

Practical View on Fund Based Accounting

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Abstract – The outcome of financial transactions of fund based accounting in educational institutions may show different results depending upon accounting practices, methods and accounting standards followed by that unit. Therefore, there is need to device a uniform system of fund based accounting for educational institutions so that similar types of transactions do not result in different > financial results.

The aim of the present study is to critically review the existing accounting practices of higher education institutions and to suggest better methods of classification and highlight the financial status. Efforts have been made to suggest a model which is legally compliant and draws from the best accounting practices. The model shall be applicable to all types of higher educational institutions and shall provide a uniform basis for comparison of financial results amongst various institutions.

Keywords – Accounting standards, Higher education, generally accepted accounting principles (GAAP), International Financial Reporting Standards (IFRS), Annual Reports, Financial Transactions.

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INTRODUCTION

Objectives of nonprofit organizations and other projects undertaken by State/Central government are different as compared to corporate and other commercial organizations which have basic objective of profit earning. The word “Fund Accounting” is applicable only on nonprofit organizations. In this article, I shall discuss on Fund Based accounting only, their treatment and suggestions for presentation of such transactions and statements in such a way which reflect the accurate status of financial transactions.

The question arises what is fund accounting and how non government entities require it and how technical advancement shall help the issues relating to fund based accounting.

Fund based accounting emphasizes on accountability instead of making profits. Such types of entities are called not for profit organizations such as churches, hospitals, schools, colleges, universities and their affiliations. Fund based accounting as an ideal technique for nonprofit earning organisations.

Fund represents the amounts of money which is kept separate to set a specific goal within an organization. The expenses incurred against that funds are required to be tracked and reported separately from other expenses. Accordingly several ledgers are

maintained representing each type of fund. Whereas, in commercial accounting, there is no requirement of maintaining such ledgers.

Fund accounting is a methodology which allows both the parties i.e. donor and recipient to track their resources go towards achieving their designated purpose.

It is pertinent to note that separate categories are created for the various requirements of fund flow and separate provisions are made and monitored according to the requirement of donations, endowments etc. Through these techniques, we come to know as to how the funds earmarked for a specific project are used.

As per Income Tax Act, 1961 as updated, nonprofits organizations enjoy special status in the form of tax breaks and other exemptions which are not granted to corporates. However, the nonprofit organisations enjoy these exemption till such time they fulfill the requirements of the Income Tax Act failing which all such privileges shall be withdrawn and such units shall be liable for compliances and deposit of income tax as is applicable on commercial organizations. It is a systematic method of showing how goals of the organization are met as per the plans for which the same are earmarked. By using fund accounting methodology

one can easily monitor the specific purpose being fulfilled for which these are implemented.

Need for Accurate presentation of financial statements in relation to Fund based Accounting System in nonprofit organizations-

The funds can be categorized as Gifts and Donations, grants, equity capital, contract, trading and loan financing.

Funds may be generated through various sources and each source must be classified in a specific manner before being placed in the proper category. Highlighting the inflows of funds through proper classification, the chances of making accounting errors are minimized. The donations and gifts can be sourced from companies, foundations, charitable trusts, funds raising events, foundation or other philanthropists who want to leave a legacy after they pass away. Unless the funds are given in response to a specific purpose or campaign, the same can be applied in any way a non-profit chooses to use it. It is also a proper way to receive tax exemptions, deductions and other privileges to reduce overheads. Grants are usually exempted from income tax, come from the public sector such as charitable trusts and foundations and given with a list of conditions before it can be applied. Generally speaking, the money coming from these sources is not required to be repaid. The conditions are those related to following specific results or outputs, to achieve the results previously agreed milestones, to return unspent funds, and strict reporting requirements on prescribed formats showing how the funds are used and how the project is progressing.

Equity Capital comes from outside investors who require share of rewards and a permanent stake in the organization. As consideration, they share the rewards out of success achieved which can be measured in monetary terms. Alternatively, the shareholders may opt to provide services or their expertise as a form of donation instead of monetary contributions.

Debt Financing is used by organizations whether secured or unsecured from various lenders in order to fund their projects which shall be repaid, usually with interest. Such loans are covered by the contract, which is considered as commercial and covered under Contract Act which both the parties need to comply with failing which the defaulter shall have to face the consequences as written on the document.

OBJECTIVES OF THE STUDY

Considering the present practices in education institutions regarding fund based accounting, the following objectives have been studied in this paper:

1. To harmonize different accounting systems and practices being followed in educational institutions in regard to Fund Based Accounting.
2. To suggest more and more transparency to curb fake transactions by private universities and suggest changes in order to bring complete accuracy in financial transactions, such as sound accounting principles, treatment of various types of funds, presenting detailed information on sources of funds by private universities, uniformity in recognition of funds related to financial transactions, accounting heads, notes to accounts and other information regarding related party transactions and peculiar transactions of shifting of funds from one person who is related to another.
3. To suggest standard formats of financial reports on fund based accounting and statements for all types of educational institutions.
4. Nonprofits can also choose to engage in partial commercial activities to raise funding. They can do so by selling goods and services to the public or other organisations. The funds generated through such activities provide freedom to utilize them as these funds do not come with conditions attached to it with respect to their utilization.

Technically, funding received by a nonprofit organizations are considered to be revenue and valuation done based on their fair market value or selling price in the market and booked as contributions received. Otherwise, other valuation techniques as allowed will be used.

If a fair valuation for a donated object is not established based on available valuation techniques, it will not be recognized as an asset. Income generated from a donation will be recognized as part of that donation received from the donor.

The donations, gifts or long lived assets without conditions imposed by donors are treated as contributions received-unrestricted Support. As an exception, there may be a policy on how long live assets will be recognized and used for. The nonprofit are required to maintain consistent and accurate financial reports.

Donation pledges that the funds can be used with the explicit permission from the donor only. Any donated assets unrecorded in the books of account will be accounted for as Contributions Received and shall not be capitalized under any circumstances. All expiring donations that occur

within donor-imposed restrictions are required to be booked within the same accounting period as the lapsed date. The expenses accrued but paid after expiration will still be borne by the donor. Similarly, accrual method is used for booking disbursements.

All expenses incurred should be clearly defined and matched to the projects for which they belong to. While submitting reports to the donor, the Operating costs must be proportionately matched with contributions received.

Accounting treatment of Assets and Liabilities in Fund Accounting

As the objective of nonprofit organizations are not to earn profits, therefore, the funds acquired fall either in the category of assets or liabilities, and are presented in the balance sheet under the appropriate heading. The funds received may be either be liquid assets (i.e. cash) or fixed assets such as land, building, machinery, and so. Liabilities are financial obligations which may be in the form of loans or unused funds.

Treatment of Expenses and Revenue in Fund Accounting

All expenses and revenues are used towards achieving a particular mission which is non profit. Both are accounted for and presented as per the segregated funds to which they have been assigned. Excess revenue is booked as liabilities in the accounting books.

BENEFITS OF FUNDS ACCOUNTING:

1. In Fund accounting the data can be accessed in one place, making the auditing process faster and easier.
2. The fund accounting methods will help in keeping track of expenditures and inflows, making it easier to trace any excesses and do the proper filing of Income Tax returns when required.
3. This would help in formation of formation of corporate strategies.
4. Fund accounting will help in implementation of disbursement faster.
5. Clear programs allow both donors and nonprofits to see how and where funds are going. Fund accounting also allows everyone to see how a specific project is progressing, and implement counter-measures to correct mistakes, if any.

Fund Accounting Terms defined-

Current Funds-These are resources, assets, and funds used in nonprofit organization. The funds can be either restricted or unrestricted.

Restricted funds use current assets as per normal practice, while unrestricted funds can be used at the disposal of board of governing body.

Non-current Funds-The funds refer as loan programs, endowment activities and capital outlay activities.

Loan Programs- The loan proceeds are used to fund their projects.

Endowment Activities-Endowment funds are donations that include a stipulation that states only income earned from the fund can be used while the original nation amount remains intact either in continuity or for a specified time period.

Capital Outlay Activities Refers to activities that pertain to money spent to acquire, maintain or repair current or fixed assets.

Agency Funds-These are used to account for resources used in a purely custodial capacity on behalf of government agencies, private organisations or individuals.

Custodial- These are funds which are disbursed following the donors specific instructions.

Challenges and control on lapses in fund accounting-

1. Utilisation of funds for the purpose for which the funding was made:

It has to be ensured that the funds are utilized by the Institutions for the purpose for which the funds were granted to them. Therefore, it is suggested that for each fund, a separate statement should form part of financial statements mentioning opening balance, funds granted, funds utilized and closing balance at the end of year.

2. Maintenance of proper records:

Proper recording of transactions in fund accounting is a big challenge. Each expenditure which is connected to designated fund is required to be tagged with that specific fund account only. The wrong recording of expenses may lead to wrong results or conclusions.

3. Manipulations done by promoters of Private Universities:

There can be chances of manipulation of funds received from various agencies/Institutions. In private Institutions incorporated under trusts/societies, there are chances of fake transactions for the purpose of manipulation of funds by private operators. Strict compliances relating to identities of the persons, Adhaar Cards, sources of their funds, statutory requirements relating to Income Tax deposit with respect to identities of the persons/Institutions funding the Trusts or Societies are required.

4. Presentation of financial statements and Audits:

There are many requirements prescribed by Institute of Chartered Accountants of India in regard to presentation of details regarding funds received from various sources and their utilization for educational institutions. The same requirements should be made mandatory and statutory auditors should qualify their reports if the same are not complied with.

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