Strictly speaking, royalty based on output is a part of cost of production and as such should be transferred to Trading account, royalty based on sales is a selling expenditure and as such should be transferred to profit and loss Account

Here the student should note that a lump - sum payment for the outright purchase of a patent, mine or book is not treated as royalty but is a capital expenditure and recorded as a fixed asset.

2.2 Definition of Royalty:

When a person has transfer his exclusive right to another person in exchange of some amount as agreed on the basis of quantity produced or sold such amount is .known as Royalty.

In short Royalty is the sum payable by the lessee to the lessor for the use of rights vested in the lessor. Lessor is the person who is the owner or having an exclusive right of a particular thing or product. Whereas lessee is the person who has taken the right to use the particular product and provide the amount to the owner for his product. It is a periodic payment. Royalty is generally paid on the basis of output or sale. It is paid for extraction of mines, for use of the patent, for use of technical know-how, to an author for sale of his books, etc.

In terms of accounting, royalty is what a lessee pays to a lessor for the use of any rights, copyrights, franchises or any such asset. It is the system of sharing of revenues between the lessee and the lessor. Let us learn more about the special accounting treatments in royalty accounts.

2.3 Royalty and Related Terminologies:

In royalty agreement between the lessor and the lessee, usually contains certain clauses as regards 'minimum rent' 'short working' and Recoupment of short working. Before going to the Accounting treatment of the transactions relating to Royalties, it is necessary to understand these terms.

1. **Lease :** It is an agreement where a person acquires a right to use an asset for a certain period of time from another person or the owner of the asset in return for a payment. The owner is known as the Lessor. The user is the Lessee. The amount paid is Royalties.

   For Example, A has developed a machine that uses less material for production. He also got it patented. Now, B wants to use it. B will have to pay a royalty to A for using the machine. Here, A is the lessor and B is the Lessor.

2. **Minimum Rent or Fixed Rent :** In the early days of business, production or sale of any concern will be very low. Hence, there is ever possibility that the Royalty based on production or sale will also be low in that period. It is the amount that has to be paid by the lessee to the lessor whether or not he has derived benefit from the asset. Hence, it is also called Dead Rent or Rock Rent. To safe guard the interest of the landlord from the low income and also to guarantee him the receipt of a minimum amount in case of low output or sale, the minimum Rent clause will be included in the Royalties agreement. It also gives incentive to the lessee to increase the production or sales. Thus minimum rent may be defined as "The minimum amount which is payable by the lessee to the landlord, irrespective of production or sale. In the presence of minimum rent

clause in Royalty agreement actual royalty based on output or sales or minimum rent whichever is higher is payable.

- When the actual royalty for a year is less than the minimum rent, the lessee will pay the minimum rent to the lessor.
- When the actual royalty for a year is more than the minimum rent, the lessee will pay the actual royalty to the lessor.
- In case of work stoppage due to the strike, lock outs owner may agree to reduce the minimum rent by certain amount.

3. **Short-workings :** It is the excess of Minimum Rent over the Actual Royalty payable. It is calculated only when it is allowed to be adjusted against the future royalties by the lessor. Short-workings = Minimum Rent – Actual Royalty

4. **Recoupment or Recovery of Short-workings :** The right of Recoupment means the right given to the lessee by the lessor to carry-forward and set-off the short-workings from the surplus of royalties over the Minimum Rent. As the lessee is required to pay the landlord minimum rent fixed in case of royalty is less, the excess of minimum rent over the royalty is dead loss to the lessee. So landlord allow to carry forward such loss for certain number of years and if during this period the royalty is more than the minimum rent the lessee is allowed to recover this short working from surplus. It can be of two types:

1. **Fixed Right of Recoupment:** When the lessor allows the lessee to adjust the short-workings only for a fixed period of time, it is known as Fixed Right of Recoupment.

2. **Floating Right of Recoupment:** When the lessor allows the lessee to adjust the short-working of any year in the next two or three years, it is known as the Floating Right of Recoupment. The period of recovery of short working may be certain number of years such as 5 years, 6 years, 7 years etc.

If the Royalties agreement allowed to recoup the short working then the short workings should be carried forward and shown in the Balance sheet so long as they are recoverable and short workings which could not be recouped should be closed by transferring to the profit and loss Account. If there is no provision in the royalty agreement for recoupment of short workings the same should be transferred to the profit and loss Account in the very year of the short workings.

The short working clause thus may permit the lessee :

a. to carry forward the short workings indefinitely or

b. to set off short workings with in a certain number of years following the year in which the short working occurs; or

c. to set off the short workings only within a certain number of years after the commencement of the lease. The questions of short working or its recoupment does not arise if the royalty agreement does not contain a clause of minium rent. In such a case, the payment of royalty is simply based on output or sales.

5. Lease premium in addition to Royalty :

In some cases the lessee may agree to pay lump - sum to the lessor in addition to royalty. This extra payment in addition to royalty is known as lease premium or goodwill. This is a capital expenditure for the lessee which can be written off every year out of the profit and loss Account during the lease period by some suitable method.

Accounting treatment: Accounting Treatment of Royalties

For the lessee, royalties are an ordinary business expenditure. Royalty paid on the basis of output is debited to Trading or Manufacturing A/c. Whereas, the royalty paid on the basis of sales is debited to Profit & Loss A/c.

2.4 Format of Journal Entries in the books of lessee

A. When royalty is less than minimum rent

1. Royalty a/c………………Dr

   Short working a/c ……….Dr

   To Landlord's a/c

2. On Payment of the cash to the landlord

   Landlord's a/c…………….Dr

   To Cash/ Bank

3. At the end of the year Royalty a/c is closed by transferring its balance to the Profit and Loss a/c

   Profit and Loss a/c…………Dr

To Royalty a/c

4. Short working a/c is closed by carrying forward balance till the period of recovery continues, if unrecovered balance is remains after the completion of the period, then it is transferred to the Profit and Loss a/c

B. If royalty is more than the minimum rent

1. If short working is recoverable

   a. Royalty a/c …………..Dr

      To Landlords a/c

   b. Landlords a/c……….Dr (Amount of Royalty)

      To Short working (Amount Recovered)

      To Cash (Amount Paid) Or

   Instead of showing the Recovery of short working on Landlord's a/c, it may be shown on Royalties a/c by passing the following entry:

   a. Royalty a/c……..Dr

      To Short working a/c (Amount Recovered)

      To Landlords a/c (Amount Payable)

   b. Landlords a/c …….Dr

      To Cash or Bank

2. If short working is not recoverable

   a. Royalty a/c…..Dr

      To Landlord's a/c

   b. Landlord a/c…Dr (Amount of Royalty)

      To Cash or Bank

2.5 Journal Entries in the books of Landlord

1. When Royalty is less than the minimum rent

   a. Lessee's a/c ………………..Dr

To Royalty Receivables a/c

To Short working Allowable a/c

b. On receipt of cash

Cash a/c……………..Dr

To Lessee's a/c

c. Royalty receivable a/c is closed by transferring its balance to the Profit and Loss account

Royalty Receivables a/c…….DR

To Profit and Loss a/c

2. When Royalty is more than the minimum rent

a. Lessee's a/c……….Dr

To Royalty receivables a/c

b. If short working is recoverable

Cash a/c……………………………..Dr (Amount received)

Short working allowable a/c ……Dr (Amount recovered)

To Lessee a/c

c. If short working is not recoverable

Cash a/c………Dr

To Lessee a/c

Note: If it is asked to open the minimum rent a/c, it is note than entries on the minimum rent a/c are made only when Royalty is less than the minimum rent.

Entries in the books of lessee

1. Minimum rent a/c……………..Dr

To Landlords a/c

2. Royalty a/c……………………….Dr

Short workings a/c………………..Dr

To Minimum Rent a/c

Other entries remains unchanged

2.6 Check your Progress

Choose the correct alternatives

1. Royalty is a …….. to lessee

    a. **Incomes** b. Expenses

    c. Income and expenses d. None of the above

2. Excess of Minimum rent over royalties is called ………..

    a. **Short workings** b. Dead rent c. Royalties d. None of the above

3. Lessor is the …………..

    a. owner b. user c. Customer d. all of the above

4. What is minimum Rent

    a**. Payment for use of land which is fixed**

    b. Payment for the use of land on the basis of output

    c. A payment made to owner

    d. None of the above

5. Short working = …………………- Royalty Payable

    a. **Minimum rent** b. Capital c. Cash d. None of the above

6. The minimum rent can ………………… be proportionately, if there is a stoppage due to strike.

    a. Increase b. **Decrease** c. No change d. all of the above

7. Short working is …………

    a. **Excess of minimum rent over the actual royalty**

    b. Excess of actual royalty over minimum rent

    c. Excess of standard output over Actual output

    d. None of the above

8. Surplus is…………….

    a. Excess of minimum rent over the actual royalty

    b. **Excess of actual royalty over minimum rent**

c. Excess of actual short working over minimum rent

d. None of the above

9. When the royalty are less than the minimum rent

   a. **Royalties account is debited with the actual amount of royalties earned**

   b. Royalties account is debited with minimum rent

   c. Royalties account is debited with the amount paid to landlord

   d. Royalties account is debited with the excess of minimum rent over actual rent

10. In the books of Lessee, short working recovered amount is debited

   a. **Profit and loss account** b. Minimum rent Account

   c. Royalty Account d. Landlord's Account

Q. 2 State the following statement true or false

1. A royalty is a payment made by a person using another person' intellectual property, like a patent or copyright, to the owner of that property - True.
2. In a business context, the "lessor" is the party who pays royalties - False (the "lessee" is the one who pays royalties).
3. A royalty can be calculated based on a percentage of sales generated from the licensed property - True.
4. A "minimum royalty" guarantees the owner of intellectual property will receive a set amount of payment regardless of usage - True.
5. In the entertainment industry, music artists often receive royalties from streaming services based on how many times their songs are played - True.
6. Dead rent is also called as mininmum rent : True

2.7 Accounting Problems

Problem No. 1 : The KGF Coal Mining co. Ltd. leased a piece of land from Mrs. Kolavari Miners for the period of ten years from 1^{st} January 2000 on the bases of the following terms and conditions:

The KGF Coal Mining co. Ltd. shall pay the minimum rent of Rs. 1400 per year for the first year with an annual increase of the Rs.140 in next subsequent year in the minimum rent merging into a royalty of 25 paise per ton of coal taken out with power to recoup the short workings in first three years only.

Following table shows the annual output of the first five years:

Sr. No.	Year	Output in Tons
1	2000	1,400
2	2001	4,200
3	2002	8,400
4	2003	11,200
5	2004	3,920

Journalise the above transactions in the books of The KGF Coal Mining co. Ltd. and also show the ledger accounts.

Solutions: Table showing the Royalty and Short working

Year a.	**Output in Tons Rs. b.**	**Minimum Rent Rs. c.**	**Royalty Rs. d. (b*0.25)**	**Short working Rs. e. (c-d)**	**Short working recovered f.**	**Short working not recovered g.**	**Amount paid to landlord h.**
2000	1,400	1,400	350	1050	-	-	1,400
2001	4,200	1,540	1050	490	-	-	1,540
2002	8,400	1,680	2,100	-	420	-	1,680
2003	11,200	1,820	2,800	-	-	1,120	2,800
2004	3,920	1,960	980	980	-	-	1,960

Journal Entries in the books of KGF Coal Mining Co. Ltd.

Date	**Particulars**	**Debit Rs**	**Credit Rs.**
31/12/2000	Royalty a/c ....Dr	350	-
	Short workings a/c ....Dr	1,050	-
	To Kolavari Miners a/c	-	1,400
	Being amount of royalty and short working		

	payable to the landlord.		
31/12/2000	Kolavari Miners a/c………………..Dr	1,400	-
	To Bank a/c	-	1,400
	Being amount paid to the landlord		
31/12/2000	Profit and Loss a/c………………Dr	350	-
	To Royalty a/c	-	350
	Being balance on the royalty a/c is transferred to profit and loss a/c.		
31/12/2001	Royalty a/c …………………………Dr	1,050	-
	Short workings a/c ……………………Dr	490	-
	To Kolavari Miners a/c		1,540
	Being amount of royalty and short working payable to the landlord.		
31/12/2001	Kolavari Miners a/c………………..Dr	1,540	-
	To Bank a/c	-	1,540
	Being amount paid to the landlord		
31/12/2001	Profit and Loss a/c………………Dr	1,050	-
	To Royalty a/c	-	1,050
	Being balance on the royalty a/c is transferred to profit and loss a/c.		
31/12/2002	Royalty a/c ……………………..Dr	2,100	-
	To Kolavari Miners a/c	-	2,100
	Being amount of royalty payable to the landlord		
31/12/2002	Kolavari Miners a/c………………..Dr	2,100	-
	To Bank a/c	-	1,680
	To Short workings	-	420
	Being amount paid to the landlord and short working recovered		
31/12/2002	Profit and Loss a/c………………Dr	3,220	

	To Royalty a/c		2,100
	To Short workings		1,120
	Being balance on the royalty a/c and irrecoverable balance on short workings are transferred to profit and loss a/c.		
31/12/2003	Royalty a/c ……………………..Dr	2,800	-
	To Kolavari Miners a/c	-	2,800
	Being amount of royalty payable to the landlord		
31/12/2003	Kolavari Miners a/c………………..Dr	2,800	-
	To Bank a/c	-	2,800
	Being amount paid to the landlord		
31/12/2003	Profit and Loss a/c………………Dr	2,800	-
	To Royalty a/c	-	2,800
	Being balance on the royalty a/c is transferred to profit and loss a/c.		
31/12/2004	Royalty a/c …………………………Dr Short workings a/c ……………………Dr To Kolavari Miners a/c Being amount of royalty and short working payable to the landlord.	980 980	 1960
31/12/2004	Kolavari Miners a/c………………..Dr	1960	
	To Bank a/c		1960
	Being amount paid to the landlord		
31/12/2004	Profit and Loss a/c………………Dr	1960	
	To Royalty a/c		980
	To Short working		980
	Being balance on the royalty a/c and short working are transferred to profit and loss a/c.		

Royalty a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2000	To Kolavari Miners a/c	350	31/12/2000	By Profit and Loss a/c	350
		350			350
31/12/2001	To Kolavari Miners a/c	1,050	31/12/2001	By Profit and Loss a/c	1,050
		1,050			1,050
31/12/2002	To Kolavari Miners a/c	2,100	31/12/2002	By Profit and Loss a/c	2,100
		2,100			2,100
31/12/2003	To Kolavari Miners a/c	2,800	31/12/2003	By Profit and Loss a/c	2,800
		2,800			2,800
31/12/2004	To Kolavari Miners a/c	980	31/12/2004	By Profit and Loss a/c	980
		980			**980**

Short Workings a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2000	To Kolavari Miners a/c	1,050	31/12/2000	By Balance c/d	1,050
		1,050			1,050
1/1/2001	To Balance b/d	1,050	31/12/2001	By Balance c/d	1,540
31/12/2001	To Kolavari Miners a/c	490			
		1,540			1,540
1/1/2002	To Balance b/d	1,540	31/12/2002	By Kolavari Miners a/c	420
				By Profit and loss a/c	1,120
		1540			1540

31/12/2004	To Kolavari Miners a/c	980	31/12/2004	By Profit and loss a/c	980
		980			**980**

Kolavari Miners a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2000	To Bank	1,400	31/12/2000	By Royalty a/c	350
				By Short workings	1,050
		1,400			1,400
31/12/2001	To Bank	1,540	31/12/2001	By Royalty a/c	1,050
				By Short workings	490
		1,540			1,540
31/12/2002	To Bank	1,680	31/12/2002	By Royalty	2,100
	To Short workings	420			
		2,100			2,100
31/12/2003	To Bank	2,800	31/12/2004	By Royalty	2,800
		2,800			2,800
31/12/2004	To Bank	1,960	31/12/2004	By Royalty a/c	980
				By Short workings	980
		1,960			1,960

Problem No. 2 : The Xylo Co. Ltd. leased a property from Yellow Co. Ltd. at a royalty of Rs. 1.50 per ton with a minimum rent of Rs. 4,000 p.a. Each year's excess of minimum rent over royalties is recoverable out of the royalties of the next five years. In the event of a strike and the minimum rental not being reached, the lease provided that minimum rent would stand reduced proportionately to time actually worked.

The results of the working were as follows,

Year	Actual Royalty Rs.
2011	Nil
2012	1,300
2013	3,700
2014	4,500
2015	7,000
2016 (Strike of 3 months)	2,400
2017	6,000

Write up the Minimum Rent, Royalties, Short-workings and Landlord's Account in the books of X Co. Ltd. for all the years.

Solution: **Royalty calculation table**

Year a.	**Royalty**	**Minimum Rent Rs. c.**	**Short working Rs. e. (c-d)**	**Short working recovered f.**	**Short working not recovered g.**
2011	Nil	4,000	4,000	-	-
2012	1,300	4,000	2,700*	-	-
2013	3,700	4,000	300	-	-
2014	4,500	4,000	-	500	-
2015	7,000	4,000	-	3,000	-
2016	2,400	3,000	600	-	500
2017	6,000	4,000	-	2,000*	700

Minimum Rent a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2011	To Yellow Co. Ltd.	4000	31/12/2011	By Short workings	4,000
		4,000			4,000
31/12/2012	To Yellow Co. Ltd.	4,000	31/12/2012	By Royalty	1,300
				By Short Workings	2,700
		4,000			4,000
31/12/2013	To Yellow Co. Ltd.	4,000	31/12/2012	By Royalty	3,700
				By Short Workings	300
		4,000			4,000
31/12/2016	To Yellow Co. Ltd.	3,000	31/12/2016	By Royalty	2,400
				By Short Workings	600
		3,000			3,000

Royalty a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2012	To Minimum Rent	1,300	31/12/2012	By Profit and Loss a/c	1,300
		1,300			1,300
31/12/2013	To Minimum Rent	3,700	31/12/2013	By Profit and Loss a/c	3,700
		3,700			3,700
31/12/2014	To Yellow co. a/c	4500	31/12/2014	By Profit and Loss a/c	4,500
		4,500			4,500
31/12/2015	To Yellow co. a/c	7,000	31/12/2015	By Profit and Loss a/c	7,000
		7,000			7,000
31/12/2016	To Minimum Rent	2,400	31/12/2016	By Profit and Loss	2,400

				a/c	
		2,400			2,400
31/12/2017	To Yellow Co. a/c	6,000	31/12/2017	By Profit and Loss a/c	6,000
		6,000			6,000

Short Workings a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2011	To Minimum Rent	4,000	31/12/2011	By Balance c/d	4,000
		4,000			4,000
1/1/2012	To Balance b/d	4,000	31/12/2012	By Balance c/d	6,700
31/12/2012	To Minimum Rent	2,700			
		6,700			6,700
1/1/2013	To Balance b/d	6,700	31/12/2013	By Balance c/d	7,000
31/12/2013	To Minimum Rent	300			
		7,000			7,000
1/1/2014	To Balance b/d	7,000	31/12/2014	By Yellow co a/c	500
				By Balance c/d	6,500
		7,000			7,000
1/1/2015	To Balance b/d	6,500	31/12/2015	By Yellow co a/c	3,000
				By Balance c/d	3,500
		6,500			6500
1/1/2016	To Balance b/d	3,500	31/12/2016	By Profit and Loss a/c	500
31/12/2016	To Minimum Rent	600		By Balance c/d	3,600
		4,100			4,100
1/1/2017	To balance b/d	3,600	31/12/2016	By Yellow co. a/c	2,000
				By Profit and Loss a/c	700
				By Balance c/d	900
		3,600			**3,600**

Problem No. 3 : Coastal India Coal Company worked a Coal Mine under a lease which provided as under:

1. Royalties to be paid at 50 paise per ton of coal.
2. Minimum Rent at Rs. 9,000 p.a.
3. Each year's excess of Minimum Rent over the actual Royalties was to be recouped during the next three years.
4. If in any year the normal rent was not attained due to strike or accident the Minimum Rent was to be reduced proportionately according to the period of stoppage.
5. Ground Rent of Rs. 500 per annum is payable by the lessee.

Following was the output:

Year	Output in tons
2015	3,000
2016	14,000
2017	18,000
2018	24,000
2019	15,000
2020	24,000

During the year 2019 there was a strike of 4 months. Prepare Royalty a/c, Landlords a/c and Short working a/c in the books of company

Solutions: Table showing the Calculations of Royalty and Short working

Solution: **Royalty calculation table:**

Year	Output in Tons Rs.	Royalty Rs.	Minimum Rent Rs.	Short working Rs.	Short working recovered	Short working not recovered	Amount paid to landlord
2015	3,000	1,500	9,000	7,500	-	-	9,000
2016	14,000	7,000	9,000	2,000	-	-	9,000
2017	18,000	9,000	9,000	-	-	-	9,000
2018	24,000	12,000	9,000		3,000	4,500	9,000

2019	15,000	7,500	6,000 (9000/12 =750*8)		1,500	500	6,000
2020	**24,000**	**12,000**	**9,000**		**-**	**-**	**9,000**

Royalty a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2015	To Landlord a/c	1,500	31/12/2015	By Profit & Loss a/c	1,500
		1,500			1,500
31/12/2016	To Landlord a/c	7,000	31/12/2016	By Profit & Loss a/c	7,000
		7,000			7,000
31/12/2017	To Landlord a/c	9,000	31/12/2017	By Profit & Loss a/c	9,000
		9,000			9,000
31/12/2018	To Landlord a/c	12,000	31/12/2018	By Profit & Loss a/c	12,000
		12,000			12,000
31/12/2019	To Landlord a/c	7,500	31/12/2019	By Profit & Loss a/c	7,500
		7,500			7,500
31/12/2020	To Landlord a/c	12,000	31/12/2020	By Profit & Loss a/c	12,000
		12,000			12,000

Short Workings A/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2015	To Landlord a/c	7,500	31/12/2015	By Balance c/d	7,500
		7,500			7,500
31/12/2016	To Balance b/d	7,500	31/12/2016	By Balance c/d	9,500
	To Landlord	2,000			
		9,500			9,500
31/12/2017	To Balance b/d	9,500	31/12/2017	To Balance c/d	9,500
		9,500			9,500

31/12/2018	To Balance b/d	9,500	31/12/2018	By Landlord	3,000
				By Profit & Loss a/s	4,500
				By Balance c/d	2,000
		9,500			9,500
31/12/2019	To Balance b/d	2,000	3112/2019	By Landlord	1,500
				By Profit & Loss a/c	500
		2,000			**2000**

Landlords a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2015	To Bank	9,000	31/12/2015	By Royalty	1,500
				By Short Workings	7,500
		9,000			9,000
31/12/2016	To Bank	9,000	31/12/2016	By Royalty	7,000
				By Short Workings	2,000
		9,000			9,000
31/12/2017	To Bank	9,000	31/12/2017	By Royalty	9,000
		9,000			9,000
31/12/2018	To Bank	9,000	31/12/2018	By Royalty	12,000
	To Short Working	3,000			
		12,000			12,000
31/12/2019	To Bank	6,000	31/12/2019	By Royalty	7,500
	To Short Working	1,500			
		7,500			7,500
31/12/2020	To Bank	12,000	31/12/2020	By Royalty	12,000
		12,000			12,000

Ground Rent a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2015	To Cash	500	31/12/2015	By Profit &/ Loss a/c	500
		500			500
31/12/2016	To Cash	500	31/12/2015	By Profit &/ Loss a/c	500
		500			500
31/12/2017	To Cash	500	31/12/2017	By Profit &/ Loss a/c	500
		500			500
31/12/2018	To Cash	500	31/12/2017	By Profit &/ Loss a/c	500
		500			500
31/12/2019	To Cash	500	31/12/2019	By Profit &/ Loss a/c	500
		500			500
31/12/2020	To Cash	500	31/12/2020	By Profit &/ Loss a/c	500
		500			500

Problem 4 : The Vishakha coal co LTD took a lease of mine from M/s Chirag C.o for a period of 25 years from 1st Jan. 2002 upon the terms of a royalty of 50 praise per tonne of coal raised with the minimum rent of Rs 20,000 and short workings if any, can be recouped within the subsequent three years.

The following was the production of coal in the first five years.

Year   Production in tonnes

2002 :   6,000

2003 :   36,000

2004:   48,000

2005 : 60,000

2006 : 64,000

Prepare Royalty calculation table.

Solution : Before solving the problem a Royalty Table is prepared

Year	Output in Tons Rs.	Royalty Rs.	Minimum Rent Rs.	Short working Rs.	Short working recovered	Short working not recovered	Amount paid to landlord
2002	6,000	3,000	20,000	17,000		--	20,000
2003	36,000	18,000	20,000	2,000		-	20,000
2004	48,000	24,000	20,000		4,000		20,000
2005	60,000	30,000	20,000		10,000	3,000	20,000
2006	64,000	32,000	20,000		12,000	-	

Problem 5

A Company leased a colliery on 1st January, 2007 at a minimum rent of 20,000 merging into a royalty of rs.1.50 per ton with power to recoup short workings over the first four years was 9,000 tons, 12,000 tons, 16,000 tons, 20,000 tons respectively Pass the necessary journal entries for each of the four years in the book of the company

Solution : **Royalty calculation table**

YEARS	Output (in tons)	Minimum rent r s	Royalty @ Rs. 1.5 per tons	Short workings	surplus	Short working recouped	Short working not recouped	Paid to land lord
2007	9,000	20,000	3500	6500	-	-	--	20,000
2008	12,000	20,000	18,000	2000	-	-	--	20,000
2009	16,000	20,000	24,000	-	4,000	4000	4500	20,000
2010	20,000	20,000	30,000	-	10,000			30,000

Journal Entries in the books of the Company

31-12-2007	short working a/c ……………………………Dr Royalty a/c ……………………………………Dr To landlord (Being royalties @r s 1.50 per ton in the make up)	6500 13500	 20,000
31-12-2007	Lanlord a/c………………………………..Dr To bank a/c (being the payment of minimum rent)	20,000	 20,000
31-12-2008	Royalties a/c ………………………………dr Short working…………………………… dr To land lord (being royalties @rs 1.50 per ton in the makeup)	18,000 2,000	 20,000
31-12-2008	Land lord a/c……………………….. dr To bank a/c (being the payment of minimum rent)	20,000	 20,000
31-12-2008	Royalties a/c…………………………………… dr To land lord a/c (being royalties @rs 1.50 per ton	20000	 20,000
31-12-2009	Land lord a/c……… ……………………dr To short working a/c To bank a/c (being minimum rent of rs 20000 paid to the land lord rs 4000 short working recouped)	20,000	 4,000 16,000
31-12-2009	Profit and loss a/c ………………………..dr To short workings a/c (being transfer of irrecoverable short workings)	4,500	 4,500
31-12-2010	Royalty a/c …………………………………dr To land lord a/c (being royalties due@ rs 1.50 per ton on 20000)	20,000	 20,000
31-12-2010	Land lord a/c ……………………………dr To bank a/c (being payment of royalties)	20,000	 20,000

Problem no. 6 : Mr. Indiagate Lockers who had patented an automatic lock granted Locks ltd. a license for ten years to manufacture and sell the locks on the following terms on 1st Jan. 2010

1. Locks ltd. to pay a Royalty of Rs. 1 for every lock sold with minimum payment of Rs. 500 p.a. Calculation to be made annually as on 31st Dec. and actual payment to be made on 1st January.
2. If for any year the royalties calculated on locks sold amount to less than Rs. 500, Locks Ltd. may set off the deficiency against royalties payable in excess of that sum in the next two years.

With effect from the end of the second year the agreement was changed and a minimum annual payment of Rs. 400 was substituted of Rs. 500, the other terms of the agreement remaining unchanged.

The number of locks sold were:

Year ended 31-12-2020: 200

31-12-2021: 400

31-12-2022 : 600

31-12-2023 : 500

Prepare ledger accounts to record the above transactions in the books of Locks Ltd. Accounts are closed on 31st Dec. annually.

Statement of Royalty

Year	No. of locks sold	Royalty Rs. 1	Minimum Rent	Short working	S.W. Recovered	Short working not recovered
2020	200	200	500	300	-	-
2021	400	400	400	-	-	-
2022	600	600	400	-	200	100
2023	500	500	400	-	-	-

In the books of Locks Ltd.

Indiagate Lockers a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2020	To balance c/d	500	31/12/2020	By Royalties	200
				By short working	300
		500			**500**
1-1-2021	To Bank	500	1-1-2021	By balance b/d	500
31/12/2021	To Balance c/d	400	31/12/2021	By Royalties	400
		900			**900**
1-1-2022	To Bank	400	1-1-2021	By Balance b/d	400
31-12-2022	To Short working	200	31-12-2022	By Royalties	600
31-12-2022	To Balance c/d	400			
		1000			**1000**
1-1-2023	To Bank	400	1-1-2023	By Balance b/d	400
31-12-2023	To Balance c/d	500	31-12-2023	By Royalties	500
		900			**900**
1-1-2024	To Bank	500	1-1-2024	By balance c/d	500

Royalties a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2000	To Invertors a/c	200	31-12-2000	By Profit & Loss a/c	200
		200			**200**
31-12-2021	To Invertors a/c	400	**31-12-2021**	By Profit & Loss a/c	400
		400			**400**
31-12-2022	To Invertors a/c	600	31-12-2022	By Profit & Loss a/c	600
		600			**600**

31-12-2023	To Invertors a/c	500	31-12-2023	By Profit & Loss a/c	500
		500			**500**

Problem No. 7

The Xylo Co. Ltd. Leased a property from Yamunadas Co. at a royalty Of 1.50 per ton with a minimum rent of Rs. 2000 p.a. Each year excess of minimum rent over royalty is recoverable out of royalty of next five years. In the event of the strike and the minimum rental not being reached the lease provided that minimum rent would stand reduced proportionately to time actually worked.

The results of the working were as follows:

Year	Actual royalty
2011	Nil
2012	650
2013	1850
2014	2250
2015	3500
2016 : strike for 3 months	1200
2017	3000

Prepare royalty a/c and short working a/c in the books of Xylo Co. Ltd. for all the years.

Year	Royalty	Minimum rent	Short working	Short working recovered	Short working unrecovered
2011	-	2000	2000	-	-
2012	650	2000	1350	-	-
2013	1850	2000	150	-	-
2014	2250	2000	-	250	-
2015	3500	2000	-	1500	-
2016	1200	1500	300	-	250
2017	3000	2000	-	1000	350

Royalties a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2012	To Minimum rent	650	31/12/2012	By Profit and Loss a/c	650
		650			**650**
31/12/2013	To Minimum rent	1850	31/12/2013	By Profit and Loss a/c	1850
		1850			**1850**
31/12/2014	To Yamunadas co	2250	31/12/2014	By Profit and Loss a/c	2250
		2250			**2250**
31/12/2015	To Yamunadas co	3500	31/12/2015	By Profit and Loss a/c	3500
		3500			3500
31/12/2016	To Minimum rent	1200	31/12/2016	By Profit and Loss a/c	1200
		1200			**1200**
31/12/2017	To Yamunadas co	3000	31/12/2017	By Profit and Loss a/c	3000
		3000			**3000**

Short Working a/c

Date	Particulars	Rs	Date	Particulars	Rs
31/12/2011	To Minimum rent	2000	31/12/2011	By balance c/d	2000
		2000			**2000**
1/1/2012	To balance b/d	2000	31/12/2012	By balance c/d	3350
31/12/2012	To Minimum rent	1350			
		3350			**3350**
1/1/2013	To balance b/d	3350	31/12/2013	By balance c/d	**3500**
31/12/2013	To Minimum rent	150			

		3500			**3500**
1/1/2014	To balance b/d	3500	31/12/2014	By Yamunadas co	250
				By Balance c/d	3250
		3500			**3500**
1/1/2015	To balance b/d	3250	31/12/2015	By Yamunadas co	1500
				By Balance c/d	1750
		3250			**3250**

2.8 Check your progress

1. What is Short-working?

Ans.: On account of the minimum rent clause contained in the royalty agreement, the lessee has to pay to the lessor every year the minimum guaranteed amount. As such, in the year of no output or low output, the minimum rent required to be paid by the lessee to the lessor for that year will be definitely more than the actual royalty for that year. The excess of minimum rent over actual royalty calculated on the basis of output or sales is termed as short-workings.

2. Who is Lessee?

Ans.: The person who takes out the special rights from its owner on lease for a consideration is called lessee or tenant or patentor or publisher.

3. What is Recoupment of Short-working?

Ans.: The right of getting back the excess payment made by the lessee in earlier years is called the right of recoupment of the short-workings. The right of recoupment of short-workings can be of three types. They are – a) Restricted (fixed) to a certain period or b) Unrestricted (floating). c) Throughout the period of lease

4. What is Royalty?

Ans.: Royalty is the periodical consideration or payment, based on the output or sale, made by one person, called lessee, to another person, called the lessor for taking out on lease the special rights vested in the lessor.

5. **Bring out the meaning of short-working with an example.**

   Ans.: The excess of minimum rent over actual royalty calculated on the basis of output or sales is termed as short-workings. Example: M/s Himalaya Publishers printed a book on Advanced Accountancy at minimum rent of Rs. 2,00,000 per annum royalty being payable @ Rs.75 per copy sold. No. of copies sold in the first year 2,000. In the above example, there is a short-working of Rs.50,000 in the first year. i.e., Minimum Rent of Rs.2,00,000 minus Rs.1,50,000 actual royalty (2,000 copies x 75 per copy).

2.9 Summary:

Royalty is a periodical payment, based on output or sale, required to be paid by one person to another in consideration of some special rights acquired e.g. the right to exploit a mine or colliery to publish a book or to manufacture an article under a patent. Royalties arises with the agreement between two parties one is the owner of the asset or the person who has rights over the asset. Other is the person who acquired the right of using it for payment of a Royalty. The person who makes the payment to the owner of the asset in exchange for the right to use his asset is known as 'lessee' and the owner of the asset as lessor or landlord. In short, Royalty is what a lessee pays to a lessor for the use of any rights, copyrights, franchises or any such asset. It is the system of sharing of revenues between the lessee and the lessor.

2.10 Exercise:

Problem – 1.

Prepare an analytical table of royalties from the following:

a) Minimum Rent – Rs.10,000 p.a. b) Royalty – Re. 1 per ton c) Short-workings are recoverable during the first 3 years d) Output during the first three years = 2,000, 5,000 and 15,000 tons respectively.

Problem – 2.

M/s PQR Co. Ltd. took a land on lease for a period of 25 years on 1-1-2019 on a royalty of Rs. 40 per ton with a minimum rent of Rs. 4,00,000 and short-workings can be recouped during the first 4 years. The annual output was as follows – 2019 - 5,000 tons; 2020 – 8,000 tons; 2021 – 10,000 tons; 2022 – 15,000 tons; 2023 – 20,000 tons. Prepare necessary ledger accounts in the books of PQR Co. Ltd.

Problem – 3.

Prepare Royalty analysis table from the following details: i) Minimum Rent Rs.75,000 p.a.. ii) Royalty payable Rs.5 per ton of output. iii) Short-working of the year can be recouped on the next 2 years out of excess royalty. iv) Output for the first five years were: Years: 1 2 3 4 5 Output in tons: 10,000, 12,200 20,800, 25,500, 35,500.

Problem – 4

A mining company leased a property from 'X' at a royalty of Rs.10 per ton with a minimum rent of Rs.24,000 p.a. Each years excess of minimum rent over roylaty is recoverable out of royalties of next three years. The results of the workings are as follows. I year 2,000 tons; II year 3,000 tons; III year 4,000 tons; IV year 5,600 tons; V year 6,000 tons. Prepare necessary ledger accounts in the books of the company for five years.

Problem – 5.

Prepare an Analysis Table from the following details: Royalty payable Rs.0.50 per ton of output. Minimum rent Rs.7,500 p.a. Short workings are recoverable during the first three years of the lease only. Output during the first three years 10,000; 14,000; and 18,000 tons respectively.

Problem – 6.

X Co. Ltd. took a lease from a landlord for a period of 25 years from 1-1-2010 on a royalty of Rs.2 per ton of coal raised with a minimum rent of Rs.20,000 and power to recoup short-workings during the first 4 years of the lease. The annual output was as follows – 2010 - 5,000 tons; 2011– 8,000 tons; 2012 – 10,000 tons; 2013 – 15,000 tons; 2014 – 20,000 tons. Prepare Minimum rent A/c, Royalty A/c, Short-workings A/c and Landlord A/c.

Problem -7

Bee Ltd. took a right to publish and sell books from Smith for 5 years. The minimum rent was fixed at Rs.20000. Royalty was fixed at Rs. 4 per book. Bee Ltd. has a right to recoup the short-workings in the first 4 years. The sales in the 5 years are given. Calculate the Royalty payable and short-workings.

References:

1. Jain and Narang : Financial Accountancy
2. M. C. Shukla & T.S. Grawal : Advanced Accountancy
3. R.L. Gupta & V.K. Gupta : Financial Accountancy
4. Shukla Grewal : Financial Accountancy
5. S.P. Jain & K.L. Narang : Advanced Accounting.

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Unit-3

Contract Accounting : Construction Contracts

Index :

3.1 Introduction:

Since each Contract is unique in itself; each Contract has its own Cost. Thus, the activity of calculation of the cost of the Contract comprises of an elaborate system for tracking all material that is issued for a contract, material transferred from or to a contract, material returned from a contract, material lost/stolen/destroyed etc. Similarly, details of labour deployed are kept for facilitating calculation of labour cost. Elements of overheads are charged as per the corporate policy so as that each Contract has its own fair share of cost thereof. Special adjustments are required in respect of incomplete contracts, amount carried to the Profit and Loss Account in respect of contracts in progress, valuation of WIP etc. In order to protect the interest of the Contractor executing the contract, specific terms are laid in Contracts viz. escalation clause, cost plus contracts etc.

3.2 Presentation of Subject Matter:

This part includes Introduction, Meaning, Definition, Accounting Procedure of Preparation of Contract Account, as well as Accounting related Construction Contracts and illustrations on Contract Accounting.

3.2.1 Contract Account:

A contract account is a record of the amounts of money that have been received from the contractee as well as any payments to be made for materials or work done.

A contract account is a bookkeeping tool that tracks the financial transactions of a contract. It is used to help businesses manage expenses, report financial information, and analyse performance.

Construction projects are complex endeavours that require meticulous financial management. Contract accounting is a crucial aspect of construction project management, focusing on the accurate recording, tracking, and reporting of financial transactions related to construction contracts. By effectively managing contract accounting, construction companies can enhance financial control, mitigate risks, and ensure the successful completion of projects within budget and on time.

3.2.2 Features of Contract Accounting:

Following are the important features of a contract accounting −

- **Direct Costs** − Direct cost is the main proportion of expenses in a contract account. However, indirect nature of expenses is also treated as direct expenses in a contract account.
- **Indirect Costs** − Proportion of the indirect cost is very low in a contract accounting such as expenses related to the head office in case of various contracts.

- **Cost Control** − Cost control is the main challenge in a contract account especially in the large-scale contracts. For example, control over the material cost, labor cost, loss, damages, etc. are difficult to regulate.
- **Surplus Material** − After completion of the constructional project, if any material such as cement, iron and steel, marbles, etc. is remained unused, is known as surplus material. Surplus materials are normally disposed of to get back the invested amount.

3.2.3 Key Components of Contract Accounting:

Contract accounting involves several key components to effectively manage project finances:

- **Project Budgeting:** Developing a comprehensive budget that includes all estimated project costs, such as labor, materials, equipment, and overhead expenses.
- **Cost Tracking:** Regularly monitoring and recording actual project costs to compare against the budget and identify any variances.
- **Revenue Recognition:** Determining the appropriate time to recognize revenue based on the percentage of completion method or other applicable revenue recognition methods.
- **Change Order Management:** Properly accounting for any changes to the original contract scope, cost, or schedule through change orders.
- **Billing and Invoicing:** Generating accurate and timely invoices for the work completed to ensure a steady cash flow.
- **Accounts Payable and Receivable:** Managing payments to suppliers, subcontractors, and managing receipts from clients.
- **Financial Reporting:** Preparing regular financial reports for stakeholders, including project owners, management, and investors.
- **Risk Assessment:** Identifying financial risks associated with the project and implementing risk management strategies.

3.2.4 Contract Types and Their Impact on Accounting:

Construction contracts can vary in structure and terms, and each type can have specific implications for contract accounting:

- **Lump Sum Contracts:** In a lump sum contract, the contractor agrees to complete the project for a fixed sum. Contract accounting involves closely managing costs to ensure profitability while delivering the project within budget.
- **Cost Plus Contracts:** In a cost-plus contract, the contractor is reimbursed for the actual costs incurred, plus a predetermined fee. Contract accounting focuses on accurate cost tracking and ensuring transparent reporting to the client.
- **Time and Material Contracts:** Time and material contracts involve billing the client based on the actual time spent and materials used. Contract accounting requires precise documentation of labor hours and materials to bill accurately.
- **Unit Price Contracts:** Unit price contracts involve billing based on the quantity of completed units. Contract accounting requires accurate measurement and tracking of completed units for proper billing.

3.2.5 Role of Contract Accounting in Construction:

In the construction industry, contract accounting involves the financial management of individual contracts or projects. It encompasses various financial activities, including budgeting, cost tracking, revenue recognition, billing, and cash flow management. The goal of contract accounting is to ensure that each construction project remains financially viable and aligned with the overall financial goals of the construction company.

Contract accounting plays a vital role in construction projects by:

- **Budget Management:** Creating and managing project budgets to accurately estimate costs and allocate resources efficiently.
- **Cost Control:** Monitoring project costs to identify potential cost overruns and implement corrective measures.
- **Revenue Recognition:** Recognizing revenue based on the progress of the project, complying with accounting standards and contract terms.

- **Contract Compliance:** Ensuring financial transactions are in accordance with contractual agreements and legal requirements.
- **Financial Reporting:** Providing stakeholders with accurate and timely financial reports on project performance.
- **Cash Flow Management:** Maintaining sufficient cash flow to meet financial obligations and project requirements.

3.2.6 Challenges in Contract Accounting for Construction Projects:

Contract accounting in construction can present several challenges that require careful management:

- **Project Complexity:** Construction projects can be intricate, involving multiple tasks, phases, and stakeholders, making accounting more complex.
- **Cost Allocation:** Allocating indirect costs and overhead expenses to specific projects requires accurate methods and data.
- **Change Orders:** Managing change orders and their financial implications on the project's budget and revenue recognition can be challenging.
- **Regulatory Compliance:** Construction companies must comply with accounting standards and tax regulations related to contract accounting.
- **Contractual Obligations:** Ensuring accurate billing and adherence to contractual terms is essential for maintaining client trust and satisfaction.
- **Resource Management:** Proper resource allocation and cash flow management are crucial for avoiding financial strain on the project.
- **Integration with ERP Systems:** Integrating contract accounting with enterprise resource planning (ERP) systems can be complex but is essential for accurate data management.

3.2.7 Effective Contract Accounting Practices:

To ensure effective contract accounting in construction projects, consider the following best practices:

- **Clear Documentation:** Maintain detailed records of all financial transactions, change orders, and contract amendments.

- **Accounting Software:** Utilize construction-specific accounting software to streamline financial processes and ensure accuracy.
- **Regular Reconciliation:** Conduct regular reconciliations of project costs, revenue, and accounts to identify any discrepancies.
- **Collaborative Communication:** Foster open communication between accounting teams and project managers to address financial concerns promptly.
- **Contract Review:** Thoroughly review all contracts to understand the financial implications and obligations for the construction company.
- **Training and Education:** Ensure accounting staff and project managers are well-trained in contract accounting principles and procedures.
- **Compliance and Audit:** Establish internal controls and conduct periodic audits to ensure compliance with accounting standards and regulations.

3.2.8 Accounting Procedure:

The usual heads under which costs of individual contract are collected are as under:

1. Material: All material issued to a particular Contract is charged to that particular contract directly. All returns and transfers are credited to that particular contract.
2. Labour: All labour that is specifically engaged on a particular contract is directly debited to the concerned contract as regards its rates and charges. Other indirect wages may be charged to each contract on some suitable basis.
3. Expenses: All expenses directly incurred for particular contracts are directly debited to it e.g. hire charges of particular machinery.
4. Depreciation on Plant and Machinery: In case of machinery used for contract work, there are two methods for charging depreciation on it to the contract: -
    a. The contract is debited with the value of the machinery and when the work is completed credited with the sale proceeds of it in case it is sold or otherwise credited with the value of it by way of revaluation,
    b. The particular contract account is debited only with the depreciation which is allocable to that particular contract.

5. Sub-Contract Charges: In case any work relating to a contract is sub-contracted, the charges for the same are debited to that particular Contract a/c.
6. Other Expenses and Accrued Charges: All other expenses related to a Contract are directly debited to it. In respect of outstanding charges, the same are debited to the concerned Contract A/c.

Retention Money:

After the completion of the contract, the asset created is handed over to the contractee for its fruitful usage. Many times, during the course of the usage certain problems arise like, leakage from the roof of a house/building constructed, cracks in the walls of the construction, wear out of the layers of the road built etc. In order to protect the contractee from such quality related issues, there is a practice of retaining part of the consideration of the contract with the contractee as a performance guarantee. This amount retained is called as Retention Money; and is normally kept with the contractee during the guarantee/warranty period; and after its elapse is returned back to the contractor.

Escalation Clause:

'Contracts with Escalation Clause' is a provision by virtue of which the contractor gets the actual increase in the cost as a percentage of the contract price initially agreed by him. This feature was introduced due to the time span over which the execution of the contract stretches; which makes an accurate estimation of the contract costs for quotation purpose very difficult. Besides, this clause comes to the rescue of the contractor in situations of war or political uncertainty when prices of material fluctuate wildly.

Work in Progress:

In case of incomplete Contracts, the amount that is to be taken to the Balance

Sheet as Work in Progress would be either of the two:

1. First Method:
    a. If there is profit, then the amount taken to the credit of P&L A/c is added to the Cost of Contract, and from this cash received on the Contract is deducted. This is WIP for B/S purpose, and

b. If there is a loss, the amount of loss is deducted from the Cost of Contract, and from it is deducted the cash received on the Contract. This is the WIP.

   Take examples showing the preparation of the Contract A/c and the amount of Profit and Loss figure.

2. Second Method: WIP for Balance Sheet = [Work Certified + Work Uncertified] - [P&L A/c Reserve A/c + Cash Received].

Cost Plus Contract:

In many cases it so happens that it becomes difficult to quote the exact price for a Contract. This may be due to the fact that a Contract is a special one, or one which was not executed in the past or the circumstances are changing so fast that a fair estimate of the Contract Cost is not possible e.g. political crisis, war etc. In such cases contractors take help of the 'cost-plus contract' clause due to which they get not only the actual cost incurred by them on the contract but also a fair margin of profit on it. For this it is necessary to have a prior agreement with respect to proof of actual expenses to be produced, agreed wastages etc. Its disadvantage is that it has no way of controlling inefficiency.

Preparation of Contract Account:

A) Recording of Cost of Contract:

All costs are recorded against the individual contract. The recording procedure of the following items may be noted carefully:

1) Materials: Materials required for a specific contract is debited to that contract account. Materials returned under materials returned note is credited to that contract. Materials transferred from one contract to another are recorded in the usual way. At the end of the accounting period the value of materials on site is a carried forward as a charge against the next period.

2) Wages: Wages of all workers engaged on a particular contract are allocated direct to that contract regardless the work they perform. Where workers move from one contract to another, time sheets must be maintained and wages may be distributed on the basis of time spent on each contract. The wages of head office and central stores is considered as overhead and are charged to contracts on some equitable basis.

3) Expenses: All expenses except material and wages are charged to individual contracts as and when they are incurred.

4) Plant and Machinery: For use of plant and machinery depreciation may be charged in any of the following ways,

   (a) When the plant is required to be used for a long time, the total cost of asset is debited to the contract in which they are used. When contract is completed or the plant is no long required it may be sold at site and the contract is credited with sale proceeds. If it is not sold the contract is credited with depreciated value. This method has a drawback that the debit side is unnecessarily inflated with the plant value and cost of contract at first sight appears to be very high. In order to overcome this problem, the difference between the original cost at commencement and depreciated value at the end of the period is obtained and is charged to the contract concerned as plant depreciation.

   (b) When plant is sent to the contract site only for short time the revaluation method just described is not satisfactory, and it is usual to charge the contract for the use on a daily or hourly basis.

5) Sub Contracts: Sub-contract costs are also debited to the Contract Account.

6) Extra Work: this forms a separate charge and where the amount involved is large, a subsidiary contract is generally entered into with the contractee.

7) Accrued Charges: all accrued charges should be debited to the contracts concerned at the end of the accounting period and carried forward in the next period.

B) Recording of Value of Profit of Contract:

(1) Certificate of Work Done: In large contracts it is usual for the contractor to obtain sums, time to time from the contractee. As the time proceeds the surveyor appointed by the contractee issues certificates to the effect that so much portion is completed. The contractor will get money according to this certificate. In some cases the terms of contract provide that the whole amount covered by the surveyor's certificate will not be paid, but a certain portion thereof shall be retained by the contractee called as retention money. On receipt of each certificate any one of the following accounting methods may be adopted:

(a) Credits the appropriate contract accounts with the value mentioned in the certificate and debit the personal account of the contractee. Cash received is credited to the Contractor's A/c and the balance is shown as debtor representing retention money.

(b) Alternatively, the contract account is credited with the value of certificate and the contractee account is debited with the amount payable immediately and a Special Retention Money account is debited with the amount so retained.

(2) Profit on Uncompleted Contracts: Where a contract is large enough to extend over years it is usual to credit a part of the profit to the P&L account each year.

If any loss is detected the whole of the loss so detected should be debited to P&L account. Unless a portion of the profit on incomplete contract is taken, the accounts may show low profits in years when no major contract is completed and exceptionally high profits in the year in which contract is completed. In these circumstances it is prudent to transfer a conservative part of the estimated profit on large contracts at the end of the year.

The determination of the amount of profit and proportion of profit to be taken to P&L account depends upon the practice and circumstances of the case.

The rules may be summarized as follows,

A. When work of contract has not been reasonably advanced. No profit is taken into account.

B. When work on contract has been reasonably advanced and covered by contractees certificate. In this case the notional profit is ascertained by deducting the cost if contract covered by surveyor’s certificate from the value of contract certified by surveyor. A portion of this profit is taken to P&L account and the balance is carried forward in the same contract as profit in suspense as a provision against future losses, increase in cost and other contingencies. The amount of profit to be credited to P&L account is ascertained from this popular formula:

= 2/3 x Notional Profit x Cash Received/Work Certified

3.2.9 Illustration:

Illustration No. 1:

From the following amount suggest the amount of profit that may be taken on Contract X which has been completed nearly 70%:

	Rs.
Total cost of contract to date	383000
Cost of contract not yet certified	23000
Value of contract certified	420000
Cash received to date	378000

Solution:

As the contract has reasonably advanced but not complete, the following formula may be used :

$$\frac{2}{3} \text{ x Notional Profit x } \frac{\text{Cash Received}}{\text{Work Certified}}$$

Now, value of contract certified to date	Rs. 420000
Cost of contract certified i.e. [(3,83,000-23,000)]	Rs. 360000
Notional profit	Rs. 60000

(cost of contract certified = total cost of contract to date – cost of contract not yet certified = Rs. 383000 – Rs. 23000 = Rs. Rs. 360000)

$$\frac{2}{3} \text{ x } 60000 \text{ x } \frac{378000}{420000} = \text{Rs. } 36000$$

A. **Where the Contract is almost Complete:** In this case the notional profit is determined by deducting the aggregate of costs to date and additional expenditure to complete the contract from the contract price. A proportion of this estimated total profit is credited to P&L account. This proportion is ascertained by adopting any one of the following formula :

(a) Estimated total profit x $\frac{\text{Value of work certified}}{\text{Contract price}}$

(b) Estimated total profit x $\frac{\text{Value of work certified}}{\text{Contract price}}$ x $\frac{\text{Cash received}}{\text{Work certified}}$

(c) Estimated total profit x $\frac{\text{Cost of work to date}}{\text{Estimated tot cost}}$

(d) Estimated total profit x $\frac{\text{Cost of work to date}}{\text{Estimated total cost}}$ x $\frac{\text{Cash received}}{\text{Work certified}}$

Illustration No. 2:

From the following information suggest the profit to be taken on a contract which is 95% complete. Illustrate the different methods of computing profit and compare the profit, had it not been nearly complete.

	Rs.
Total cost of contract to date	190000
Estimated additional expenditure	10000
(including Provision for contingencies)	
Contract price	250000
Value of contract certified	230000
Cost of work not certified	5000
Cash received	215000

Solution:

As the contract is almost complete, the calculation of profit may be made as follows,

Estimated profit	Rs.
Contract price	250000
Estimated total expenditure	200000
Estimated total profit	50000

(a) Estimated total profit x $\frac{\text{Value of work certified}}{\text{Contract price}}$

$= 50000 \text{ x } \frac{230000}{25000} = \text{Rs. } 46000$

(b) Estimated total profit x $\frac{\text{Value of work certified}}{\text{Contract price}}$ x $\frac{\text{Cash received}}{\text{Work certified}}$

$= 50000 \text{ x } \frac{230000}{250000} \text{ x } \frac{215000}{230000} = \text{ Rs. } 43000$

(c) Estimated total profit x $\frac{\text{Cost of work to date}}{\text{Estimated total cost}}$

$$= 50000 \times \frac{190000}{200000} = \text{Rs. } 47500$$

(d) Estimated total profit x $\frac{\text{Cost of work to date}}{\text{Estimated total cost}} \times \frac{\text{Cash received}}{\text{Work certified}}$

$= 50000 \times \frac{190000}{200000} \times \frac{215000}{230000} =$ Rs 44402 (approx)

Assuming the contract has reasonably advanced but not almost complete, the computation of profit to be taken as follows:

	Rs.
Value of contract certified	230000
Cost of contract certified i.e. ₹ 1,90,000 – ₹ 5,000	185000
Notional profit	45000

Profit to be taken to P&L a/c = $\frac{2}{3} \times 45000 \times \frac{215000}{230000}$ = Rs. 28043 (approx)

(2) **Valuation of work in progress:** the best way of finding out amount of work in progress for Balance sheet purpose is to add profit taken to P&L a/c to cost of contract to date and from this aggregate cash received is deducted. If there is a loss in a contract the loss should be deducted from cost of contract to date and from the amount thus arrived at cash received is deducted. This balance represents work in progress.

➢ **Cost Plus Contract, Target Price Contract and Escalator Clause:**

Where the probable cost of contract cannot be computed in advance with a reasonable degree of accuracy, a cost-plus contract is generally adopted whereby the contractor receives his total costs plus a profit, which may be a percentage of cost or fixed by reference to a scale which is definitely related to total cost. Such cost plus or lime and line contracts are undertaken for production of special articles not usually manufactured, e.g, production of newly designed aircraft component, or in case of urgent repair of ships, vehicles, power house etc, or in case of constructions during war time. From the manufacturers point of view, this type of contract protects him from the risk of fluctuations in market price of material, labour and other services. In order to avoid disputes in future, manufacturer must settle the admissible costs such as, supervision, fixed expenses and losses, such as allowances for scrap, wastage, normal loss etc. Moreover, it provides for the stipulations as to documents to be put in evidence to prove the claim of the contractor and steps to be taken for reconciliation of difference of opinion between the contractor and contractee as regards cost ascertainment. The customer usually reserves the right of cost audit but he does not not mind to pay more if there is genuine rise in cost. This contract ensures that price paid will depend on cost rather than on arbitrary commitment to a specific price. However, this system puts a premium on inefficiency and there is no incentive to reduce cost. A variation of this type of costing is target costing whereby the contractor receives an agreed sum of profit over his predetermined costs. In addition, a figure is agreed as the target figure, and if actual costs are below this target the contractor is also entitled to a bonus which is a proportion of savings thus made. In order to avoid the element of risk from both sides there may be an escalator clause in the contract providing for change in the price of contract due to the change in the price of raw materials and labour or change in the utilization of factors of production. Thus, in a contract with transport undertaking, the price per ton mile will increase or decrease for each rise or fall of price of petrol by 10% of the prevailing price. Here the contractor has to produce sufficient proof of excess cost before the customer agrees to re-imburse such costs.

Illustration No. 3:

Construction ltd is engaged on two contracts D & E during the year. The following particulars are obtained at the year-end:

	Contract D	Contract E
Date of commencement	April 1 Rs.	September 1 Rs.
Contract price	600000	500000
Materials delivered direct to site	120000	50000
Materials issued from store	40000	10000
Materials returned to store	4000	2000
Materials on site December 31	22000	8000
Direct labour payments	140000	35000
Direct expense	60000	30000

Architects' fees	2000	1000
Establishment fees	25000	7000
Plant installed at cost	80000	70000
Value of plant December 31	65000	64000
Accrued wages December 31	10000	7000
Accrued expenses December 31	6000	5000
Cost of contract not yet certified	23000	10000
Value of contract certified by architect	420000	135000
Cash received from contractee	378000	125000

During the period, material amounting to Rs. 9000 has been transferred from contract D to contract E.

You are required to show;

(a) contract accounts, contractee's accounts

(b) Extract from the balance sheet as at December 31, clearly showing the calculation of work in progress.

Solution:

Contract D account

Dr. Cr.

Particular	Rs.	Particular	Rs.
To Materials direct	120000	By Materials returned to stores	4000
To Materials ex store	40000	By Materials transferred to Contract E	9000
To Wages paid	140000	By Stock of materials c/d	22000
To Direct expenses	60000	By Cost of contract c/d	383000
To Plant depreciation	15000		
To Architects fees	2000		
To Establishment charges	25000		
To Wages accrued, c/d	10000		

To Direct expenses accrued, c/d	6000		
	418000		418000
To Cost of contract b/d	383000	By Value of contract certified	420000
To P&L a/c profit taken	36000	By Cost of contract not yet certified c/d	23000
To Profit in suspense a/c c/d	24000		
	443000		443000
To Stock of materials b/d	22000	By Wages accrued b/d	10000
To Cost of contract not yet Certified b/d	23000	By Direct expenses accrued b/d	6000
		By Profit in suspense b/d	24000

Contractee Account (D)

Dr. Cr.

Particular	Rs.	Particular	Rs.
To Value of work certified	420000	By Cash	378000
		By Balance c/d	42000
	420000		420000
To Balance b/d	42000		

Contractee account E

Dr. Cr.

Particular	Rs.	Particular	Rs.
To Value of work certified	135000	By Cash	125000
		By Balance c/d	10000
	135000		420000
To Balance b/d	10000		

Dr. **Contract E account** Cr.

Particular	Rs.	Particular	Rs.
To Materials, direct	50000	By Materials returned to store	2000
To Materials, ex-store	10000	By Stock of materials c/d	8000
To Materials from contract D	9000	By Cost of contract c/d	150000
To Wages paid	35000		
To Direct expenses	30000		
To Plant depreciation	6000		
To Architects fees	1000		
To Establishment charges	7000		
To Wages accrued c/d	7000		
To Expenses accrued c/d	5000		
	160000		160000
To Cost of contract b/d	150000	By Value of contract certified By Cost of contract not yet	135000
		certified c/d	10000
		By P&L a/c—loss on Contract	5000
	150000		150000
To Stock of materials b/d	8000	By Wages accrued b/d	7000
To Cost not yet certified b/d	10000	By Expenses accrued b/d	5000

Balance sheet as at December 31 (extract only for contracts)

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
P&L a/c			Fixed assets:		
Profit of D	36000		Plant at cost	150000	
Loss of E	5000		Depreciation	21000	
		31000			129000
Sundry creditors			Current assets:		
Wages accrued	17000		Stock of materials	30000	
Expenses accrued	11000		Work in progress	61000	
		28000			91000

Calculation of work in progress		
Contract D-	Rs.	Rs.
Cost of contract to date	383000	
Add profit taken	36000	419000
Less cash received	378000	
		41000
Contract E.		
Cost of contract to date	150000	
Less loss incurred	5000	145000
Less cash received	125000	20000
Total work in progress		61000

Note: profit calculation of contract D:

$$\frac{2}{3} \text{x Notionalprofit x} \frac{\text{cash received}}{\text{value of work certified}}$$

$$= \frac{2}{3} \text{ x } 60000 \text{ x} \frac{378000}{420000} = \text{Rs. } 36000$$

Note: the method described just now is very popular and is helpful to students in answering questions. However, the following modified method is also extensively used by many contractors:

Illustration No. 4:

Assuming the same figures in respect of contract D of the problem above, prepare the contract accounts to show the position at December 31, retaining an adequate provision against possible losses before final acceptance of the contract.

Solution:

Contract D account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Materials, direct	120000	By Materials returned to store	4000
To Materials, ex-store	40000	By Materials tfd to contract E	9000
To Wages paid	140000	By Stock of materials c/d	22000
To Direct expenses	60000	By Cost of contract not certified c/d	23000
To Plant depreciation	15000	By cost of contract certified up to date c/d	360000
	418000		418000
To Cost of contract certified b/d	360000	By Wages accrued b/d	10000
To Cost of contract not certified b/d	23000	By Direct expenses accrued b/d	6000
To Stock of material b/d	22000		

Contract D certificate account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance c/d	420000	By Certificates up to date	420000
	420000		420000

Contract D retentions account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Certificate account	42000	By Certificates up to date	420000

Contractee account (D)

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Certificate account	378000	By Cash at bank	378000

Contract D profit provision account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Transfer to P&L a/c	36000	By Provision c/d	36000
	36000		36000
Balance b/d	36000		

N.B. the balance sheet position will remain the same.

Illustration No. 5 : The BBA Construction Company undertakes large contracts. The following particulars related to contract No. 125 carried out during the year ended on 31st March, 2015.

Particulars	Rs.	Particulars	Rs.
Work certified by architect	1,43,000	Wages accrued on 31st March 2015	1,8000
Cost of work not certified	3,400	Direct expenditure	2,400
Plant installed at site	11,300	Materials on hand on 31st March 2015	1,400

Value of plant on 31st March 2015	8,200	Materials returned to store	400
Materials sent to site	64,500	Direct expenditure accrued on 31st March 2015	200
Labour	54,800	Contract price	2,00,000
Establishment charge	3,250	Cash received from contractee	1,30,000

Prepare a Contract Account for the period ending 31st March 2015 and find out the profit. It was decided to transfer 2/3 of the profit on cash basis to Profit and Loss Account.

Solution :

Contract No. 125 Account for the year ending 31st March, 2015

Particulars	Rs.	Particulars	Rs.
To Materials sent to site	64,500	By Materials returned	400
To Labour	54,800	By Materials in hand	1,400
To Establishment charge	3,250	By Work-in-Progress:	
To Direct expenses	2,400	Certified	1,43,000
To Wages accrued	1,800	Uncertified	3,400
To Direct expenses accured	200	By Plant at site	8,200
To Plant at site	11,300		
To Notional Profit c/d	18,150		
	1,56,400		1,56,400
To P & L A/c	11,000	By Notional Profit b/d	18,150
(18,150 x 2/3) x (1,30,000/1,43,000)			
To Reserve	7,150		
	18,150		18,150

Illustration No. 6 :

Simplex Construction Ltd. Agreed to take a contract for construction of a bridge on 01.07.2017. The contract price was Rs. 5,00,000. The company incurred following expenses up to 31.12.2017.

Particulars	Rs.
Materials consumed	1,10,000
Wages	40,000
Direct expenses	20,000
Plant purchased on 01.07.2017	1,00,000
Materials in hand on 31.12.2017	5,000

Additional information :

* Depreciation on plant @10% per annum.
* Charge other works expenses @20% of wages & office expenses @10% of works cost.
* The amount certified by the contractee's engineer was Rs. 3,00,000, retention money being 20% of the certified value.

Prepare Contract A/c showing the amount of profit that the company can reasonably take to its P/L A/c.

Solution :

Simplex Construction Ltd.

Contract No. 126 Account for the year ending 31st March, 2015

Dr. Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
31.12.2017		**31.12.2017**	
To Materials consumed	1,10,000	By Work-in-progress c/d	3,00,000
To wages	40,000	(value of work certified)	
To direct expenses	20,000		
To depreciation on plant (6	5,000		

months)			
To other works expenses (20% on wages)	8,000		
Works Cost	1,83,000		
To office expenses (10% on works cost)	18,300		
	2,01,300		
To Profit & Loss A/c (profit transferred) (WN:1)	52,640		
To Work-in-progress c/d (provision)	46,060		
	3,00,000		3,00,000
01.01.2018			
To Work-in-progress b/d: Value of certified work 3,00,000			
Less : Provision 46,060	2,53,940		

Working Notes:

1. Proportion of profit to be transferred to Profit & Loss A/c:

   Accounting profit : Rs. (3,00,000 – 2,01,300) = Rs. 98,700

   Profit on realized basis : 80% of Rs. 98,700 = 78,960

   Proportion to be transferred to P/L A/c : 2/3 of Rs. 78,960 = Rs. 52,640

Issustration No. 7 :

S Ltd. Furnished the following information in respect of incomplete contract as on 31.3.2016.

Particulars	Contract A (Rs.)	Contract B (Rs.)
Contract Price	2,40,000	1,50,000
Work certified	2,16,000	1,00,000

Estimated cost of completion of contract	2,10,000	1,20,000
Cash received	1,16,000	80,000
Uncertified Work	10,000	7,000
Cost of contract (expenditure incurred up to 31.3.16)	1,80,000	95,000

Calculate the profit to be carried to P/L A/c for the year ended 31.3.16

Solution :

P Ltd.

Contract No. 127 Account for the year ending 31st March, 2015

Dr. Cr.

Particulars	A	B	Particulars	A	B
To cost of contract	1,80,000	95,000	By works certified	2,16,000	1,00,000
To Notional profit c/d	46,000	12,000	By works uncertified	10,000	7,000
	2,26,000	1,07,000		2,26,000	1,07,000
To P/L A/c (WN:1)	22,716	6,400	By Notional profit b/d	46,000	12,000
To Reserve	23,284	5,600			
	46,000	12,000		46,000	12,000

Working Notes :

1. Proportion of profit to be transferred to Profit & Loss A/c:

Accounting Profit x $\frac{(ca \quad received)}{(work\ certified)}$ x $\frac{2}{3}$

Contract A :

46,000 x $\frac{1,60,000}{2,16,000}$ x $\frac{2}{3}$ = Rs. 22,716

Contract B :

12,000 x $\frac{80,000}{1,00,000}$ x $\frac{2}{3}$ = Rs. 6,400

Illustration 8 :

The following was the expenditure on a contract for Rs. 6,00,000

Particulars	Amount
Material	1,20,000
Wages	1,64,000
Plant	20,000
Overheads	8,600

Cash received on account of the contract was Rs. 2,40,000 being 80% of the work certified. The Value of material in hand was Rs. 10,000. The plant has undergone 20% depreciation.

Solution :

Dr. **Contract Account** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Materials	1,20,000	By Material in hand	10,000
To Wages	1,64,000	By Plant on hand	16,000
To Plant	20,000	By Work-in-Progress	
To Overheads	8,600	Work Certified	3,00,000
To Notional Profit	13,400	(2,40,000x100/80)	
	3,26,000		**3,26,000**
To Profit and Loss A/c	7,147	By Notional Profit b/d	13,400
To Work-in-Progress	6,253		
	13,400		**13,400**

Illustration 9 :

The following is the condensed record of the transactions as on 31st December 2014 relating to special contract completed during the year.

Material bought from market Rs. 1,500

Materials issued from the stores	Rs. 500
Wages	Rs. 2,440
Direct expenses	Rs. 294
Work on cost 25% of direct wages	
Office on cost 10% of prime cost	
Contract price	Rs. 6,000

You are required to prepare a contract account keeping in view that the material returned amounted to Rs. 240.

Solution :

Dr. **Contract Account** **Cr.**

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Materials			By Material Returned	240
Purchased	1,500		By Contractee's Account	6,000
Issued from store	500	2,000		
To Wages		2,440		
To Direct Expenses		294		
To Work on Cost (2,440x25/100)		610		
To Office on Cost (10% of Rs. 4,494)		450		
To Profit and Loss A/c		446		
		6,240		**6,240**

Note:

1. Prime cost = (1,500 + 500 + 2,440 + 294) = -240 = Rs. 4,494
2. Since the contract has been completed in the first year itself hence, no reserve in required. The entire excess of credit in contract account called Notional Profit has been credited to the Profit & Loss A/c.

➢ **Check Your Progress:**

A. Multiple Choice Questions:

1. Contract Costing is used in

   a. Paint Industry b. Chemical Industry

   c. Road Construction d. Refinery.

2. In contract costing; costs are accumulated___

   a. Yearwise b. Quarterwise

   c. Halfyearly d. Contractwise.

3. Contract Costing while assessing the profit on incomplete uses the concept of

   a. Total Profit b. Super Profit

   c. Notional Profit d. Allocated Profit.

4. Contract Costing has its root in

   a. Job Costing b. Process Costing

   c. Unit Costing d. Target Costing.

5. Contracts with escalation clause become a necessity in

   a. Normal times b. Political uncertainty

   c. Routine Activities d. Construction Industry.

B. State Whether True or False:

1. All contracts are signed with an escalation clause.
2. Usually, all contracts conclude within one year.
3. Retention Money is an essential feature of a Contract.
4. When work on a contract has not substantially advanced, no amount of unrealized profit is credited to the Profit & Loss Account.
5. Notional Profit is the difference between the sum total of Work Completed & Certified +Work Completed but uncertified; and the Cost of Contract.

C. Fill in the Blanks:

1. Ship Builders use the concept of ____costing in calculations of costs.
2. To protect the Contracter from unexpected increase in costs, contracts have an ____clause.
3. Return of material is shown on the _____side of the Contract Account.
4. Valuation of WIP becomes a necessity in case of ______Contracts.
5. An architect's certificate is available in respect of ______.

D. Match the following:

Column A	**Column B**
1. Contract Costing.	a. Control of Costs.
2. Target Costing.	b. To guarantee quality of work.
3. Work In Process	c. Balance Sheet.
4. Retention Money.	d. Payment towards contract.
5. Contractee.	e. Construction of Houses.

3.3 Summary:

From the overall discussion it is understood that a Job refers to any specific assignment, contract or work order wherein work is executed as per customer's specific requirements. The output of the job generally consists of one unit or a manageable number of units. Ascertainment of cost of each Job is called Job Costing.Job Costing is an attempt to calculate the cost of nonstandard, non-routine jobs. Furthermore, Contract Costing approaches the problems faced by contractors in the execution of contracts which spill over more than on accounting period.Contract costing, also known as terminal costing, is a variant of job costing. Contract means a big job in which work is done at site and not in factory premises. The cost of each contract is ascertained. Thus, in this method of costing, each contract is a cost unit and an account is opened for each contract in the books of contractor to ascertain profit/loss thereon.

3.4 Terms to Remember:

- **Job Costing:** Specific order costing involving accumulation of costs relating to a single cost unit-the 'job' - when each order is of comparatively short duration. It is also called job order costing.
- **Job Cost Sheet:** A statement showing cost and profit relating to a specific job a batch or a contract.
- **Contract Costing:** That form of specific order costing which applies where work isundertaken as per customer's special requirement.
- **Notional Profit**: it is an apparent profit.
- **Escalation:** increase/rise in an activity
- **Target Costing:** a bench mark for completion of a contract.
- **Retention Money:** amount kept towards assurance of quality of work executed.
- **Cost plus Contracts:** a condition which guarantees a contractor a fare consideration.

3.5 Answers to Check Your Progress:

Session A:

A. Ans: d, b, b, a, c

B. Ans: 1. False, 2. True, 3. True, 4. False, 5. False

C. Ans: 1. Jobs, 2. Job, 3. Job, 4. Estimation, 4. Jobs

D. Ans: 1-D, 2-A, 3-E, 4-B, 5-C.

Session B:

A. Ans: c, d, c, a, b

B. Ans.1. False, 2. False, 3. True, 4. True, 5. True

C. Ans. 1. Contract, 2. Escalation, 3. Credit, 4. Incomplete, 5. Work Completed

D. Ans.1-5, 2-1, 3-3, 4-2, 5-4

3.6 Exercise:

1. Define Job Costing and describe its essential features.
2. What is job costing? Explain the objectives of job costing.
3. What is job costing? Enumerate the objectives, features, advantages and disadvantages of job order costing system.
4. What is contract costing? Explain briefly the distinguishing features of contract costing.
5. Explain the term work certified.
6. Write short notes on:

   (a) Cost plus contract

   (b) Work certified

   (c) Work uncertified
7. Contracts have their basis in Job Costing. Explain this sentence and give the essential features of Contract Costing.
8. A work order for 100 units of a commodity has to pass through four different machines of which the machine hour rates are: Machine P – Rs. 1.25, Machine Q – Rs. 2.50, Machine R – Rs. 3 and Machine S – Rs. 2.25 Following expenses have been incurred on the work order – Materials ` 8,000 and Wages ` 500. Machine - P has been engaged for 200 hours. Machine - Q for 160 hours, Machine - R for 240 hours and Machine - S for 132 hours. After the work order has been completed, materials worth ` 400 are found to be surplus and are returned to stores. Office overhead used to be 40% of works costs, but on account of all-round rise in the cost of administration, distribution and sale, there has been a 50% rise in the office overhead expenditure. Moreover, it is known that 10% of production will have to be scrapped as not being upto the specification and the sale proceeds of the scrapped output will be only 5% of the cost of sale. If the manufacturer wants to make a profit of 20% on the total cost of the work order, find out the selling price of a unit of commodity ready for sale.

9. The data pertaining to Heavy Engineering Ltd. using are as follows at the end of 31.3.2017. Direct material Rs. 9,00,000; Direct wages Rs. 7,50,000; Selling and distribution overhead Rs.5,25,000; Administrative overhead Rs. 4,20,000, Factory overhead Rs.4,50,000 and Profit Rs. 6,09,000. (a) Prepare a cost sheet showing all the details. (b) For 2012-13, the factory has received a work order. It is estimated that the direct materials would be Rs. 12,00,000 and direct labour cost Rs. 7,50,000. What would be the price of work order if the factory intends to earn the same rate of profit on sales, assuming that the selling and distribution overhead has gone up by 15%? The factory recovers factory overhead as a percentage of direct wages and administrative and selling and distribution overheads as a percentage of works cost, based on the cost rates prevalent in the previous year.

10. A firm of Builders, carrying out large contracts kept in contract ledger, separate accounts for each contract on 30th June, 2017, the following were shown as being the expenditure in connection with Contract No. 555.

    Materials purchased Rs.1,16,126 Materials issued from stores Rs.19,570 Plant, which has been used on other contracts Rs. 25,046 Additional plant Rs. 7,220 Wages Rs.1,47,268 Direct expenses Rs.4,052 Proportionate establishment expenses 17,440

    The contract which had commenced on 1st February, 2017 was for Rs.6,00,000 and the amount certified by the Architect, after deduction of 20% retention money, was Rs. 2,41,600 the work being certified on 30th June, 2017. The materials on site were Rs.19,716. A contract plant ledger was also kept in which depreciation was dealt with monthly the amount debited in respect of that account is Rs. 2260. Prepare Contract Account showing profit on the contract.

11. A contractor commenced the work on a particular contract on 1st April, 2016 he usually closes his books of accounts for the year on 31st December of each year. The following information is revealed from his costing records on 31st December, 2016.

    Materials sent to site Rs. 43,000 Jr. Engineer Rs. 12,620 Labour Rs. 1,00,220 A machine costing Rs. 30,000 remained in use on site for 1/5th of year. Its working life was estimated at 5 years and scrap value at Rs. 2,000 A supervisor is paid Rs. 2,000 per month and had devoted one half of his time on the contract. All other expenses were Rs.14,000 the materials on site were Rs. 2,500. The contract price was Rs. 4,00,000. On 31st December, 2016 2/3rd of the contract was completed however, the architect gave certificate only for Rs. 2,00,000. On which 80% was paid. Prepare Contract Account.

12. XY Ltd undertook a contract, the following was the expenditure on a contract for Rs. 3,00,000

Material issued to contract	Rs. 51,000
Plant issued for contract	Rs. 15,000
Wages	Rs. 81,000
Other expenses	Rs. 5,000

Cash received on account of contract up to 31st March, 2014 amounted to Rs. 1,28,000 being 80% of work certified. Of the plant and material charged to the contract plant costing Rs. 1,500 and material costing Rs. 2,000 were lost. On 1st March 2014, plant which cost Rs. 1,000 was returned to the store, the cost of work done but not certified was Rs. 1,500 and material costing Rs. 1,250 were in hand on site. Provide 10% depreciation on plant, reserve 1/3 of profit received and prepare contract account from the above particulars.

13. Mr. A has undertaken several contract works. He maintains a separate record for each contract. From the records for the year ending 31-12-14, prepare contract account for Contract No. 50 and find the amount transferred to profit and loss account.

	Rs.
Direct purchase of material	90,000
Material issued from stores	25,000
Wages	1,22,000
Direct expenses	12,000
Machinery purchased	80,000
Establishment charges	27,000

The contract price was Rs. 7,50,000. Cash received up to 31-12-2008 was Rs. 3,00,000 which is 80% of work certified. Material at site Rs. 8,000. Depreciation for Machine Rs. 8,000.

3.7 References for Further Study:

1. Khan and Jain (2007). Cost Accounting, New Delhi: India, Tata McGraw hill. 2nd edition, ISBN: 0-07-0440224-8, pp -1.1-1.8
2. S.P. Jain and K.L. Narang (2012). Cost and Management Accounting; Kalyani Publishers, 23, Daryaganj, New Delhi-110 002.
3. Bhar B. K. (2008). Cost Accounting: Methods and Problems. Kolkata: Academic Publishers.
4. S. N. Maheshwari and CA Sharad K. Maheshwari (). Accounting for Management. 3rd revised and enlarged edition, Sultan Chand & Sons.
5. M. N. Arora (2013). Cost Accounting: Principles and Practice. Noida: 12th edition, Vikas Publishing House, pp1.1-13.30.

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Unit-4

Accounts of Non-Government Organizations

Index

4.0 Objectives:

After studying this unit, students will be able ---

1. To understand the concept of Government Grants
2. To learn theory and practical aspect of Non-Government Accounting
3. To gain the knowledge about the Non-Government Organization
4. To Prepare the final accounts of Non-Government Organization

4.1 Introduction:

4.1.1 Introduction to accounting for Government Grants

Accounting for government grants involves recognizing, measuring, and reporting the financial assistance provided by governments or other public bodies. These grants are collected for supporting specific activities or purposes such as research, development, or infrastructure projects. The key challenge in accounting for government grants lies in determining when and how to recognize these funds in the financial statements.

4.2 Presentation of Subject Matter

4.2.1 Introduction to NGOs

Non-Governmental Organizations (NGOs) are non-profit, voluntary entities that work independently of government control to address societal issues, provide services, and promote causes. They play a crucial role in complementing government efforts, advocating for policy changes, and providing essential services and support in various sectors such as health, education, environment, and human rights.

4.2.2 Definition of NGO

Definition:

A **Non-Governmental Organization (NGO)** is defined as an organization that:

Is Non-Profit: Operates without the intention of making a profit. Any surplus revenue is reinvested in the organization's activities and goals rather than being distributed to shareholders or owners.

Is Independent of Government Control: Although NGOs may receive government funding, they operate independently of government influence and do not function as a part of government agencies.

Works for Social, Environmental, or Humanitarian Goals: Engages in activities aimed at improving society, addressing social issues, and promoting causes such as health, education, poverty alleviation, environmental protection, and human rights.

Operates Voluntarily: Typically involves voluntary participation from individuals who contribute their time, skills, and resources to support the organization's mission.

Is Registered and Recognized: May be formally registered under specific laws or regulations depending on the country, such as the Societies Registration Act, Trusts Act, or Companies Act in India.

4.2.3 Characteristics of NGOs

Mission-Driven: Focused on achieving specific objectives that align with their mission statement, which often involves addressing societal needs or advocating for social change.

Organizational Structure: Can be structured as trusts, societies, or non-profit companies, depending on the legal framework in their respective countries.

Funding: Primarily funded through donations, grants, and fundraising activities. Some NGOs also generate income through social enterprises or investments.

Accountability: Required to maintain transparency and accountability in their operations and financial management. They often report their activities and finances to stakeholders, donors, and regulatory bodies.

Diverse Areas of Work: Engage in a wide range of activities, including but not limited to humanitarian aid, environmental conservation, education, healthcare, economic development, and advocacy.

4.3 Record for Government Grants in Accounting

4.3.1. Government Grants-

4.3.1.1 Meaning -Government Grants

Government grants are financial aids given by government entities to support activities that are deemed beneficial for the public. These grants can be provided for various purposes, including research, infrastructure, community projects, or operational support.

4.3.2.2 Types of Government Grants

1. **Operating Grants**: Provide funds for the general operating expenses of an organization.
2. **Capital Grants**: Fund specific projects or purchases, such as equipment or infrastructure.
3. **Project Grants**: Designated for specific projects with defined goals and time-frames.

4.3.2.3 Accounting Principles for Government Grants

1. **Recognition**: Government grants should be recognized in financial statements when there is reasonable assurance that the grant conditions will be met and the grant will be received.
2. **Measurement**: Grants are typically measured at fair value or the amount of cash expected to be received.
3. **Presentation**: Grants are usually presented as income or revenue in financial statements. The presentation may vary based on the nature of the grant and the entity's accounting policies.

4.3.2.4 Accounting Standards

- **International Financial Reporting Standards (IFRS)**: Under IFRS, particularly IAS 20, government grants are recognized as income over the periods necessary to match them with the related costs that they are intended to compensate.

- **Generally Accepted Accounting Principles (GAAP)**: In the U.S., the accounting for government grants is governed by ASC 958-605, which outlines the recognition and presentation of contributions and grants.

4.3.2.5 Reporting Requirements

- **Financial Statements**: Grants should be reported in the financial statements, including the balance sheet and income statement. The nature and extent of the grants should be disclosed in the notes to the financial statements.

Compliance: Organizations must comply with specific conditions attached to the grants, and detailed reporting may be required to demonstrate that these conditions are being met.

4.3.2.6 Common Challenges

- **Compliance**: Ensuring that the conditions of the grant are met can be complex and requires diligent tracking and reporting.
- **Recognition Timing**: Determining the correct timing for recognizing grant income can be challenging, particularly if there are multiple conditions attached.
- **Documentation**: Maintaining proper documentation to support the receipt and use of grant funds is crucial for audit purposes.

4.3.2.7 Best Practices

- **Record Keeping**: Maintain detailed records of all grant-related transactions and communications.
- **Regular Reviews**: Periodically review grant agreements and conditions to ensure compliance and accurate reporting.
- **Training**: Provide training for staff on grant management and accounting practices to ensure accurate and efficient handling.

Understanding and adhering to the accounting principles and reporting requirements for government grants helps ensure transparency, compliance, and effective use of the funds received.

4.3.3 Record for government grants in accounting

The following are the steps to be followed for record the government grants. By following these steps, you can effectively manage and account for government grants, ensuring compliance and proper financial oversight.

4.3.3.1 Steps to be followed for record the government grants

Maintaining the accounting of government grants requires careful attention to ensure compliance with regulations and proper financial management. Here's a step-by-step guide to help you manage these grants effectively:

1. Understand the Grant Requirements

- **Review Grant Agreement:** Thoroughly read the grant agreement to understand the terms, conditions, and reporting requirements.
- **Compliance Requirements:** Familiarize yourself with relevant regulations, such as the Uniform Guidance in the U.S., or specific local regulations applicable to the grant.

2. Set Up a Separate Account

- **Create a Dedicated Fund:** Set up a separate fund or account in your accounting system specifically for the grant. This helps in tracking and reporting the grant funds separately from other funds.

3. Record Grant Receipts

- **Initial Receipt:** Record the grant funds as they are received. This entry typically includes debiting the cash account and crediting a grant revenue account.
- **Grant Advances:** If the grant is awarded in advance, record it as a liability (deferred revenue) until the funds are expended.

4. Track Expenditures

- **Allocate Costs:** Ensure that expenditures related to the grant are charged directly to the grant fund or account.
- **Documentation:** Maintain detailed records and documentation for all expenses. This includes invoices, receipts, and proof of payment.

- **Cost Allocation:** If the grant involves multiple projects or activities, allocate costs appropriately and ensure they align with the grant's requirements.

5. **Maintain Accurate Records**
   - **Categorize Expenses:** Categorize expenses according to the grant's budget categories. This helps in ensuring that spending aligns with the approved budget.
   - **Regular Reconciliation:** Regularly reconcile the grant account to ensure that all transactions are recorded accurately and that there are no discrepancies.

6. **Prepare Financial Reports**
   - **Regular Reporting:** Prepare financial reports as required by the grant agreement. This may include progress reports, financial statements, and performance reports.
   - **Compliance:** Ensure that reports are compliant with the reporting guidelines specified in the grant agreement or by the granting agency.

7. **Audit and Review**
   - **Internal Audits:** Conduct internal audits periodically to review the grant's financial management and compliance.
   - **External Audits:** Prepare for external audits by ensuring that all records are accurate and complete. Granting agencies may require an annual audit or a specific audit related to the grant.

8. **Close Out the Grant**
   - **Final Report:** Prepare and submit a final report to the granting agency upon completion of the grant period. This report should include a summary of expenditures and outcomes.
   - **Account Reconciliation:** Reconcile the grant account to ensure that all funds have been expended as per the grant agreement.

9. **Compliance with Regulations**
   - **Stay Updated:** Stay updated with changes in regulations and accounting standards related to government grants.
   - **Training:** Provide training for staff involved in managing and accounting for government grants

4.4 Types of NGOs

1. **Operational NGOs:** Focus on implementing projects and providing services directly to communities. Examples include organizations working on disaster relief or education.
2. **Advocacy NGOs:** Aim to influence public policy, raise awareness, and advocate for changes in laws and practices. Examples include organizations working on human rights or environmental protection.
3. **Development NGOs:** Concentrate on long-term development goals, such as economic growth, poverty reduction, and sustainable development. Examples include organizations working on rural development and microfinance.
4. **Charitable NGOs:** Provide direct assistance to individuals or communities in need, such as food distribution, medical aid, or housing.

4.5 Role of NGOs

1. **Service Delivery:** Provide essential services and support in areas where government or private sector efforts may be insufficient or absent.
2. **Advocacy and Policy Influence:** Advocate for policy changes and raise awareness on critical issues to drive social change and influence public policy.
3. **Capacity Building:** Empower communities by building local capacity, providing education and training, and promoting self-reliance.
4. **Research and Innovation:** Conduct research to identify needs, develop solutions, and innovate new approaches to address societal challenges.

Non-Governmental Organizations (NGOs) in India are governed by various acts and regulations depending on their specific structure and activities. Here are the primary acts under which NGOs can be registered and operate:

1. **Societies Registration Act, 1860**
   - **Applicability:** This act is applicable for NGOs that are registered as societies.
   - **Purpose:** It allows for the formation of societies for charitable purposes, such as promoting education, health, and welfare.
   - **Features:**
     - A society must have a minimum of seven members.
     - Registration is done with the Registrar of Societies in the respective state.
     - Societies are required to maintain records, including minutes of meetings and annual accounts.
2. **Trusts Act, 1882**
   - **Applicability:** This act is relevant for NGOs registered as trusts.
   - **Purpose:** It governs the establishment and administration of private trusts created for charitable purposes.
   - **Features:**
     - Trusts can be created by a settlor who transfers property to the trust for charitable purposes.
     - Trusts must have a trust deed that outlines the objectives and administration of the trust.
     - Registration is done with the local sub-registrar.
3. **Companies Act, 2013**
   - **Applicability:** This act applies to NGOs registered as Section 8 companies (formerly Section 25 companies) under the Companies Act, 1956.
   - **Purpose:** It regulates the formation and management of non-profit companies, including those formed for charitable or social objectives.
   - **Features:**

- Section 8 companies are established for promoting commerce, art, science, religion, charity, or any other useful object.
- They cannot distribute profits to members.
- Registration is done with the Registrar of Companies (RoC).

4. Foreign Contribution (Regulation) Act, 2010 (FCRA)

- **Applicability:** This act governs the receipt of foreign contributions by NGOs.
- **Purpose:** It regulates the acceptance and use of foreign donations to ensure they are used for the purposes for which they were intended.
- **Features:**
  - NGOs receiving foreign donations must register under FCRA.
  - They must comply with reporting requirements and use the funds only for charitable activities.

5. Income Tax Act, 1961

- **Applicability:** This act is relevant for tax exemptions and benefits for NGOs.
- **Purpose:** It provides tax benefits to NGOs, such as exemptions on income under sections like 12A/12AA and 80G.
- **Features:**
  - NGOs can apply for tax exemptions and must comply with annual filing requirements.
  - Donations made to NGOs may be eligible for tax deductions for donors.

6. Charitable Endowments Act, 1890

- **Applicability:** This act is relevant for endowments and trusts with a focus on charitable purposes.
- **Purpose:** It regulates the management and administration of charitable endowments.

- **Features:**
    - It provides provisions for the administration and management of charitable endowments.

4.6 Methods of Accounting for Government Grants

Accounting for government grants can be approached using different methods, depending on the nature of the grant and the applicable accounting standards. The two primary methods are the **Income Approach** and the **Deferred Grant Approach**. Here's an overview of these methods and their variations:

1. Income Approach

The Income Approach, also known as the **Income Recognition Approach**, involves recognizing grant income in the financial statements as the grant conditions are met or as the related expenses are incurred.

a. **Recognition Over Time**:

- Grants are recognized as income in the same periods as the related costs are incurred. This approach aligns grant income with the expenses it is intended to cover, reflecting the matching principle.

b. **Application under IFRS**:

- Under IAS 20 (International Accounting Standard 20), government grants are recognized as income on a systematic basis over the periods necessary to match them with the related costs. For instance, if a grant is provided to cover specific research costs, the income is recognized as those costs are incurred.

c. **Application under US GAAP**:

- Under ASC 958-605 (Not-for-Profit Entities – Revenue Recognition), grants are recognized as revenue when the related expenses are incurred, or when the conditions specified in the grant agreement are met.

2. Deferred Grant Approach

The Deferred Grant Approach, also known as the **Deferred Income Approach**, involves initially recording the grant as a liability (deferred income) and then recognizing it as income over time as the grant conditions are met.

a. Initial Recognition:

- Upon receiving the grant, the amount is recorded as deferred income (a liability) rather than immediately recognizing it as income.

b. **Income Recognition**:

- The deferred income is then recognized as revenue on a systematic basis over the periods in which the related costs are incurred or as the grant conditions are satisfied.

c. **Application under IFRS**:

- IAS 20 allows for the deferred grant approach, particularly for grants related to assets. For example, if a grant is provided for the purchase of equipment, the grant amount may be recognized as income over the useful life of the equipment.

d. Application under US GAAP:

- Similar principles apply under ASC 958-605. For capital grants, the deferred approach may be used, and the grant income is recognized over the useful life of the asset purchased.

3. Specific Approaches for Different Types of Grants

a. **Operating Grants**:

- Generally, operating grants are recognized as income when the related expenses are incurred or over the period the expenses are incurred.

b. **Capital Grants**:

- For capital grants, the deferred grant approach is often used. The grant is recognized as income over the useful life of the asset it is intended to support.

c. **Project Grants**:

- Project grants are recognized based on the project's progress or the completion of specific milestones. Income is recognized as the project progresses or when specific conditions are met.

4. **Variations and Considerations**

a. **Conditional vs. Unconditional Grants**:

- **Conditional Grants**: Grants with specific conditions (e.g., performance milestones) are often recognized as income only when the conditions are met.
- **Unconditional Grants**: Grants with no specific conditions are usually recognized as income immediately upon receipt or over time.

b. **Restricted vs. Unrestricted Funds**:

- **Restricted Funds**: Grants with restrictions on their use are tracked separately and recognized in accordance with the restrictions.
- **Unrestricted Funds**: Grants with no restrictions are recognized as income when received or as expenses are incurred.

5. **Reporting and Disclosure**

Regardless of the method used, it's essential to provide clear disclosures in the financial statements regarding:

- The nature and extent of government grants received.
- The accounting policy used for recognizing grant income.
- Any conditions or restrictions attached to the grants.
- The impact of the grants on financial performance and position.

By choosing the appropriate accounting method and adhering to relevant standards, organizations can ensure accurate and transparent reporting of government grants.

4.7. Types of Government Grants

Government grants come in various types, each serving different purposes and subject to specific conditions. Here's an overview of the main types of government grants:

1. **Operating Grants**

The purpose of the operating grants is to support the ongoing operational expenses of an organization.

Characteristics:

- **Unrestricted**: Often provided without specific conditions on how the funds are to be used, although they must generally be used to support the organization's activities.
- **Usage**: Helps cover general costs such as salaries, utilities, and administrative expenses.

2. **Capital Grants**

The opurpose of the capital grants is to fund long-term investments in assets like property, equipment, or infrastructure.

Characteristics:

- **Restricted Use**: Typically earmarked for the purchase or improvement of fixed assets.
- **Depreciation**: The value of capital grants is usually recognized as income over the useful life of the asset.

3. **Project Grants**

The purpose of the project grants is to support specific projects or initiatives with defined goals and timeframes.

Characteristics:

- **Conditional**: Often come with detailed terms and conditions regarding project outcomes, milestones, and deadlines.
- **Reporting**: Requires detailed reporting on project progress and expenditures.

4. **Research Grants**

The purpose of research grants is to support scientific or academic research and development projects.

Characteristics:

- **Conditional**: Generally require the achievement of specific research goals and often include detailed reporting requirements.
- **Competitive**: Often awarded through a competitive application process, with rigorous peer review.

5. Conditional Grants

The purpose of conditional grants is to provide funding based on the fulfillment of specific conditions or performance criteria.

Characteristics:

- **Milestone-Based**: Funds are disbursed upon meeting predetermined milestones or achieving specific outcomes.
- **Accountability**: Requires ongoing monitoring and reporting to ensure conditions are met.

6. Unconditional Grants

The purpose of unconditional grants is to provide funding without specific conditions on its use.

Characteristics:

- **Flexible**: Funds can be used for a wide range of purposes as long as they align with the general objectives of the grantor.
- **Immediate Use**: Often available for immediate use upon receipt.

7. Matching Grants

The purpose of matching grants is to encourage organizations to raise funds from other sources by providing additional funding that matches the amount raised.

Characteristics:

- **Matching Requirement**: The grantor matches funds raised by the recipient, often up to a certain limit.
- **Incentive**: Encourages fundraising efforts and can leverage additional resources.

8. Block Grants

The purpose of block grants is to provide funding for broad programs or activities with flexibility in use.

Characteristics:

- **Broad Use**: Funds can be used for a range of activities within a specific program area, such as community development or health services.

- **Flexible Reporting**: Generally involves less detailed reporting compared to project-specific grants.

9. Formula Grants

The purpose of formula grants is to distribute funding based on a predetermined formula, often related to specific criteria or metrics.

Characteristics:

- **Automatic Distribution**: Funds are allocated according to a formula based on factors such as population size, income levels, or other relevant metrics.
- **Consistent Allocation**: Provides a predictable source of funding based on established criteria.

10. Entitlement Grants

The purpose of entitlment grants is to provide funding to individuals or organizations based on eligibility criteria.

Characteristics:

- **Eligibility-Based**: Recipients must meet specific eligibility requirements to receive the grant.
- **Automatic Payment**: Payments are often automatic once eligibility is confirmed.

11. Performance-Based Grants

The purpose of percormance based grants is to give reward or incentivize organizations based on performance outcomes.

Characteristics:

- **Outcome-Based**: Funding is contingent upon achieving specific performance targets or outcomes.
- **Evaluation**: Requires regular assessment and reporting to measure performance against agreed-upon goals.

12. Emergency Grants

The purpose of emergency grants is to provide immediate funding in response to urgent situations, such as natural disasters or crises.

Characteristics:

- **Urgent Need**: Designed to address immediate needs or unforeseen circumstances.
- **Short-Term**: Often intended for short-term relief and recovery efforts.

Understanding these types of government grants helps organizations identify the most appropriate funding opportunities and effectively manage and utilize the grants they receive.

4.8 Sources of NGO Funding

NGOs are not entirely dependent on government grants, although they often receive funding from various government sources. Here's a detailed look at how NGOs are funded and the extent of their dependency on government grants:

Sources of NGO Funding

Government Grants:

1. **Nature:** Government grants are funds provided by governmental bodies for specific projects or general operational support. These grants are often competitive and come with specific requirements and reporting obligations.
2. **Dependency:** While government grants can be a significant source of funding, they are not the sole source. NGOs typically seek to diversify their funding base to reduce dependency on any single source.

Private Donations:

1. **Individual Donors:** Many NGOs receive financial support from individual contributors who make one-time or recurring donations.
2. **Major Donors:** Some NGOs attract large donations from philanthropists or wealthy individuals who support their missions.

Corporate Sponsorship and Donations

1. **Corporate Social Responsibility (CSR):** Companies often provide funding as part of their CSR initiatives. This can include direct donations, sponsorships of events, or in-kind contributions.

2. **Partnerships:** Corporations may partner with NGOs for specific projects or programs.

Foundations and Trusts:

1. **Private Foundations:** Many NGOs receive grants from private foundations that support charitable activities aligned with their goals.
2. **Family Trusts:** Some NGOs benefit from donations or endowments from family trusts that support various causes.

International Organizations:

1. **Multilateral Agencies:** NGOs may receive funding from international bodies such as the United Nations, World Bank, or regional development banks.
2. **Global Charitable Foundations:** Organizations like the Bill & Melinda Gates Foundation provide grants for global health, education, and development projects.

Fundraising Events:

1. **Events:** NGOs often organize fundraising events such as charity auctions, galas, and walks to raise money and engage the community.
2. **Campaigns:** Crowd funding and special fundraising campaigns can also generate significant support.

Membership Fees:

1. **Associations:** Some NGOs operate on a membership model, where individuals or organizations pay membership fees that contribute to their funding.

Earned Income:

1. **Social Enterprises:** Some NGOs operate businesses or social enterprises that generate income to support their activities. This can include selling products, providing services, or other revenue-generating activities.

4.9 Accounting For Government Grants

Accounting for government grants involves recording various transactions in the journal to reflect the receipt, use, and reporting of grant funds accurately. Here are the typical journal entries associated with government grants:

4.9.1Journal Entries

1. Recording the Receipt of a Government Grant

When a government grant is received, you need to record the inflow of funds. The specific entry will depend on whether the grant is conditional or unconditional, and if it's for operating or capital purposes.

a. Unconditional Grant Received

For Operating Grants:

Cash/Bank A/C------------------------ Dr.XXX

To Grant Income A/C XXX

- **Dr. Cash/Bank**: Increases assets, reflecting the receipt of funds.
- **Cr. Grant Income**: Recognizes the income as it is not tied to specific conditions.

For Capital Grants:

Cash/Bank A/C----------------Dr.XXX

To Deferred Income A/C(Capital Grant) XXX

- **Dr. Cash/Bank**: Increases assets.
- **Cr. Deferred Income**: Records the grant as a liability, to be recognized over the useful life of the asset.

b. Conditional Grant Received

If conditions are not yet me

Cash/Bank A/C ---------------------Dr. XXX

To Deferred Income (Conditional Grant) A/C XXX

- **Dr. Cash/Bank**: Reflects receipt of funds.
- **Cr. Deferred Income**: Liabilities until conditions are met.

2. Recording Expenditures Related to Government Grants

For Operating Expenses

Expense Account A/C -------------------------Dr.XXX

Cash/Bank A/C XXX

- **Dr. Expense Account**: Records the expense incurred.
- **Cr. Cash/Bank**: Decreases cash as funds are spent.

For Capital Expenditure

Fixed Assets A/C ----------------------------Dr.XXX

Cr. Cash/Bank A/C XXX

- **Dr. Fixed Assets**: Increases assets as capital expenditures are made.
- **Cr. Cash/Bank**: Reflects the payment for the asset.

3. Recognizing Grant Income Over Time

For capital grants, income is recognized over the asset's useful life. If using the deferred income approach, you need to amortize the grant income periodically.

Deferred Income (Capital Grant) A/C--------------Dr.XXX

Cr. Grant Income A/C XXX

- **Dr. Deferred Income**: Reduces the liability.
- **Cr. Grant Income**: Recognizes income over time as the asset is used.

4. Recording Performance-Based or Milestone-Based Payments

When specific milestones or performance criteria are achieved, and payments are made or recognized, record the revenue or income accordingly.

Deferred Income (Conditional Grant) A/C-----------------------Dr. XXX

To Grant Income A/C XXX

- **Dr. Deferred Income**: Reduces the liability as milestones are met.
- **Cr. Grant Income**: Recognizes income as conditions are fulfilled.

5. Adjusting Entries for Grant Expenses and Income

At the end of an accounting period, you may need to make adjustments to align expenses and income with the reporting period.

a. Accruing Expenses Related to Grants

Expense Account A/C-----------------------Dr. XXX

To Accrued Liabilities A/C XXX

- **Dr. Expense Account**: Accrues expenses related to the grant.
- **Cr. Accrued Liabilities**: Records the amount payable.

b. Adjusting Grant Income

Grant Income A/C -------------------------Dr. XXX

To Deferred Income (Capital Grant) A/C XXX

- **Dr. Grant Income**: Adjusts recognized income.
- **Cr. Deferred Income**: Ensures proper income recognition.

6. Closing Entries for Government Grants

At the end of the accounting period, ensure that grant-related accounts are properly closed to reflect accurate balances in financial statements.

a. Closing Grant Income Accounts

Grant Income A/C --------------------Dr. XXX

To Income Summary XXX

- **Dr. Grant Income**: Closes grant income account.
- **Cr. Income Summary**: Transfers income to the summary account.

Example

Assume a non-profit organization receives a 100,000 capital grant to purchase equipment. The equipment is bought for 80,000, and the grant conditions are met over time.

1. Receipt of Capital Grant

Cash/Bank A/C -------------------Dr.100,000

To Deferred Income (Capital Grant) 100,000

2. Purchase of Equipment:

Equipment A/C --------------------------------Dr.80,000

To Cash/Bank 80,000

3. **Recognize Grant Income Over Time:** Assume you recognize grant income of 10,000 per year over 10 years.

Deferred Income (Capital Grant) A/C-----------------------Dr.10,000

Cr. Grant Income 10,000

Final Accounts of Government Organization

Problem No. 1: Recording Grant Revenue

The NGO "Clean Water Initiative" received a government grant of Rs. 50,000 for a water purification project. The grant was deposited into the NGO's bank account on January 23.

Cash A/C-----------------Dr. 50,000

To Grant Revenue A/C 50,000

The Cash account is debited because the NGO received cash. The Grant Revenue account is credited to recognize the income from the government grant.

Problem No.2: Allocating Grant Funds for Expenses

The "Clean Water Initiative" used Rs.20,000 of the government grant to purchase water filtration equipment and Rs.5,000 for staff salaries related to the project.

Equipment Expense A/C -----------------Dr.20,000

To Cash A/C 20,000

The Equipment Expense account is debited because the NGO incurred an expense. The Cash account is credited as funds were used to pay for the equipment.

Salary Expense A/C----------------Dr. 5,000

To Cash A/C 5,000

The Salary Expense account is debited to recognize the salary expense. The Cash account is credited as the salaries were paid from the grant funds.

Problem No. 3: Reporting Grant Funds Received but Not Yet Spent

The "Clean Water Initiative" received an additional government grant of Rs.30,000 on December 1 but has not yet spent any of these funds.

Cash A/C---------------- Dr. 30,000

To Unspent Grant FundsA/C 30,000

The Cash account is debited for the amount received. The Unspent Grant Funds account (a liability account) is credited to show that the funds have been received but not yet expended.

Problem No.4: Adjusting for Grant Funds Used in the Next Fiscal Year

The "Clean Water Initiative" spends Rs.10,000 of the previously received grant funds on project-related expenses.

Project ExpenseA/C------------------Dr. 10,000

To Cash A/C 10,000

The Project Expense account is debited to record the expense. The Cash account is credited as the funds are used to pay for the project expenses.

Adjust Unspent Grant Funds:

Unspent Grant Funds A/C-----------------------Dr. 10,000

To Grant Revenue A/C 10,000

The Unspent Grant Funds account is debited to reduce the liability, and the Grant Revenue account is credited to reflect the reduction in unspent grant funds.

Journal Entries of Government Grants

Accounting for government grants involves recording various transactions in the journal to reflect the receipt, use, and reporting of grant funds accurately. Here are the typical journal entries associated with government grants:

1. Recording the Receipt of a Government Grant

When a government grant is received, you need to record the inflow of funds. The specific entry will depend on whether the grant is conditional or unconditional, and if it's for operating or capital purposes.

a. Unconditional Grant Received

Cash A/C---------		
To Grant Income A/C		
(Being govt. Grant received)		
Cash A/C ---Dr.		
To Deferred Income (Capital Grant)		
(Being capital grant received)		
Cash A/C -----------------Dr.		
To Deferred Income (Conditional Grant)		
(Being conditional grant received)		
Expenses Account --------------------------------Dr.		
To Cash/Bankd A/C		
(Being operating expenses paid)		
Fixed Asset a/c------Dr.		
To Cash/Bank		
(Being capital expenditure incurred		
Deferred Income A/C---------------Dr.		
To Grant income A/C		
(Being income is recognised over the assets useful life)		
Expenses A/C ------Dr.		
To Accrued Liabilities		
(Being expenses accruing related to grants)		
Grant Income A/C -----Dr.		
To Deferred Income A/C		
(Being adjusting the grant income)		

Example

Assume a non-profit organization receives a Rs.100,000 capital grant to purchase equipment. The equipment is bought for Rs.80,000, and the grant conditions are met over time.

1. **Receipt of Capital Grant**

   Cash/Bank A/C--------------------- Dr.100,000

   To Deferred Income (Capital Grant) 100,000

2. **Purchase of Equipment:**

   Equipment A/C-------------------------Dr.80,000

   To Cash/Bank 80,000

3. **Recognize Grant Income Over Time:** Assume you recognize grant income of Rs.10,000 per year over 10 years.

   Deferred Income (Capital Grant) A/C-------------------Dr. 10,000

   Grant Income A/C 10,000

Problem No.5 : The NGO "Clean Water Initiative" received a government grant of Rs.50,000 for a water purification project. The grant was deposited into the NGO's bank account on January 15 ,2024.

Cash A/C--------------Dr.50000

To Grant Revenue A/C 50000

(The Cash account is debited because the NGO received cash. The Grant Revenue account is credited to recognize the income from the government grant.)

Problem No.-6 : The "Clean Water Initiative" used Rs.20,000 of the government grant to purchase water filtration equipment and Rs.5,000 for staff salaries related to the project.

Equipment Expenses A/C----------------Dr. 20000

To Cash A/C 20000

(The Equipment Expense account is debited because the NGO incurred an expense. The Cash account is credited as funds were used to pay for the equipment.)

Problem No.7: Salary expenses Rs. 5000 paid.

Salary expenses A/C -------------Dr. 5000

To Cash A/C 5000

(The Salary Expense account is debited to recognize the salary expense. The Cash account is credited as the salaries were paid from the grant funds.)

Problem No. 8 : At the end of the financial year, the "Clean Water Initiative" received an additional government grant of Rs.30,000 on December 1 but has not yet spent any of these funds.

Cash A/C-----------Dr.30,000

To Unspent Grant Funds A/C 30000

Problem No.9 : In the following fiscal year, the "Clean Water Initiative" spends Rs.10,000 of the previously received grant funds on project-related expenses.

Project Expenses A/C ------------Dr.10000

To Cash A/C 10000

(The Project Expense account is debited to record the expense. The Cash account is credited as the funds are used to pay for the project expenses.)

Problem No.10:

Unspent Grant Funds A/C----------------Dr.. 10000

To Grant Revenue 10000

(The Unspent Grant Funds account is debited to reduce the liability, and the Grant Revenue account is credited to reflect the reduction in unspent grant funds.)

Corpus Funds (Endowment Funds)

In NGO accounting, the term "Scorpus Funds" or "Endowment Funds," which are more common in NGO and non-profit financial reporting.

Corpus Funds (Endowment Funds)

Definition: Corpus funds, also known as endowment funds, refer to the principal amount of a donation that an organization receives, which is intended to be held in perpetuity or for a long term. The principal amount is typically invested, and the income generated from these investments can be used to support the NGO's ongoing activities and operations. The corpus fund is recorded in the balance-sheet under heading non current assets

Example: An NGO receives a donation of Rs. 500,000 designated as corpus funds. These funds are invested in a portfolio generating Rs.25,000 in income for the year.

Journal Entries:

Particulars	Debit (Rs)	Credit (Rs.)
Bank A/C --Dr.	500000	
To Corpus Fund A/C		500000
(Being corpus fund received)		
Bank A/c--------------------Dr	15000	
To Investment Income A/C		15000
(Being Investment Income Received)		
Program Expenses ---------------------------------Dr.	15000	
To Bank A/C		15000
(Being expenses incurred from investment income)		

4.8 FINAL ACCOUNTS OF NON-GOVERNMENT ORGANISATION.

4.8.1 Balance Sheet of NGO

Following is the vertical form of balance sheet of the NGO **Assets**

Assts	Rs.	Rs.
Current Assets		
Cash and Bank Balances		
Receivables(Grants ,Donations)		
Inventory		
Pre paid Expenses		
Non Current Assets		
Fixed Assets(Land , Building , Equipement)		
Investments		

Intangible Assets(Patent , Software)		
Total Assets		
Liabilities		
Current Liabilities		
Payable(Vendor payments, Accrued Expenses)		
Short Term Loans		
Other Current Liabilities		
Non Current Liabilities		
Long Term Loans		
Deferred Liabilities		
Total Liabilities		
Net Assets		
1. Unrestricted Net Assets		
2. Temporally Restricted Net Assets		
3. Permanently Restricted Net Assets		
Total Net Assets		
Total Liabilities and Net Assets		

NGO Income and Expenditure Account

Particulars	Rs.	Rs.
Income		
Grants and Donations		
Government Grants		
Private Donations		
Corporate Sponsorships		
Other Income		
Fundraising Events		
Membership Fees		
Investment Income		
Total Income		

Expenditure		
Program expanses		
Direct Program Costs		
Salaries and Wages		
Travel and Supplies		
Administrative Expenses		
Office Rent and Utilities		
Administrative Salaries		
Office Supplies		
Fundraising Edpenses		
Costs of Fundraising Events		
Marketing and Promotion		
Other Expenses		
Depreciation		
Miscellaneous Expenses		
Total Expenses		
Excess of Income Over Expenditure(Surplus) or Deficit		

Adjustment Entries of NGO Accounting

Adjustment entries in non-governmental organization (NGO) accounting are essential for ensuring that financial statements accurately reflect the organization's financial position and performance. These entries are made at the end of an accounting period to account for accrued and deferred items, among other adjustments. Here’s an overview of common adjustment entries with examples:

Common Types of Adjustment Entries

Accrued Revenues: Recognize income earned but not yet received.

Accrued Expenses: Recognize expenses incurred but not yet paid.

Deferred Revenues: Record income received in advance but not yet earned.

Deferred Expenses: Record expenses paid in advance but not yet incurred.

Prepaid Expenses: Adjust for expenses paid in advance.

Depreciation: Allocate the cost of fixed assets over their useful life.

Examples of Adjustment Entries

1. Accrued Revenues

The NGO "Green Earth" provided consulting services worth Rs.2,000 in December 2023 but will only receive payment in January 2024.

Accounts Receivable A/C -------------Dr.2,000

To Consulting Revenue A/C 2,000

*The Accounts Receivable account is debited to recognize the amount owed by the client, and Consulting Revenue is credited to recognize the earned income.

2. Accrued Expenses

The NGO incurred Rs. 1,500 in utilities expense for December 2023, but the bill will be paid in January 2024

Utilities ExpenseA/C -----------------------------Dr.1,500

To Accrued Expenses A/C 1,500

* Utilities Expense is debited to reflect the incurred expense, while Accrued Expenses (a liability) is credited to recognize the amount owed.

3. Deferred Revenues

The NGO received a Rs.10,000 grant in December 2023 for a project that will start in January 2024.

Cash A/C -----------------------------Dr.10,000

To Deferred Grant Revenue A/C 10,000

* Cash is debited to recognize the receipt of funds. Deferred Grant Revenue (a liability) is credited to show that the income has not yet been earned.

4. Deferred Expenses

The NGO paid Rs.6,000 for an insurance policy on December 1, 2023, covering six months. By December 31, one month of coverage has been used.

Insurance Expense A/C -----------------------Dr.1,000

To Prepaid Insurance A/C 1,000

* Insurance Expense is debited for the portion of the insurance used in December, and Prepaid Insurance is credited to reduce the asset account by the amount used.

5. Prepaid Expenses

The NGO prepaid Rs.3,000 for office supplies in November 2023. By December 31, 1,200 worth of supplies have been used.

Supplies ExpenseA/C ---------------------Dr.1,200

To Prepaid Supplies A/C 1,200

* Supplies Expense is debited to recognize the expense incurred, while Prepaid Supplies (an asset) is credited to adjust the asset balance for supplies used.

6. Depreciation

The NGO purchased office equipment for Rs.5,000 with a useful life of 5 years. The straight-line depreciation method is used.

Depreciation Expense ------------------ Dr.1,000

To Accumulated Depreciation $1,000

* Depreciation Expense is debited to reflect the allocation of the equipment's cost, and Accumulated Depreciation (a contra-asset account) is credited to reduce the book value of the equipment.

Accounting of NGO

Accounting for non-governmental organizations (NGOs) involves unique considerations compared to for-profit entities. NGOs must account for donations, grants, and other sources of revenue while adhering to specific regulatory requirements and ensuring transparency in their financial reporting. Here's an overview of key aspects of NGO accounting:

1. Financial Statements

a. Balance Sheet

- **Assets:** Resources owned by the NGO, including cash, receivables, equipment, and investments.
- **Liabilities:** Obligations owed by the NGO, such as accounts payable and loans.

- **Net Assets:** The difference between assets and liabilities, showing the NGO's financial position. It typically includes unrestricted, temporarily restricted, and permanently restricted net assets.

b. Statement of Activities (Income and Expenditure Statement)

- **Revenues:** Includes donations, grants, fundraising income, and other sources.
- **Expenses:** Covers program expenses, administrative costs, and fundraising costs.
- **Change in Net Assets:** The difference between revenues and expenses, showing the surplus or deficit for the period.

c. Statement of Cash Flows

- **Operating Activities:** Cash received from and used in core operations.
- **Investing Activities:** Cash used for or received from investments and asset purchases.
- **Financing Activities:** Cash received from or paid for loans and capital contributions.

d. Statement of Functional Expenses (often included in the notes or as a separate statement)

- **Program Services:** Direct costs related to the NGO's mission.
- **Management and General:** Overhead costs associated with running the organization.
- **Fundraising:** Costs incurred to raise funds.

2. Revenue Recognition

NGOs recognize revenue from various sources:

- **Donations:** Recognized when received or promised (if unconditional).
- **Grants:** Recognized based on the terms of the grant agreement, either when received or as the associated expenses are incurred.
- **Fundraising Events:** Revenue from events is recognized when the event occurs, with associated expenses reported separately.

3. **Classification of Net Assets**

- **Unrestricted Net Assets:** Funds that are not restricted by donors and can be used for any purpose.
- **Temporarily Restricted Net Assets:** Funds restricted by donors for specific purposes or time periods.
- **Permanently Restricted Net Assets:** Funds that must be maintained permanently, with only the income used for operational purposes (e.g., endowment funds).

4. **Expense Allocation**

NGOs must allocate expenses between program services, management and general, and fundraising. This allocation ensures that financial reports accurately reflect the costs associated with fulfilling the organization's mission.

Expense Allocation Example:

If an NGO incurs \$100,000 in total expenses, with \$70,000 directly supporting programs, \$20,000 for administrative costs, and \$10,000 for fundraising, the allocation might look like this:

- **Program Services:** \$70,000
- **Management and General:** \$20,000
- **Fundraising:** \$10,000

5. **Accounting for Grants and Donations**

a. **Government Grants:**

- **Recognized:** Based on the grant agreement, either as funds are received or as expenses are incurred.
- **Deferred Recognition:** If funds are received in advance of meeting grant requirements, they are initially recorded as deferred revenue.

b. **Donations:**

- **Unconditional Donations:** Recognized when received.
- **Conditional Donations:** Recognized when conditions are met.

6. **Accounting for Fixed Assets**

- **Acquisition:** Fixed assets are recorded at their cost.
- **Depreciation:** Allocated over the useful life of the asset, typically using straight-line or another systematic method.
- **Disposal:** When assets are sold or otherwise disposed of, any gain or loss is recorded.

7. **Internal Controls**

NGOs must establish internal controls to safeguard assets, ensure accuracy in financial reporting, and comply with regulations. Key controls include:

- **Segregation of Duties:** Ensuring that no one person has control over all aspects of a financial transaction.
- **Regular Reconciliation:** Regularly reconciling bank statements and other financial records.
- **Approval Processes:** Implementing procedures for approving expenditures and transactions.

Problem No.11: Income and Expenditure Account

Scenario: The NGO "Education for All" has the following financial data for the year ended March 31, 2023:

- **Receipts:** Donations: 40,000,Grants: 20,000,Fundraising Income: 10,000
- **Expenditure:** Program Expenses: 50,000,Administrative Expenses: 10,000, Fundraising Expenses: 5,000

Task: Prepare the Income and Expenditure Account for the year ended March 31, 2023.

Solution:

Income and Expenditure Account for the Year Ended March 31, 2023

Particulars	**Rs**
Income	
Donations	40,000

Grants	20,000
Fundraising Income	10,000
Total Income	70,000
Expenditure	
Program Expenses	50,000
Administrative Expenses	10,000
Fundraising Expenses	5,000
Total Expenditure	65,000
Excess of Income Over Expenditure (Surplus)	5,000

Problem **No.** 12: Balance Sheet

Following is the financial information for "Education for All" as of March 31, 2023:

- **Assets:** Cash: Rs.10,000,Equipment: Rs.15,000,Less: Accumulate Depreciation: Rs.3,000
- **Liabilities:** Accounts Payable: Rs.2,000,Accrued Expenses: 1,000
- **Net Assets:** Unrestricted Net Assets at Beginning of Year: Rs.8,000 (before adjustments) Prepare the Balance Sheet as of March 31, 2023.

Balance Sheet as of March 31, 2023

Assets	Rs.
Current Assets	
Cash	10,000
Non-Current Assets	
Equipment	15,000
Less: Accumulated Depreciation	(3,000)
Total Non-Current Assets	12,000
Total Assets	22,000
Liabilities	

Accounts Payable	2,000
Accrued Expenses	1,000
Total Liabilities	3,000
Net Assets	
Unrestricted Net Assets (Beginning)	8,000
Add: Surplus from Income and Expenditure	5,000
Total Net Assets	13,000
Total Liabilities and Net Assets	22,000

Problem No. 13: "Education for All" paid Rs.1,200 in advance for an insurance policy on March 1, 2023, covering six months. By December 31, 2023, one month of coverage has been used. Record the adjustment entry for the insurance expense as of March 31, 2023.

Insurance Expense -----------------------------------Dr. Rs.200

To Prepaid Insurance Rs.200

The Insurance Expense account is debited for the cost of one month's coverage (1,200 / 6 months = 200 per month), while Prepaid Insurance is credited to adjust the asset account for the expense incurred.

Problem No.14: Accrued Expense

Scenario: The NGO incurred Rs. 500 in utility expenses in December 2023, but the bill will be paid in January 2024.Record the accrued expense as of December 31, 2023

Utilities Expense A/C---------------------Dr.500

To Accrued Expenses 500

* The Utilities Expense account is debited to recognize the expense incurred, and the Accrued Expenses account is credited to show the amount owed but not yet paid

Income and Expenditure Account

Problem No.15: NGO "Health for All" received Rs.60,000 in donations and spent Rs. 45,000 on program expenses, Rs. 8,000 on administrative expenses, and Rs.3,000 on fundraising expenses. Prepare income and Expenditure A/c

Solution: Income and Expenditure Account for the Year Ended March 31, 2023

Particulars	**Rs.**
Income	
Donations	60,000
Total Income	60,000
Expenditure	
Program Expenses	45,000
Administrative Expenses	8,000
Fundraising Expenses	3,000
Total Expenditure	56,000
Excess of Income Over Expenditure	4,000

Problem No.16: NGO "Clean Water Initiative" had Rs.30,000 in grants, Rs.5,000 in donations, and incurred Rs.20,000 in program costs, Rs.6,000 in admin costs, and Rs.4,000 in fundraising costs.

Solution: Income and Expenditure Account for the Year Ended March 31, 2023

Particulars	**Rs.**
Income	
Grants	30,000
Donations	5,000
Total Income	35,000
Expenditure	
Program Expenses	20,000
Administrative Expenses	6,000
Fundraising Expenses	4,000
Total Expenditure	30,000
Excess of Income Over Expenditure	5,000

Problem No.17: "Education First" received Rs.15,000 in grants and Rs.10,000 from a fundraising event. The organization spent Rs.12,000 on educational programs and Rs.5,000 on administrative costs. Prepare income and expenditure A/C .

Income and Expenditure Account for the Year Ended March 31, 2023

Particulars	Rs.
Income	
Grants	15,000
Fundraising Income	10,000
Total Income	25,000
Expenditure	
Program Expenses	12,000
Administrative Expenses	5,000
Total Expenditure	17,000
Excess of Income Over Expenditure	8,000

Problem No.18: NGO "Youth Empowerment" had total income of Rs.40,000 (including Rs.25,000 in donations and Rs.15,000 in grants). Expenses included Rs.30,000 for programs, Rs.6,000 for admin, and Rs.2,000 for fundraising. Prepare Income and Expinditure a/c

Income and Expenditure Account for the Year Ended March 31, 2023

Particulars	Rs.
Income	
Donations	25,000
Grants	15,000
Total Income	40,000
Expenditure	
Program Expenses	30,000
Administrative Expenses	6,000
Fundraising Expenses	2,000
Total Expenditure	38,000
Excess of Income Over Expenditure	2,000

Problem No.19: "Health for All" has cash of Rs.12,000, equipment worth Rs.20,000 with accumulated depreciation of Rs.4,000, accounts payable of Rs.3,000, and a grant receivable of Rs.2,000. prepare balance-sheet

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	12,000
Grant Receivable	2,000
Total Current Assets	14,000
Non-Current Assets	
Equipment	20,000
Less: Accumulated Depreciation	(4,000)
Total Non-Current Assets	16,000
Total Assets	30,000
Liabilities	
Accounts Payable	3,000
Total Liabilities	3,000
Net Assets	
Unrestricted Net Assets	27,000
Total Liabilities and Net Assets	30,000

Problem No.20: NGO "Environment Care" has 8,000 in cash, 15,000 in fixed assets (net of 2,000 accumulated depreciation), and 5,000 in accounts payable. Net assets at the beginning were 10,000.

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	8,000
Non-Current Assets	
Fixed Assets (Net)	13,000

Total Assets	21,000
Liabilities	
Accounts Payable	5,000
Total Liabilities	5,000
Net Assets	
Beginning Net Assets	10,000
Add: Excess of Income Over Expenditure	6,000
Total Net Assets	16,000
Total Liabilities and Net Assets	21,000

Problem No.21: "Community Support" has Rs.25,000 in cash, Rs.10,000 in receivables, Rs.8,000 in equipment, and Rs.4,000 in accrued expenses. Accumulated depreciation on equipment is Rs.1,000.

Balance Sheet as of March 31, 2023

Assets	**Rs**
Current Assets	
Cash	25,000
Receivables	10,000
Total Current Assets	35,000
Non-Current Assets	
Equipment	8,000
Less: Accumulated Depreciation	(1,000)
Total Non-Current Assets	7,000
Total Assets	42,000
Liabilities	
Accrued Expenses	4,000
Total Liabilities	4,000
Net Assets	
Unrestricted Net Assets	38,000

Problem No.22: "Education for All" prepaid Rs.2,400 for rent on March 1, 2023, covering four months. By March 31, one month of rent has been used.

Rent Expense A/C----------Dr.600

To Prepaid Rent 600

Explanation: Rent Expense is debited to recognize one month of rent used (2,400 / 4 months = Rs.600), and Prepaid Rent is credited to adjust the asset account.

Problem No.23: "Health for All" received Rs.1,000 in advance for a workshop scheduled to be held next year.

Cash A/C-------------------Dr.----------------1,000

To Deferred Revenue 1,000

Problem No.24: "Clean Water Initiative" incurred 750 in office supplies in December 2023 but has not yet received the invoice.

Office Supplies Expense A/C-------------------------Dr.750

To Accrued Expenses 750

Problem No.25: NGO "Safe Homes" has the following balances as on March 31, 2023:Cash: 5,000

Accounts Receivable: Rs.3,000, Furniture (Cost Rs.6,000, Accumulated Depreciation Rs.1,000),Accounts Payable: Rs.2,000,Unrestricted Net Assets: 4,000 (beginning balance)

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	5,000
Accounts Receivable	3,000
Total Current Assets	8,000
Non-Current Assets	
Furniture	6,000
Less: Accumulated Depreciation	(1,000)

Total Non-Current Assets	5,000
Total Assets	13,000
Liabilities	
Accounts Payable	2,000
Total Liabilities	2,000
Net Assets	
Unrestricted Net Assets	4,000
Add: Surplus from Income and Expenditure	7,000
Total Net Assets	11,000
Total Liabilities and Net Assets	13,000

Problem No. 26: "Animal Welfare" has Cash: 7,500, Fixed Assets (Cost 12,000, Accumulated Depreciation 3,000), Accounts Payable: 1,500, Net Assets (Beginning Balance): 10,000, Surplus for the Year: 2,000

Balance Sheet as of March, 2023

Assets	**Rs.**
Current Assets	
Cash	7,500
Non-Current Assets	
Fixed Assets	12,000
Less: Accumulated Depreciation	(3,000)
Total Non-Current Assets	9,000
Total Assets	16,500
Liabilities	
Accounts Payable	1,500
Total Liabilities	1,500
Net Assets	
Beginning Net Assets	10,000

Add: Surplus for the Year	2,000
Total Net Assets	12,000
Total Liabilities and Net Assets	16,500

Problem No. 27: NGO "Youth Outreach" has Cash: 6,000, Equipment (Cost 8,000, Accumulated Depreciation 2,000), Accrued Expenses: Rs.1,200,Fund Balance (Beginning): 5,000, Excess of Income Over Expenditure: 3,800

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	6,000
Non-Current Assets	
Equipment	8,000
Less: Accumulated Depreciation	(2,000)
Total Non-Current Assets	6,000
Total Assets	12,000
Liabilities	
Accrued Expenses	1,200
Total Liabilities	1,200
Net Assets	
Beginning Fund Balance	5,000
Add: Excess of Income Over Expenditure	3,800
Total Net Assets	8,800
Total Liabilities and Net Assets	12,000

Problem No.28: "Community Health" has Cash: 9,000, Receivable: 4,000, Office Furniture (Cost 5,000, Accumulated Depreciation 1,000), Accounts Payable: 2,500, Net Assets (Beginning): 6,000, Surplus for the Year: 3,500

Balance Sheet as of March 31, 2023

Assets	Rs.
Current Assets	
Cash	9,000
Grants Receivable	4,000
Total Current Assets	13,000
Non-Current Assets	
Office Furniture	5,000
Less: Accumulated Depreciation	(1,000)
Total Non-Current Assets	4,000
Total Assets	17,000
Liabilities	
Accounts Payable	2,500
Total Liabilities	2,500
Net Assets	
Beginning Net Assets	6,000
Add: Surplus for the Year	3,500
Total Net Assets	9,500
Total Liabilities and Net Assets	17,000

Problems Based on Adjustment Entries

Problem No.29: "Youth Outreach" paid 1,200 for a one-year insurance policy on November 1, 2023. By March31, 2023, two months of coverage have been used.

Insurance Expense --------------------Dr. 200

To Prepaid Insurance 200

Problem No.30: "Safe Homes" incurred Rs.500 in utility expenses in March 2023, but the invoice will be paid in January 2024.

Utilities Expense ------------------------------Dr. 500

To Accrued Expenses 500

Problem No.32 : "Animal Welfare" received Rs.2,500 in advance for a fundraising event to be held next year.

Cash ---------------------- Dr.2,500

To Deferred Revenue 2,500

Problem No.33 : "Clean Water Initiative" prepaid Rs.1,800 for an annual subscription on March 1, 2023. By March 31, one month of the subscription has been used.

Subscription Expense -------------------------Dr. 150

To Prepaid Subscription 150

Problem No.34: "Health for All" has 600 in accrued salaries that will be paid in January 2024.

Salaries Expense A/C --- 600

To Accrued Salaries 600

Problem No.35: "Community Health" has received a Rs. 4,000 grant in December 2023 for a project starting in January 2024.

Cash A/C ---------------------------------Dr.4,000

To Deferred Grant Revenue 4 ,000

Problem No.36: Income and Expenditure Account

"Books for All" has the following for the year ended March 31, 2023:

Income: Donations: Rs. 25,000,Grants: Rs. 15,000,Fundraising Events: Rs.8,000

Expenditure: Program Expenses: Rs.30,000, Administrative Expenses: Rs.5,000, Fundraising Expenses: Rs.3,000

Solution:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Donations	25,000
Grants	15,000

Fundraising Events	8,000
Total Income	48,000
Expenditure	
Program Expenses	30,000
Administrative Expenses	5,000
Fundraising Expenses	3,000
Total Expenditure	38,000
Excess of Income Over Expenditure	10,000

Problem No. 37: "Books for All" has the following balances as of March 31, 2023

Assets: Cash Rs. 7,000, Accounts Receivable Rs.2,500,

Books (Cost Rs.12,000, Accumulated Depreciation Rs.2,000

Liabilities: Accounts Payable: Rs.1,200

Net Assets: Unrestricted Net Assets (Beginning): Rs.8,000

Balance Sheet as of March 31, 2023

Assets	Rs.
Current Assets	
Cash	7,000
Accounts Receivable	2,500
Total Current Assets	9,500
Non-Current Assets	
Books	12,000
Less: Accumulated Depreciation	(2,000)
Total Non-Current Assets	10,000
Total Assets	19,500
Liabilities	
Accounts Payable	1,200
Total Liabilities	1,200

Net Assets	
Unrestricted Net Assets (Beginning)	8,000
Add: Surplus from Income and Expenditure	10,000
Total Net Assets	18,000
Total Liabilities and Net Assets	19,500

Problem No.38: Adjustment for Prepaid Rent

"Books for All" paid 1,200 for rent on Feb 1, 2023, for six months. By March 31, 2023, two months of the rent have been used.

Rent Expense A/C ---------------------------- Dr. Rs.400

To Prepaid Rent Rs.400

Problem No.39: Adjustment for Accrued Salaries

"Health for All" incurred Rs.2,000 in salaries for March 2023, which will be paid in April 2024

Salaries Expense ---------------------- Dr.2,000

To Accrued Salaries 2,000

Problem No.40: Income and Expenditure Account with Depreciation

Education First" received Rs. 50,000 in donations and spent Rs.40,000 on programs. Depreciation on equipment is Rs.2,000.

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Donations	50,000
Total Income	50,000
Expenditure	
Program Expenses	40,000
Depreciation	2,000
Total Expenditure	42,000
Excess of Income Over Expenditure	8,000

Problem No.41: Balance Sheet with Accrued Interest

Scenario: "Education First" has: Cash: Rs.5,000,Equipment (Cost 20,000, Accumulated Depreciation Rs.5,000), Accrued Interest: Rs.300, Accounts Payable: Rs,1,500, Net Assets (Beginning): Rs.6,000

Solution:

Balance Sheet as of December 31, 2023

Assets	**Rs.**
Current Assets	
Cash	5,000
Non-Current Assets	
Equipment	20,000
Less: Accumulated Depreciation	(5,000)
Total Non-Current Assets	15,000
Total Assets	20,300
Liabilities	
Accounts Payable	1,500
Accrued Interest	300
Total Liabilities	1,800
Net Assets	
Beginning Net Assets	6,000
Add: Surplus from Income and Expenditure	12,500
Total Net Assets	18,500
Total Liabilities and Net Assets	20,300

Problem No.42: Adjustment for Deferred Revenue

Scenario: "Community Health" received Rs. 1,800 for a program starting next year, but it was recorded as income.

Deferred Revenue Rs.1,800

To Program Income Rs.1,800

Problem No.43: Income and Expenditure Account with Investment Income

"Environment Care" received Rs.3,000 in donations, Rs.2,000 in grants, and Rs.500 in investment income. Expenses include Rs.4,000 for programs and Rs.1,000 for administration.

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Donations	3,000
Grants	2,000
Investment Income	500
Total Income	5,500
Expenditure	
Program Expenses	4,000
Administrative Expenses	1,000
Total Expenditure	5,000
Excess of Income Over Expenditure	500

Problem No.44: Balance Sheet with Prepaid Expenses

"Safe Homes" has: Cash: Rs.10,000, Prepaid Insurance: Rs.1,200 (for one year), Equipment (Cost Rs.8,000, Accumulated Depreciation Rs.2,000), Accounts Payable: Rs.1,000, Net Assets (Beginning): Rs.5,000

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	10,000
Prepaid Insurance	1,200
Total Current Assets	11,200
Non-Current Assets	
Equipment	8,000
Less: Accumulated Depreciation	(2,000)

Total Non-Current Assets	6,000
Total Assets	17,200
Liabilities	
Accounts Payable	1,000
Total Liabilities	1,000
Net Assets	
Beginning Net Assets	5,000
Add: Surplus from Income and Expenditure	11,200
Total Net Assets	16,200
Total Liabilities and Net Assets	17,200

Problem No.45: Adjustment for Depreciation

"Arts Foundation" purchased equipment costing Rs.4,000 on July 1, 2023. Depreciation is Rs.800 per year

Depreciation Expense -------------------- Dr. Rs.400

To Accumulated Depreciation Rs.400

Problem No. : "Global Aid Foundation" is an NGO that works on various humanitarian projects. As of March 2023, the following balances and transactions are to be considered for the preparation of the Balance Sheet:

Assets: Current Assets:

1. Cash: Rs.15,000
2. Accounts Receivable (including grants receivable): Rs. 8,000
3. Inventory (supplies and materials for projects): Rs. 4,500
4. Prepaid Expenses (insurance, rent, etc.): Rs. 1,200

Non-Current Assets:

1. Equipment (Cost Rs.20,000, Accumulated Depreciation Rs. 5,000)
2. Building (Cost Rs.50,000, Accumulated Depreciation Rs. 10,000)
3. Investments (long-term investments): Rs. 6,000

Liabilities:

Current Liabilities:

1. Accounts Payable: Rs.3,000
2. Accrued Expenses (e.g., salaries, utilities): Rs.2,500
3. Deferred Revenue (grants received in advance for future periods): Rs.4,000

Long-Term Liabilities: Long-Term Loan (due in 5 years): Rs.10,000

Net Assets: Unrestricted Net Assets:

1. Beginning Balance: Rs.12,000
2. Surplus for the Year: Rs.8,500

Temporarily Restricted Net Assets: Funds received for specific projects (not yet spent): Rs.7,000

Solution

To prepare the Balance Sheet for "Global Aid Foundation" as of March 31, 2023, follow these steps:

1. Calculate Total Assets:

Current Assets:

- Cash: Rs.15,000
- Accounts Receivable: Rs.8,000
- Inventory: Rs.4,500
- Prepaid Expenses: Rs.1,200

Total Current Assets = Cash + Accounts Receivable + Inventory + Prepaid Expenses = Rs.15,000 + Rs.8,000 + Rs.4,500 + Rs.1,200 = Rs.28,700

Non-Current Assets:

- Equipment (Net of Depreciation): Cost Rs.20,000 - Accumulated Depreciation Rs.5,000 = Rs.15,000
- Building (Net of Depreciation): Cost Rs.50,000 - Accumulated Depreciation Rs.10,000 = Rs.40,000

- Investments: Rs.6,000

Total Non-Current Assets = Equipment (Net) + Building (Net) + Investments = Rs.15,000 + Rs.40,000 + Rs.6,000 = Rs.61,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.28,700 + Rs.61,000 = Rs.89,700

2. Calculate Total Liabilities:

Current Liabilities:

- Accounts Payable: Rs.3,000
- Accrued Expenses: Rs.2,500
- Deferred Revenue: Rs.4,000

Total Current Liabilities = Accounts Payable + Accrued Expenses + Deferred Revenue = Rs. 3,000 + Rs.2,500 + Rs.4,000 = Rs.9,500

Long-Term Liabilities:

- Long-Term Loan: Rs.10,000

Total Long-Term Liabilities = Long-Term Loan = Rs.10,000

Total Liabilities = Total Current Liabilities + Total Long-Term Liabilities = Rs.9,500 + Rs.10,000 = Rs.19,500

3. Calculate Net Assets:

Unrestricted Net Assets:

- Beginning Balance: Rs.12,000
- Add: Surplus for the Year: Rs.8,500

Total Unrestricted Net Assets = Beginning Balance + Surplus for the Year = Rs.12,000 + Rs.8,500 = Rs.20,500

Temporarily Restricted Net Assets:

- Funds received for specific projects: Rs.7,000

Total Net Assets = Unrestricted Net Assets + Temporarily Restricted Net Assets = Rs.20,500 + Rs.7,000 = Rs.27,500

4. **Prepare the Balance Sheet:**

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	15,000
Accounts Receivable	8,000
Inventory	4,500
Prepaid Expenses	1,200
Total Current Assets	28,700
Non-Current Assets	
Equipment (Net)	15,000
Building (Net)	40,000
Investments	6,000
Total Non-Current Assets	61,000
Total Assets	89,700
Liabilities	
Current Liabilities	
Accounts Payable	3,000
Accrued Expenses	2,500
Deferred Revenue	4,000
Total Current Liabilities	9,500
Long-Term Liabilities	
Long-Term Loan	10,000
Total Long-Term Liabilities	10,000
Total Liabilities	19,500
Net Assets	
Unrestricted Net Assets	20,500

Temporarily Restricted Net Assets	7,000
Total Net Assets	27,500
Total Liabilities and Net Assets	89,700

Problem No.46: Balance Sheet with Capital Fund and Fixed Assets

"Green Planet NGO" as of March 31, 2023, has the following financial data:

Assets: Current Assets:

Cash: Rs.20,000

Accounts Receivable (including grants receivable): Rs.10,000

Inventory (supplies): Rs.5,000

Prepaid Expenses (rent and insurance): Rs.2,000

Non-Current Assets:

Equipment (Cost Rs.15,000, Accumulated Depreciation Rs.3,000)

Building (Cost Rs.40,000, Accumulated Depreciation Rs.8,000)

Liabilities: Current Liabilities:

Accounts Payable: Rs.2,500

Accrued Expenses (salaries, utilities): Rs.3,500

Long-Term Liabilities: Bank Loan (due in 4 years): Rs.12,000

Net Assets:

1. **Capital Fund (Beginning Balance):** Rs.15,000
2. **Surplus for the Year:** Rs.9,000

Solution

Calculate Total Assets:

Current Assets:

Cash: Rs.20,000

Accounts Receivable: Rs.10,000

Inventory: Rs.5,000

Prepaid Expenses: Rs.2,000

Total Current Assets = Rs20,000 + Rs.10,000 + Rs.5,000 + Rs.2,000 = Rs.37,000

Non-Current Assets:

Equipment (Net of Depreciation): Rs.15,000 - Rs.3,000 = Rs.12,000

Building (Net of Depreciation): Rs.40,000 - Rs.8,000 = Rs.32,000

Total Non-Current Assets = Rs.12,000 + Rs.32,000 = Rs.44,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.37,000 + Rs.44,000 = Rs.81,000

Calculate Total Liabilities:

Current Liabilities:

Accounts Payable: Rs.2,500

Accrued Expenses: Rs.3,500

Total Current Liabilities = Rs.2,500 + Rs.3,500 = Rs.6,000

Long-Term Liabilities:

Bank Loan: Rs.12,000

Total Liabilities = Rs.6,000 + Rs.12,000 = Rs.18,000

Calculate Net Assets:

Capital Fund and Surplus:

Beginning Capital Fund: Rs.15,000

Add: Surplus for the Year: Rs.9,000

Total Net Assets = Rs.15,000 + Rs.9,000 = Rs.24,000

Prepare the Balance Sheet:

Balance Sheet as of March 31, 2023

Assets	**RS.**
Current Assets	
Cash	20,000

Accounts Receivable	10,000
Inventory	5,000
Prepaid Expenses	2,000
Total Current Assets	37,000
Non-Current Assets	
Equipment (Net)	12,000
Building (Net)	32,000
Total Non-Current Assets	44,000
Total Assets	81,000
Liabilities	
Current Liabilities	
Accounts Payable	2,500
Accrued Expenses	3,500
Total Current Liabilities	6,000
Long-Term Liabilities	
Bank Loan	12,000
Total Long-Term Liabilities	12,000
Total Liabilities	18,000
Net Assets	
Capital Fund	15,000
Add: Surplus for the Year	9,000
Total Net Assets	24,000
Total Liabilities and Net Assets	81,000

Problem No.47: Balance Sheet with Endowment Fund and Grants Receivable

"Future Leaders NGO" as of December 31, 2023, has the following data:

Assets: Current Assets:

Cash: Rs.25,000

Accounts Receivable (Grants Receivable): Rs.12,000

Inventory (Educational Materials): Rs.3,500

Prepaid Expenses (Insurance): Rs.1,500

Non-Current Assets:

Vehicles (Cost Rs.10,000, Accumulated Depreciation Rs.2,000)

Office Building (Cost Rs.30,000, Accumulated Depreciation Rs.6,000)

Endowment Fund Investments: Rs.15,000

Liabilities: Current Liabilities:

Accounts Payable: Rs.4,000

Accrued Expenses (Utilities, Maintenance): Rs.2,000

Long-Term Liabilities: Mortgage Payable (due in 10 years): Rs.8,000

Net Assets:

1. **Unrestricted Net Assets:** Rs.18,000
2. **Temporarily Restricted Net Assets (for specific projects):** Rs.7,000

Exercise

Calculate Total Assets:

Current Assets:

- Cash: Rs.25,000
- Accounts Receivable: Rs.12,000
- Inventory: Rs.3,500
- Prepaid Expenses: Rs.1,500

Total Current Assets = Rs.25,000 + Rs.12,000 + Rs.3,500 + Rs.1,500 = Rs.42,000

Non-Current Assets:

- Vehicles (Net of Depreciation): Rs.10,000 - Rs.2,000 = Rs.8,000
- Office Building (Net of Depreciation): Rs.30,000 - Rs.6,000 = Rs.24,000
- Endowment Fund Investments: Rs.15,000

Total Non-Current Assets = Rs.8,000 + Rs.24,000 + Rs.15,000 = Rs.47,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.42,000 + Rs.47,000 = Rs.89,000

Calculate Total Liabilities:Current Liabilities:

- Accounts Payable: Rs.4,000
- Accrued Expenses: Rs.2,000

Total Current Liabilities = Rs.4,000 + Rs.2,000 = Rs.6,000

Long-Term Liabilities: Mortgage Payable: Rs.8,000

Total Liabilities = Rs.6,000 + Rs.8,000 = Rs.14,000

Calculate Net Assets:Net Assets:

- Unrestricted Net Assets: Rs.18,000
- Temporarily Restricted Net Assets: Rs.7,000

Total Net Assets = Rs.18,000 + Rs.7,000 = Rs.25,000

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	25,000
Accounts Receivable	12,000
Inventory	3,500
Prepaid Expenses	1,500
Total Current Assets	42,000
Non-Current Assets	
Vehicles (Net)	8,000
Office Building (Net)	24,000
Endowment Fund Investments	15,000
Total Non-Current Assets	47,000
Total Assets	89,000

Liabilities	
Current Liabilities	
Accounts Payable	4,000
Accrued Expenses	2,000
Total Current Liabilities	6,000
Long-Term Liabilities	
Mortgage Payable	8,000
Total Long-Term Liabilities	8,000
Total Liabilities	14,000
Net Assets	
Unrestricted Net Assets	18,000
Temporarily Restricted Net Assets	7,000
Total Net Assets	25,000
Total Liabilities and Net Assets	89,000

Problem No.48: Balance Sheet with Donations Received and Unspent Grants

"Education for All NGO" as of March 31, 2023, has the following data:

Assets: Current Assets:

- Cash: Rs.18,000
- Accounts Receivable (Pledges): Rs.6,000
- Unspent Grants (Restricted Funds): Rs.5,000
- Prepaid Expenses (Rent and Insurance): Rs.1,000

Non-Current Assets:

- Computers (Cost Rs.8,000, Accumulated Depreciation Rs.2,000)
- Furniture (Cost Rs.4,000, Accumulated Depreciation Rs.1,000)

Liabilities: Current Liabilities:

- Accounts Payable: Rs.3,500
- Accrued Expenses (Salaries, Utilities): Rs.2,000

Long-Term Liabilities: Loan for Office Renovation (due in 5 years): Rs.7,000

Net Assets:

1. **Unrestricted Net Assets:** Rs.12,000
2. **Temporarily Restricted Net Assets:** Rs.5,000

Calculate Total Assets: Current Assets:

- Cash: Rs.18,000
- Accounts Receivable: Rs.6,000
- Unspent Grants: Rs.5,000
- Prepaid Expenses: Rs.1,000

Total Current Assets = Rs.18,000 + Rs.6,000 + Rs.5,000 + Rs.1,000 = Rs.30,000

Non-Current Assets:

- Computers (Net of Depreciation): Rs.8,000 - Rs.2,000 = Rs.6,000
- Furniture (Net of Depreciation): Rs.4,000 - Rs.1,000 = Rs.3,000

Total Non-Current Assets = Rs.6,000 + Rs.3,000 = Rs.9,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.30,000 + Rs.9,000 = Rs.39,000

Calculate Total Liabilities: Current Liabilities:

- Accounts Payable: Rs.3,500
- Accrued Expenses: Rs.2,000

Total Current Liabilities = Rs.3,500 + Rs.2,000 = Rs.5,500

Long-Term Liabilities: Loan for Office Renovation: Rs.7,000

Total Liabilities = Rs.5,500 + Rs.7,000 = Rs.12,500

Calculate Net Assets: Net Assets:

- Unrestricted Net Assets: Rs.12,000
- Temporarily Restricted Net Assets: Rs.5,000

Total Net Assets = Rs.12,000 + Rs.5,000 = Rs.17,000

Prepare the Balance Sheet:

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	18,000
Accounts Receivable	6,000
Unspent Grants	5,000
Prepaid Expenses	1,000
Total Current Assets	30,000
Non-Current Assets	
Computers (Net)	6,000
Furniture (Net)	3,000
Total Non-Current Assets	9,000
Total Assets	39,000
Liabilities	
Current Liabilities	
Accounts Payable	3,500
Accrued Expenses	2,000
Total Current Liabilities	5,500
Long-Term Liabilities	
Loan for Office Renovation	7,000
Total Long-Term Liabilities	7,000
Total Liabilities	12,500
Net Assets	
Unrestricted Net Assets	12,000
Temporarily Restricted Net Assets	5,000
Total Net Assets	17,000
Total Liabilities and Net Assets	39,000

Problem No. 49: Balance Sheet with Endowment Fund and Temporary Investments

"Health and Wellness NGO" as of March 31, 2023, has the following balances:

Assets:Current Assets:

Cash: Rs.22,000

Accounts Receivable (Donations): Rs.7,000

Temporary Investments (Short-term): Rs.3,000

Prepaid Expenses (Annual Subscription): Rs.1,500

Non-Current Assets:

Medical Equipment (Cost Rs.25,000, Accumulated Depreciation Rs.6,000)

Building (Cost Rs.55,000, Accumulated Depreciation Rs.11,000)

Endowment Fund Investments: Rs.20,000

Liabilities: Current Liabilities:

Accounts Payable: Rs.2,800

Accrued Expenses (Utilities, Maintenance): Rs.1,700

Long-Term Liabilities: Bond Payable (due in 8 years): Rs.15,000

Net Assets:

1. **Unrestricted Net Assets:** Rs.16,000
2. **Temporarily Restricted Net Assets (for future projects):** Rs.10,000

Calculate Total Assets: Current Assets:

- Cash: Rs.22,000
- Accounts Receivable: Rs.7,000
- Temporary Investments: Rs.3,000
- Prepaid Expenses: Rs.1,500

Total Current Assets = Rs.22,000 + Rs.7,000 + Rs.3,000 + Rs.1,500 = Rs.33,500

Non-Current Assets:

- Medical Equipment (Net of Depreciation): Rs.25,000 - Rs.6,000 = Rs.19,000
- Building (Net of Depreciation): Rs.55,000 - Rs.11,000 = Rs.44,000
- Endowment Fund Investments: Rs.20,000

Total Non-Current Assets = Rs.19,000 + Rs.44,000 + Rs.20,000 = Rs.83,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.33,500 + Rs.83,000 = Rs.116,500

Calculate Total Liabilities: Current Liabilities:

- Accounts Payable: Rs.2,800
- Accrued Expenses: Rs.1,700

Total Current Liabilities = Rs.2,800 + Rs.1,700 = Rs.4,500

Long-Term Liabilities: Bond Payable: Rs.15,000

Total Liabilities = Rs.4,500 + Rs.15,000 = Rs.19,500

Calculate Net Assets: Net Assets:

- Unrestricted Net Assets: Rs.16,000
- Temporarily Restricted Net Assets: Rs.10,000

Total Net Assets = Rs.16,000 + Rs.10,000 = Rs.26,000

Prepare the Balance Sheet:

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	22,000
Accounts Receivable	7,000
Temporary Investments	3,000
Prepaid Expenses	1,500
Total Current Assets	33,500

Non-Current Assets	
Medical Equipment (Net)	19,000
Building (Net)	44,000
Endowment Fund Investments	20,000
Total Non-Current Assets	83,000
Total Assets	116,500
Liabilities	
Current Liabilities	
Accounts Payable	2,800
Accrued Expenses	1,700
Total Current Liabilities	4,500
Long-Term Liabilities	
Bond Payable	15,000
Total Long-Term Liabilities	15,000
Total Liabilities	19,500
Net Assets	
Unrestricted Net Assets	16,000
Temporarily Restricted Net Assets	10,000
Total Net Assets	26,000
Total Liabilities and Net Assets	116,500

Problem No.50: Balance Sheet with Restricted and Unrestricted Funds

"Children's Education NGO" as of March 31, 2023, has the following financial information:

Assets: Current Assets:

Cash: Rs.30,000

Accounts Receivable (Grants and Donations): Rs.15,000

Restricted Cash (for future programs): Rs.8,000

Prepaid Expenses (Program Materials): Rs.2,000

Non-Current Assets:

Land (Cost Rs.50,000)

Building (Cost Rs.60,000, Accumulated Depreciation Rs.12,000)

Furniture and Fixtures (Cost Rs.12,000, Accumulated Depreciation Rs.4,000)

Liabilities: Current Liabilities:

Accounts Payable: Rs.5,000

Accrued Expenses (Salaries, Utilities): Rs.3,000

Long-Term Liabilities:

Mortgage Payable (due in 6 years): Rs.20,000

Net Assets:

1. **Unrestricted Net Assets:** Rs.25,000
2. **Temporarily Restricted Net Assets (for specific educational programs):** Rs.8,000

Solution

Calculate Total Assets: Current Assets:

Cash: Rs.30,000

Accounts Receivable: Rs.15,000

Restricted Cash: Rs.8,000

Prepaid Expenses: Rs.2,000

Total Current Assets = Rs.30,000 + Rs.15,000 + Rs.8,000 + Rs.2,000 = Rs.55,000

Non-Current Assets:

- Land: Rs.50,000
- Building (Net of Depreciation): Rs.60,000 - Rs.12,000 = Rs.48,000
- Furniture and Fixtures (Net of Depreciation): Rs..12,000 - Rs.4,000 = Rs.8,000

Total Non-Current Assets = Rs.50,000 + Rs.48,000 + Rs.8,000 = Rs.106,000

Total Assets = Total Current Assets + Total Non-Current Assets = Rs.55,000 + Rs.106,000 = Rs.161,000

Calculate Total Liabilities: Current Liabilities:

- Accounts Payable: Rs.5,000
- Accrued Expenses: Rs.3,000

Total Current Liabilities = Rs.5,000 + Rs.3,000 = Rs.8,000

Long-Term Liabilities: Mortgage Payable: Rs.20,000

Total Liabilities = Rs.8,000 + Rs.20,000 = Rs.28,000

Calculate Net Assets: Net Assets:

- Unrestricted Net Assets: Rs.25,000
- Temporarily Restricted Net Assets: Rs.8,000

Total Net Assets = Rs.25,000 + Rs.8,000 = Rs.33,000

Prepare the Balance Sheet:

Balance Sheet as of March 31, 2023

Assets	**Rs.**
Current Assets	
Cash	30,000
Accounts Receivable	15,000
Restricted Cash	8,000
Prepaid Expenses	2,000
Total Current Assets	55,000
Non-Current Assets	
Land	50,000
Building (Net)	48,000
Furniture and Fixtures (Net)	8,000
Total Non-Current Assets	106,000
Total Assets	161,000

Liabilities	
Current Liabilities	
Accounts Payable	5,000
Accrued Expenses	3,000
Total Current Liabilities	8,000
Long-Term Liabilities	
Mortgage Payable	20,000
Total Long-Term Liabilities	20,000
Total Liabilities	28,000
Net Assets	
Unrestricted Net Assets	25,000
Temporarily Restricted Net Assets	8,000
Total Net Assets	33,000
Total Liabilities and Net Assets	161,000

Problem of Income and expenditure account

Problem No.51: Income and Expenditure Account with Grants and Donations

Scenario:

"Green Earth NGO" for the year ended December 31, 2023, has the following data:

Income:

- Grants Received: Rs.50,000
- Donations from Individuals: Rs.20,000
- Membership Fees: Rs.5,000
- Interest Income on Investments: Rs.2,000

Expenditure:

- Salaries and Wages: Rs.30,000
- Rent: Rs.8,000

- Utilities: Rs.2,500
- Program Expenses: Rs.15,000
- Depreciation of Equipment: Rs.1,500

Prepare the Income and Expenditure Account for the year ended March 31, 2023:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Grants Received	50,000
Donations from Individuals	20,000
Membership Fees	5,000
Interest Income on Investments	2,000
Total Income	77,000
Expenditure	
Salaries and Wages	30,000
Rent	8,000
Utilities	2,500
Program Expenses	15,000
Depreciation of Equipment	1,500
Total Expenditure	56,000
Surplus for the Year	21,000

Problem No.52: Income and Expenditure Account with Special Projects and Fundraising

"Health Care NGO" for the year ended March 31, 2023, has the following data:

Income:

- Donations for Special Projects: Rs.35,000
- Fundraising Events: Rs.10,000
- Grants from Government: Rs.25,000
- Income from Investments: Rs.1,500

Expenditure:

- Salaries and Benefits: Rs.28,000
- Special Project Expenses: Rs.20,000
- Office Supplies: Rs.3,000
- Depreciation on Building: Rs.2,000

Prepare the Income and Expenditure Account for the year ended March 31, 2023:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Donations for Special Projects	35,000
Fundraising Events	10,000
Grants from Government	25,000
Income from Investments	1,500
Total Income	71,500
Expenditure	
Salaries and Benefits	28,000
Special Project Expenses	20,000
Office Supplies	3,000
Depreciation on Building	2,000
Total Expenditure	53,000
Surplus for the Year	18,500

Problem No.53: Income and Expenditure Account with Membership Fees and Operational Cost

"Education for Youth NGO" for the year ended March 31, 2023, has the following data:

Income:

- Membership Fees: Rs.12,000
- Donations from Corporates: Rs.30,000
- Grants Received: Rs.40,000

- Investment Income: Rs.3,000

Expenditure:

- Salaries: Rs.25,000
- Educational Materials: Rs.10,000
- Office Rent: Rs.6,000
- Utilities: Rs.1,500
- Depreciation on Computers: Rs.2,000

Prepare the Income and Expenditure Account for the year ended March 31, 2023:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Membership Fees	12,000
Donations from Corporates	30,000
Grants Received	40,000
Investment Income	3,000
Total Income	85,000
Expenditure	
Salaries	25,000
Educational Materials	10,000
Office Rent	6,000
Utilities	1,500
Depreciation on Computers	2,000
Total Expenditure	44,500
Surplus for the Year	40,500

Problem No. 54: Income and Expenditure Account with Restricted and Unrestricted Funds

"Arts and Culture NGO" for the year ended March 31, 2023, has the following data:

Income:

- Unrestricted Donations: Rs.25,000
- Restricted Donations (for specific projects): Rs.15,000
- Grants from Foundations: Rs.20,000
- Revenue from Art Exhibitions: Rs.8,000
- Interest Income: Rs.1,000

Expenditure:

- Program Expenses (for specific projects): Rs.18,000
- Salaries and Wages: Rs.22,000
- Administrative Costs: Rs.6,000
- Depreciation on Art Collection: Rs.1,500

Prepare the Income and Expenditure Account for the year ended March 31, 2023:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Unrestricted Donations	25,000
Restricted Donations	15,000
Grants from Foundations	20,000
Revenue from Art Exhibitions	8,000
Interest Income	1,000
Total Income	69,000
Expenditure	
Program Expenses	18,000
Salaries and Wages	22,000

Administrative Costs	6,000
Depreciation on Art Collection	1,500
Total Expenditure	47,500
Surplus for the Year	21,500

Problem No. 55: Income and Expenditure Account with Special Funding and Operating Cost

"Community Support NGO" for the year ended 31, 2023 March, has the following data:

Income:

- Special Funding for Community Outreach: Rs.40,000
- General Donations: Rs.12,000
- Government Grants: Rs.35,000
- Rental Income from Property: Rs.4,000
- Investment Income: Rs.2,500

Expenditure:

- Community Outreach Programs: Rs.35,000
- Salaries and Wages: Rs.20,000
- Property Maintenance: Rs.3,000
- Utilities: Rs.2,500
- Depreciation on Property: Rs.2,000

Prepare the Income and Expenditure Account for the year ended March 31, 2023:

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Special Funding for Community Outreach	40,000
General Donations	12,000

Government Grants	35,000
Rental Income from Property	4,000
Investment Income	2,500
Total Income	93,500
Expenditure	
Community Outreach Programs	35,000
Salaries and Wages	20,000
Property Maintenance	3,000
Utilities	2,500
Depreciation on Property	2,000
Total Expenditure	62,500
Surplus for the Year	31,000

Problem No.56: Adjustments for Prepaid Expenses and Accrued Income

"Health for All NGO" for the year ended March 31, 2023, has the following unadjusted balances:

Income:

- Donations Received: Rs.70,000
- Grants Received: Rs.30,000

Expenditure:

- Salaries and Wages: Rs.40,000
- Rent: Rs.10,000 (Paid in advance for 2 months of 2024)
- Utilities: Rs. 5,000
- Office Supplies: Rs.2,000

Adjustments:

1. **Prepaid Rent:** Rent of Rs.10,000 was paid for 2 months in advance (April and May 2024).
2. **Accrued Income:** Interest income of Rs.500 was earned but not received as of March 31, 2023.

Adjustments to Income and Expenditure Account:

Prepaid Rent:

- o Rent paid in advance for 2 months (2024): Rs.10,000 / 12 months = Rs.833 per month.
- o Prepaid Rent to be adjusted for 2 months: Rs.833 × 2 = Rs.1,666.
- o Rent Expense to be adjusted: Rs.10,000 - Rs.1,666 = Rs.8,334.

Accrued Income:

- o Interest Income to be added: Rs.500.

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations Received	70,000
Grants Received	30,000
Interest Income (Accrued)	500
Total Income	100,500
Expenditure	
Salaries and Wages	40,000
Rent (Adjusted)	8,334
Utilities	5,000
Office Supplies	2,000
Total Expenditure	55,334
Surplus	**45166**

Balance Sheet

Assets	Rs.
Current Assets	
Cash	20,000
Accounts Receivable	5,000
Prepaid Rent	1,666
Accrued Income (Interest)	500
Total Current Assets	27,166
Liabilities	
Current Liabilities	
Accounts Payable	3,000
Accrued Expenses	2,000
Total Liabilities	5,000
Net Assets	
Unrestricted Net Assets	22,166
Total Net Assets	22,166
Total Liabilities and Net Assets	27,166

Problem No.57 : Adjustments for Depreciation and Outstanding Expenses

"Community Development NGO" for the year ended March 31, 2023, has the following unadjusted balances:

Income:

- Donations: Rs.50,000
- Grants: Rs.20,000

Expenditure:

- Salaries and Wages: Rs.35,000
- Rent: Rs.12,000
- Utilities: Rs.4,500

- Equipment Purchase: Rs.10,000 (with a useful life of 5 years, straight-line depreciation)

Adjustments:

1. Equipment purchased needs to be depreciated.
2. Utilities of Rs.500 are outstanding and need to be recorded.

Adjustments to Income and Expenditure Account:

Depreciation: Equipment Depreciation: Rs.10,000 / 5 years = Rs.2,000.

Outstanding Expenses: Utilities to be adjusted: Rs.4,500 + Rs.500 = Rs.5,000.

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations	50,000
Grants	20,000
Total Income	70,000
Expenditure	
Salaries and Wages	35,000
Rent	12,000
Utilities (Adjusted)	5,000
Depreciation on Equipment	2,000
Total Expenditure	54,000
Surplus	16000

Balance Sheet Adjustments:

Assets	**Rs.**
Non-Current Assets	
Equipment (Cost)	10,000
Less: Accumulated Depreciation	(2,000)
Net Non-Current Assets	8,000

Current Assets	
Cash	15,000
Accounts Receivable	7,000
Total Current Assets	22,000
Total Assets	30,000
Liabilities	
Current Liabilities	
Accounts Payable	2,000
Outstanding Utilities	500
Total Liabilities	2,500
Net Assets	
Unrestricted Net Assets	27,500
Total Net Assets	27,500
Total Liabilities and Net Assets	30,000

Problem No. 58: Adjustments for Accrued Income and Prepaid Expenses

"Education Support NGO" for the year ended March 31, 2023, has the following unadjusted balances:

Income:

- Grants: Rs.60,000
- Donations: Rs.25,000

Expenditure:

- Salaries: Rs.40,000
- Rent: Rs.7,000
- Program Expenses: Rs.15,000
- Prepaid Insurance: Rs.2,000 (for the next year)

Adjustments:

1. Income from a completed project of Rs.2,500 is accrued but not yet received.

2. Insurance was paid in advance for the next year.

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Grants	60,000
Donations	25,000
Accrued Income	2,500
Total Income	87,500
Expenditure	**Rs.**
Salaries	40,000
Rent	7,000
Program Expenses	15,000
Total Expenditure	62,000
Surplus	**22500**

Balance Sheet Adjustments:

Assets	**Rs.**
Current Assets	
Cash	10,000
Accrued Income	2,500
Prepaid Insurance	2,000
Total Current Assets	14,500
Total Assets	14,500
Liabilities	
Current Liabilities	
Accounts Payable	3,000
Total Liabilities	3,000
Liabilities	
Current Liabilities	

Accounts Payable	3,000
Total Liabilities	3,000
Net Assets	
Unrestricted Net Assets	11,500
Total Net Assets	11,500
Total Liabilities and Net Assets	14,500

Problem No. 59: Adjustments for Deferred Income and Depreciation

"Arts for All NGO" for the year ended March 31, 2023, has the following unadjusted balances:

Income:

- Donations: Rs.40,000
- Grants: Rs.15,000

E59xpenditure:

- Salaries: Rs.25,000
- Rent: Rs.6,000
- Art Supplies: Rs.5,000
- Equipment Purchase: Rs.15,000 (with a useful life of 10 years, straight-line depreciation)

Adjustments:

1. A grant of Rs.5,000 was received for a project starting in 2024.
2. Equipment needs to be depreciated.

(Equipment Depreciation: Rs.15,000 / 10 years = Rs.1,500.)

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs**
Donations	40,000
Grants (Adjusted for Deferred Income)	10,000
Total Income	50,000

Expenditure	
Salaries	25,000
Rent	6,000
Art Supplies	5,000
Depreciation on Equipment	1,500
Total Expenditure	37,500
Surplus	**12500**

Balance Sheet as on 31-3-2023

Assets	**Rs.**
Non-Current Assets	
Equipment (Cost)	15,000
Less: Accumulated Depreciation	(1,500)
Net Non-Current Assets	13,500
Current Assets	
Cash	10,000
Total Current Assets	10,000
Total Assets	23,500
Liabilities	
Current Liabilities	
Deferred Income	5,000
Total Liabilities	5,000
Net Assets	
Unrestricted Net Assets	18,500
Total Net Assets	18,500
Total Liabilities and Net Assets	23,500

Problem No.61: Adjustments for Accrued Salaries and Unutilized Funds

"Helping Hands NGO" for the year ended Marc 31, 2023, has the following unadjusted balances:

Income:

- Donations: Rs.80,000
- Grants: Rs.25,000

Expenditure:

- Salaries: Rs.50,000 (Accrued Salaries of $3,000 not yet paid)
- Rent: Rs.10,000
- Project Expenses: Rs.15,000
- Unutilized Grant Funds: Rs.5,000 (to be carried forward)

Adjustments:

1. Accrued salaries of Rs.3,000 need to be recorded.
2. Grant funds of Rs.5,000 not utilized to be carried forward.

   (Grant Funds adjustment: Rs.5,000 (to be shown as a liability).

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations	80,000
Grants	25,000
Total Income	105,000
Expenditure	
Salaries (Adjusted)	53,000
Rent	10,000
Project Expenses	15,000
Total Expenditure	78,000
Surplus	**27000**

Balance Sheet as on 31-3-2023

Assets	**Rs.**
Current Assets	
Cash	20,000
Accounts Receivable	10,000
Total Current Assets	30,000
Total Assets	30,000
Liabilities	**Rs.**
Current Liabilities	
Accrued Salaries	3,000
Unutilized Grant Funds	5,000
Total Liabilities	8,000
Net Assets	
Unrestricted Net Assets	22,000
Total Net Assets	22,000
Total Liabilities and Net Assets	30,000

Problem No. 62: Prepaid Expenses and Accrued Income

Global Aid NGO" has the following transactions for the year ending March 31, 2023:

Income:

- Donations Received: Rs.80,000
- Government Grant (for a 2-year project starting next year): Rs.40,000

Expenditure:

- Salaries: Rs.50,000
- Rent (paid in advance for 3 months of 2024): Rs.9,000
- Utilities: Rs.4,500
- Office Supplies: Rs.3,500

Adjustments:

1. Rent paid in advance should be adjusted.
2. Interest income of Rs.700 earned but not yet received.

Income and Expenditure Account for the Year Ended March 31, 2023

Income	**Rs.**
Donations Received	80,000
Government Grant (adjusted)	0
Accrued Interest Income	700
Total Income	80,700
Expenditure	
Salaries	50,000
Rent (Adjusted)	6,750
Utilities	4,500
Office Supplies	3,500
Total Expenditure	64,750
Surplus	**15950**

Balance Sheet Adjustments:

Assets	**Rs.**
Current Assets	
Cash	25,000
Accrued Income	700
Prepaid Rent	2,250
Total Current Assets	27,950
Non-Current Assets	
Equipment	15,000
Total Assets	42,950
Liabilities	

Current Liabilities	
Accounts Payable	5,000
Total Liabilities	5,000
Net Assets	
Unrestricted Net Assets	37,950
Total Net Assets	37,950
Total Liabilities and Net Assets	42,950

Problem No.63: Deferred Income and Depreciation

"Children's Education NGO" for the year ending March 31, 2023, has the following data:

Income:

- Donations: Rs.55,000
- Grants Received (including $10,000 for the next year): Rs.30,000

Expenditure:

- Salaries: Rs.45,000
- Rent: Rs.8,000
- Equipment Purchase: Rs.12,000 (with a useful life of 4 years, straight-line depreciation)

Adjustments:

1. Rs.10,000 of grants received are for the next year.
2. Equipment depreciation needs to be recorded.

   (Equipment Depreciation: Rs.12,000 / 4 years = Rs.3,000.)

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations	55,000
Grants (Adjusted for Deferred Income)	20,000
Total Income	75,000

Expenditure	
Salaries	45,000
Rent	8,000
Depreciation on Equipment	3,000
Total Expenditure	56,000
Surplus	**19000**
Assets	
Current Assets	
Cash	15,000
Total Current Assets	15,000
Non-Current Assets	
Equipment (Cost)	12,000
Less: Accumulated Depreciation	(3,000)
Net Non-Current Assets	9,000
Total Assets	24,000
Liabilities	
Current Liabilities	
Deferred Income	10,000
Total Liabilities	10,000
Net Assets	
Unrestricted Net Assets	14,000
Total Net Assets	14,000
Total Liabilities and Net Assets	24,000

Problem No.64 : Accrued Expenses and Prepaid Income

"Clean Water NGO" for the year ended March 31, 2023, has the following details:

Income:

- Donations: Rs.70,000

- Grant Received (for a project starting in 2024): Rs.15,000

Expenditure:

- Salaries: Rs.40,000
- Rent: Rs.12,000
- Utilities: Rs.6,000
- Prepaid Income (for services to be provided next year): Rs.3,000

Adjustments:

1. Utilities of Rs.500 are accrued but not paid.
2. Rs.3,000 prepaid income needs to be adjusted.

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations	70,000
Grant (Adjusted for Prepaid Income)	12,000
Total Income	82,000
Expenditure	**Rs.**
Salaries	40,000
Rent	12,000
Utilities (Adjusted)	6,500
Total Expenditure	58,500
Surplus	**23500**

Balance Sheet Adjustments

Assets	**Rs.**
Current Assets	
Cash	20,000
Total Current Assets	20,000
Non-Current Assets	
Equipment	15,000

Total Assets	35,000
Liabilities	
Current Liabilities	
Accrued Utilities	500
Total Liabilities	500
Net Assets	**$**
Unrestricted Net Assets	34,500
Total Net Assets	34,500
Total Liabilities and Net Assets	35,000

Problem No.65: Bad Debts and Donations Receivable

"Urban Development NGO" for the year ending March 31, 2023, reports:

Income:

- Donations: Rs.90,000
- Grants: Rs.20,000

Expenditure:

- Salaries: Rs.55,000
- Rent: Rs.11,000
- Program Expenses: Rs.15,000
- Bad Debts Written Off: Rs.2,000

Adjustments:

1. Rs.4,000 in donations are receivable but not yet received.
2. Write off bad debts of Rs.2,000.

Income and Expenditure Account for the Year Ended March 31, 2023:

Income	**Rs.**
Donations	90,000
Grants	20,000

Total Income	110,000
Expenditure	**Rs.**
Salaries	55,000
Rent	11,000
Program Expenses	15,000
Bad Debts	2,000
Total Expenditure	83,000
Surplus	**27000**

Balance Sheet Adjustments:

Assets	**Rs.**
Current Assets	
Cash	25,000
Donations Receivable	4,000
Total Current Assets	29,000
Non-Current Assets	
Equipment	20,000
Total Assets	49,000
Liabilities	
Current Liabilities	
Accounts Payable	4,000
Total Liabilities	4,000
Net Assets	
Unrestricted Net Assets	45,000
Total Net Assets	45,000
Total Liabilities and Net Assets	49,000

Problem No.65: Accrued Donations and Unused Grant

"Environmental NGO" for the year ending March 31, 2023, shows:

Income:

- Donations: Rs.100,000
- Grants (including Rs.8,000 for next year): Rs.25,000

Expenditure:

- Salaries: Rs.60,000
- Rent: Rs.14,000
- Project Expenses: Rs.20,000
- Unused Grant Funds (to be carried forward): Rs.5,000

Adjustments:

1. Donations of Rs.3,000 are accrued but not yet received.
2. Unused grant funds of Rs.5,000 to be carried forward.

Income and Expenditure Account for the Year Ended March 31, 2023:

Balance Sheet Adjustments

Income	**Rs.**
Donations (Adjusted for Accrued Donations)	103,000
Grants (Adjusted for Unused Grant Funds)	20,000
Total Income	123,000
Expenditure	
Salaries	60,000
Rent	14,000
Project Expenses	20,000
Total Expenditure	94,000
Surplus	**29000**

Balance sheet as on 31-3-2023

Assets	Rs.
Current Assets	
Cash	35,000
Accrued Donations	3,000
Total Current Assets	38,000
Non-Current Assets	
Equipment	18,000
Total Assets	56,000
Liabilities	
Current Liabilities	
Unused Grant Funds	5,000
Total Liabili66ties	5,000
Net Assets	
Unrestricted Net Assets	51,000
Total Net Assets	51,000
Total Liabilities and Net Assets	56,000

Problem No.66: Deferred Income and Prepaid Expenses

Scenario:

"Arts and Culture NGO" has the following balances for the year ending March 31, 2023:

Income:

- Donations: Rs.45,000
- Grants Received (including Rs.5,000 for next year): Rs.25,000

Expenditure:

- Salaries: Rs.30,000
- Rent: Rs.8,000 (paid for next year)

- Art Supplies: Rs.6,000

Adjustments:

1. **Deferred Income:** Rs.5,000 is to be deferred.
2. **Prepaid Rent:** Rent paid for the next year needs adjustment.

Income and Expenditure Account for the Year Ended December 31, 2023:

Income	**Rs.**
Donations	45,000
Grants (Adjusted for Deferred Income)	20,000
Total Income	65,000
Expenditure	**Rs.**
Salaries	30,000
Rent (Adjusted)	0
Art Supplies	6,000
Total Expenditure	36,000
Surplus	**29000**

Balance Sheet as on 31-3-2023

Assets	**Rs.**
Current Assets	
Cash	15,000
Prepaid Rent	8,000
Total Current Assets	23,000
Total Assets	23,000
Liabilities	**Rs.**
Current Liabilities	
Deferred Income	5,000
Total Liabilities	5,000
Net Assets	**Rs.**

Unrestricted Net Assets	18,000
Total Net Assets	18,000
Total Liabilities and Net Assets	23,000

Check Your Porgress

Multiple Choice Questions

1. **----------**is typically considered income for an NGO

   a. Donations b. Depreciation

   c. Bad Debts d. Interest Expense

2. In NGO accounting a surplus indicates -----------

   a. The organization has more liabilities than assets.

   b. The organization has more income than expenditure.

   c. The organization has more expenditure than income.

   d. The organization has no cash flow.

3. ---------------account would you use to record a grant that is received but is intended for use in the next financial year.

   a. Income and Expenditure Account

   b. Deferred Income Account

   c. Prepaid Expense Account

   d. Accrued Expense Account

4. If an NGO receives a donation that has to be used for a specific project, it should be recorded -------------

   a. As unrestricted income b. As an investment

   c. As restricted income d. As a liability

5. ------------------ would not typically be found on an NGO's Balance Sheet?

   a. Unrestricted Net Assets b. Program Expenses

   c. Accrued Liabilities d. Fixed Assets

6. ---------- has an Accrued Expense represent in NGO accounting

a. An expense that has been paid but not yet incurred.

b. An expense that has been incurred but not yet paid.

c. An income that has been earned but not yet received.

d. A donation that is still pending.

7. ------------ is the purpose of depreciation in NGO accounting.

   a. To allocate the cost of an asset over its useful life.

   b. To adjust the value of cash held.

   c. To recognize donations in advance.

   d. To record liabilities.

8. If an NGO has prepaid insurance, then it is recorded----------

   a. As a liability　　b. As a current asset

   c. As income　　d. As an expense

9. How should unused grant funds be reported in the financial statements of an NGO**.**

   s. As income　　b. As an expense

   c. As a liability　　d. As equity

10. In NGO accounting, donations received for a specific purpose are treated as:

    a. General Income　　b. Revenue Expenditure

    c. Capital Expenditure　　d. Restricted Funds

11. What does the Income and Expenditure account represent for an NGO?

    a. Profit and loss　　b. Financial performance

    c. Donations received　　d. Capital employed

12. Which of the following is shown on the debit side of an NGO's Income and Expenditure account?

    a. Donations received　　b. Salaries paid

    c. Accrued income　　d. Surplus fund

13. An NGO's Income and Expenditure account is prepared based on ------- concept

a. Cash basis b. Accrual basis

c. Mixed basis d. Receipts and Payments

14. In an Income and Expenditure account, donations for specific purposes are:

a. Credited to income b. Debited to expenditure

c. Recorded in liabilities d. Transferred to capital fund

15. Which of the following is NOT considered while preparing the Income and Expenditure account?

a. Accrued expenses b. Prepaid expenses

c. Capital receipts d. Outstanding income

16. The Income and Expenditure account of an NGO reflects:

a. Profit or loss b. Surplus or deficit

c. Cash flow d. Revenue earned

17. Income and Expenditure account is prepared in:

a. Vertical form only b. Horizontal form only

c. Either form d. In notes to accounts

18. Which item appears on the credit side of the Income and Expenditure account?

a. Salaries b. Subscriptions c. Office rent d. Repairs

19. In the NGO accounting excess of income over expenditure is termed as:

a. Profit b. Deficit c. Surplus d. Gain

20. How is depreciation treated in an NGO’s Income and Expenditure account?

a. Added to the income b. Ignored

c. Charged to expenditure d. Shown under liabilities

21. Which of the following is NOT part of the Income and Expenditure account of an NGO?

a. Sale of investments b. Annual subscription fees

c. Donations for general purposes   d. Specific fund donation

22. Income and Expenditure account records:

    a. Both cash and non-cash transactions

    b. Only cash transactions

    c. Only non-cash transactions

    d. Fixed asset sale only

23. Deficit in the Income and Expenditure account means:

    a. Expenses are higher than income

    b. Income is higher than expenses

    c. Cash receipts are high

    d. Excess donations

24. Subscription received in advance by an NGO is shown in the Income and Expenditure account as:

    a. Income   b. Expenditure

    c. Current liability   d. Prepaid income

25. Which of the following will appear in the Expenditure section of the Income and Expenditure account?

    a. Interest received   b. Donation received

    c. Maintenance charges   d. Accrued income

26. Which of the following appears on the Income side of the Income and Expenditure account?

    a. Honorarium paid   b. Insurance premium

    c. Entrance fees   d. Loan repayment

27. Which of the following is credited to the Income and Expenditure account?

    a. Government grant for project   b. Payment for repairs

    c. Purchase of fixed assets   d. Sale of old equipment

28. Life membership fees are generally:

a. Shown as income b. Added to capital fund

c. Treated as expenditure d. Treated as reserve

29. Capital expenditures of an NGO are:

    a. Shown in Income and Expenditure account

    b. Recorded in the balance sheet

    c. Ignored

    d. Transferred to profit and loss

30. Which one of these is debited in the Income and Expenditure account?

    a. Donations received

    b. Government grants

    c. Office rent paid

    d. Subscription fees

2. State the True/False

1. Accrued expenses represent costs that have been incurred but not yet paid.
2. Donations received for a specific project should be classified as unrestricted income.
3. The Balance Sheet shows the financial position of an NGO at a specific point in time.
4. Deferred income should be recognized as revenue in the current accounting period.
5. Depreciation is a non-cash expense that reflects the reduction in value of an asset over time.
6. Program expenses are included in the Balance Sheet.
7. Prepaid expenses should be recorded as liabilities.
8. Surplus in the Income and Expenditure Account indicates that the NGO's income exceeded its expenditures.
9. Grants received for future periods should be recorded as current income.

10. Accrued income represents income that has been earned but not yet received.
11. The balance sheet shows the financial position of an NGO.
12. Specific fund donations are shown as liabilities in the balance sheet.
13. Fixed assets appear on the liability side of the balance sheet.
14. Subscriptions due are shown as an asset.
15. The balance sheet is always prepared at the start of the year.
16. Depreciation is added to the cost of fixed assets in the balance sheet.
17. Life membership fees are shown as capital in the balance sheet.
18. Accrued expenses are shown as liabilities in the balance sheet.
19. Donations for a specific purpose are shown under the capital fund.
20. Prepaid expenses are treated as an asset in the balance sheet.
21. Liabilities include bank overdraft and outstanding expenses.
22. Subscription received in advance is shown as income in the balance sheet.
23. Cash and bank balances are shown on the liabilities side of the balance sheet.
24. Capital fund includes the NGO's surplus.
25. Long-term loans are recorded under assets.
26. Balance sheet does not record revenue or income.
27. Outstanding expenses are shown under current liabilities.
28. Donations for general purposes are shown as income in the balance sheet.
29. Fixed deposits are classified as current assets in the balance sheet.
30. Subscription due but not received is treated as a liability in the balance sheet.

4.10 Answer to Check your Progress

1] MCQ-

1-a	2 -b	3-b	4 - c	5 - b	6 - b
7-a	8 - b	9-c	10-d	11-b	12-b
13-b	14-c	15-c	16-b	17-c	18-b
19-c	20-c	21-a	22-a	23-a	24-c
25-c	26-c	27-d	28-b	29-b	30-c

2] True or false-

1-T	2-F	3-T	4-F	5-T	6-F
7-F	8-T	9-F	10-T	11-T	12-T
13-F	14-T	15-F	16-F	17-T	18-F
19-T	20-F	21-T	22-F	23-F	24-T
25-F	26-T	27-T	28-F	29-T	30-T

4.10 Summary:

- The **Income and Expenditure Account** reflects the NGO's operational financial performance over the year, showing surplus or deficit.
- The **Balance Sheet** provides a snapshot of the financial position at the end of the year, listing assets, liabilities, and the **Corpus Fund**.
- **Adjustments** ensure the financial statements adhere to the accrual concept, reflecting all accrued income and expenses.
- The **Corpus Fund** is a dedicated fund that forms part of the capital of the NGO, ensuring financial stability for future operations.

4.11 Terms to Remember

Fund Accounting: A system that emphasizes accountability rather than profitability, focusing on the sources and uses of funds.

Donor Restrictions: Specific limitations placed by donors on how their contributions can be used.

General Fund: The main fund used for an NGO's operational expenses that are not restricted by donors.

Restricted Funds: Funds that can only be used for specific purposes, as stipulated by the donor.

Unrestricted Funds: Funds that can be used for any purpose by the NGO.

Revenue Recognition: The process of recognizing income from donations, grants, and other sources when it is earned, not necessarily when cash is received.

Expenditure: The costs incurred by the NGO in carrying out its activities, which can include operational costs, program expenses, and administrative expenses.

Financial Statements: Reports summarizing the financial status of the NGO, typically including the Statement of Financial Position, Statement of Activities, and Statement of Cash Flows.

Budgeting: The process of creating a plan to allocate financial resources for specific programs and operational costs.

Audit: An independent examination of financial records and statements to ensure accuracy and compliance with accounting standards and regulations.

Grant Management: The process of overseeing the use of grant funds, including tracking expenditures, reporting to donors, and ensuring compliance with grant agreements.

Statement of Financial Position: A financial statement that summarizes the NGO's assets, liabilities, and net assets at a specific point in time.

Statement of Activities: A financial statement that shows the revenue and expenses over a certain period, highlighting the changes in net assets.

Net Assets: The difference between an NGO's total assets and total liabilities, representing the organization's equity.

In-Kind Contributions: Non-cash donations such as goods, services, or volunteer time that have a monetary value.

Cash Flow Management: The process of monitoring and controlling the inflow and outflow of cash to ensure the NGO can meet its financial obligations.

Program Expenses: Costs that directly support the NGO's programs and services.

Administrative Expenses: Overhead costs necessary for the organization to function but not directly tied to specific programs.

4.12 Exercise

Problem 1: NGO "Health for All" received Rs.60,000 in donations and spent Rs.45,000 on program expenses, Rs.8,000 on administrative expenses, and Rs.3,000 on fundraising expenses.

From the above information prepare Income and Expenditure Account for the Year Ended December 31, 2023

Problem 2: NGO "Clean Water Initiative" hadRs. 30,000 in grants, Rs.5,000 in donations, and incurred Rs.20,000 in program costs, Rs.6,000 in admin costs, and Rs.4,000 in fundraising costs.

From the given information prepare **Income and Expenditure Account for the Year Ended March 31, 2023**

Problem 3: "Education First" received Rs.15,000 in grants and Rs.10,000 from a fundraising event. The organization spent Rs.12,000 on educational programs and Rs.5,000 on administrative costs.

Income and Expenditure Account for the Year Ended March 31, 2023

Problem 4: Scenario: NGO "Youth Empowerment" had total income of Rs.40,000 (including Rs.25,000 in donations and Rs.15,000 in grants). Expenses included Rs.30,000 for programs, Rs.6,000 for admin, and Rs.2,000 for fundraising.

Prepare **Income and Expenditure Account for the Year Ended March 31, 2023**

Balance Sheet

Problem 5: "Health for All" has cash of Rs.12,000, equipment worth Rs.20,000 with accumulated depreciation of Rs.4,000, accounts payable of Rs.3,000, and a grant receivable of Rs.2,000.

Prepare Balance Sheet as of March 31, 2023

Problem 6: NGO "Environment Care" has Rs.8,000 in cash, Rs.15,000 in fixed assets (net of Rs.2,000 accumulated depreciation), and Rs.5,000 in accounts payable. Net assets at the beginning were Rs.10,000.

Prepare balanceseet as on **Balance Sheet as of March 31, 2023**

Problem 7: "Community Support" has Rs.25,000 in cash, Rs.10,000 in receivables, Rs.8,000 in equipment, and Rs.4,000 in accrued expenses. Accumulated depreciation on equipment is Rs.1,000.

Solution: Balance Sheet as of March 31, 2023

4.13 References for Further Study

1. Sharma, R. (2010). *Accounting and Financial Management for NGOs*. New Delhi: *Vikas Publishing House*.
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4. Joshi, S., & Gokhale, N. (2012). *Financial Governance in NGOs: Accounting Challenges in the Indian Context*. *Indian Journal of Finance and Accounting*, Vol. 3, Issue 4, pp. 22-31.
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