

# AccountAble™

Commonly Confused Terms

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## Overview

Most of the time accountants use normal English<sup>1</sup>. But there are times when they use words in a special way. For example, a harmless statement such as 'I am processing your payment' may mean that your voucher is being given third degree!

Other than that, what do accountants mean when they say...

## Donations

Donations are made by individuals. Normally, there is no condition attached. This means you can use donations for any suitable purpose.

Some NGOs start special funds. For example, you may have a special fund called 'Orissa Cyclone Fund'. In such a case, donations become earmarked. Donations raised for 'Orissa Cyclone Fund' should not be used<sup>2</sup> for other work.

<sup>1</sup> Or any other language

<sup>2</sup> In some cases, these can be redirected. For example, suppose the funds can no longer be used for Orissa Cyclone. In such case, the NGO's Board may have to pass a resolution. This will allow the NGO to use the funds for some other purpose.

## Grants

Grants are made by foundations or donor-agencies. Companies and governments also make grants. Grants are normally made for a specific purpose. You cannot use it for any other purpose. If you have to, then you need the donor's permission first.

## Honorarium

Honorarium is a fee for professional services. But all fees for professional services are not honorarium. So when can you say honorarium instead of fees?

One, when the professional does not ask for a fee. Two, when traditionally no fixed price is set for the service.

What does 'profession' mean? Most dictionaries emphasize specialization. For example, Oxford's<sup>3</sup> says that a profession is a 'vocation or calling, especially learned or scientific'. Webster's<sup>4</sup> defines it as 'a calling requiring specialized knowledge and academic preparation'.



On this basis, payment of salaries to staff should not be called honorarium. However, *dakshina*<sup>5</sup> [picture location: to a priest can rightly be called honorarium<sup>6</sup>.

## Single Entry System

Single entry is a system of bookkeeping where you mainly make one entry for each transaction. This entry is made in the cash book (called *rokad bahi*). This looks like the normal cash book and can tell you how much cash you have.

When the transaction is related to purchase or sale, the entry stops there. However, if you have given a loan to someone, you take one more step. You post the entry to his/her personal account. This account is kept in a ledger (called *khata bahi*).

<sup>3</sup> The Oxford Dictionary for the Business World, 1993

<sup>4</sup> Webster's New Encyclopedic Dictionary, 1993

<sup>5</sup> Token payment for performing a religious ceremony

<sup>6</sup> Chamber's English-Hindi Dictionary, 1994

So what is missing here? No ledger account is kept for sales, purchases, fixed assets etc.

Single entry system is no longer taught in schools or colleges. Most professional accountants do not have a clear idea what it means. The system is, however, still used in Indian villages and traditional business communities.



## Double Entry System

The cashbook in double entry system is similar. But with one major difference: all entries made in the cashbook are posted to one or other ledger account.

Postings to personal accounts are similar to single entry system. But how do we handle sales, purchases etc.? Here the double entry system does something very clever. It opens 'nominal'<sup>7</sup> accounts for these. Similarly for fixed assets, it opens 'real accounts'.

Using this trick, double entry system becomes a self-balancing system. This unique feature has led to double-entry system being adapted all over the world. All NGOs and grant-making agencies in India follow double-entry system of accounting.

## Basis of Accounting

When should you pass an entry for expenses? When you receive the bill or when you pay it sometime later? This depends on the basis of accounting you have adopted.

### Cash basis

If you follow cash basis, then you pass entries only when cash (or cheque) is paid or received.

This means an unpaid bill will not be treated as an expense. Similarly an outstanding grant will not be treated as income.

This is the most common basis of accounting among NGOs. However, it is not suitable for all NGOs. If you get lots of services on credit, but use cash basis of accounting, then you have a problem. Your accounts will show a wrong picture.

### Accrual basis (Mercantile)

Some accountants do not like cash basis. They say that if a service has been used, then you must pay for it. If so, then why not account for the expense? It will also help

show whether you have enough money for all the pending bills.

Under accrual basis, you should pass entries for expenses or income when these become due. It does not matter whether cash/ cheque has been received or paid.

Expenses become due when you become legally liable to pay for them. Income becomes due when you have a legal right to recover it.

### Mixed basis

But do you have a legal right to recover donations? Donations are gifts. If someone promises you a gift and then fails to send it across, what can you do? Nothing. That's what the law says for donations also. It is for this reason that you can't do much about a donation cheque that bounces.

Due to this reason, some NGOs follow a mixed basis<sup>8</sup> of accounting. Expenses are recognized when services or goods are received. Donations and some grants are accounted only when received. But other contractual income, such as rent or interest, is accounted when due.

## Corpus

Corpus is a Latin word, which means 'body'. This word occurs all over in law and medicine. Both these disciplines owe a lot to Latin. For non-profit organizations, it means the main body (or principal) of the trust.

Most people think of corpus as an asset.



This is reasonably correct from a common sense point of view. The corpus is represented by cash or investments, and sometimes by property (movable or immovable). All

these appear on the Assets side of the Balance Sheet.

However, from an accounting point of view, corpus is a liability. It is the control entry (or mirror reflection) for funds kept in reserve.

It is generally believed that a corpus should not be touched or broken. However, income from the corpus (interest, rent, etc.) can be

<sup>7</sup> Nominal means 'for the sake of name only'

<sup>8</sup> Also called 'modified accrual basis'

used for running the trust. It is normally unrestricted. This means it need not be reserved for a particular program.

How does a corpus grow? A donor may give some money or property, saying that it should form part of the corpus. This will get added to the corpus. Can the trust move some of its surplus into the corpus by passing a resolution? There is no clarity on this.

By the way, if you had more than one corpus, what would you call them? Corpora.

## Endowment

Endowment means 'money or property given to a person or institution to provide an income'. In USA, people are more familiar with endowment than corpus. Endowment is shown on the liabilities side. The related investments appear on Assets side.

Endowment funds are normally kept in long-term investments. The income from endowment may be restricted for use in a particular program. Or it may be unrestricted – this means you can use it for any of the NGO's activities.

Donors normally expect periodic reporting for endowments. How is it invested? How much income does it produce? How is the income used? Restrictions<sup>9</sup> on an endowment should be explained in notes attached to the Balance Sheet.

## Surplus or Deficit

Surplus occurs when income in a year is more than expenditure. Deficit occurs when your expenditure is more than your income.

However, before calculating surplus, you must make provision for unspent grants. If you don't, then your financial statements will show a wrong picture.

If you are into fund-raising, you may be raising funds for specific programs. At the end of the year, part of this fund may be unspent. You should make a provision for this before calculating surplus or deficit.

Such provisions are advisable even when you follow cash basis of accounting.

## General Fund

General Fund is unrestricted fund. It is built up from surplus over the years. It can be used for any suitable activity of the society.

General Fund can be created in FCRA section also. It should be named in a different way such as 'FCRA General Fund'. For more details see 'Unrestricted FC Funds' in AccountAble 55: Puzzles of FCRA.

## Voucher

In accounting, a voucher has several uses. It explains a transaction. It also authorizes the transaction. It shows which account head is to be debited and which one is to be credited. The voucher also carries the name of your organization.

Your organization may use just simple vouchers<sup>10</sup> or specialized ones. This means you will have one type of vouchers for cash payments (called cash vouchers) and another for bank payments (bank vouchers). Then you might also have journal vouchers.

Sometimes, the voucher also provides proof of payment. For example, a person may sign a voucher to show that he or she has received the money.

## Supports

In other cases, the proof of payment will be a cash memo or bill. This is attached to the voucher as a support. A voucher may also have several supports.



*Sometimes a patient may also need several supports.*

## Cash memo

When you buy something and pay in cash, you get a cash memo. The cash memo helps you keep the payment in your memory. It also helps prove that you have paid the money. Most shopkeepers will give you a cash memo if you ask for it.

A cash memo should show the name and address of the shop. It should also show the items purchased (description, quantity, rate, value). The date of purchase should also be given.

For some items such as medicines<sup>11</sup>, the shopkeeper must give a cash memo. All shops registered under sales tax also must issue a cash memo when asked.

<sup>9</sup> Restrictions are conditions for the use of fund or its income.

<sup>10</sup> See 'AccountAble 4: The New Voucher' for more on voucher design

<sup>11</sup> Only licensed chemists can sell most medicines.

In smaller places, it is sometimes difficult to get cash memos. In such a case, you can ask the shopkeeper to write the name and address of the shop on a paper. He / she then can write down what you have purchased, at what rate and the money you paid. The shopkeeper should then sign it. This would be enough for most small purchases.



## Bill

A bill<sup>12</sup> is similar to a cash memo. There is only one difference. A bill means that cash has not been paid yet. But you have received the items or services.

This means that a bill should be addressed to your organization. Also when the bill is paid, you should get a receipt. If you don't get a proper receipt, then the shopkeeper must acknowledge the payment on the bill and sign again.

When you make the payment by an account-payee cheque<sup>13</sup>, it may not be necessary<sup>14</sup> to get a receipt. However, you can ask the receiver to sign for the cheque.

## Stock Register

Stock Register is for items that are purchased and sold or used. These may be raw materials or finished goods. In the NGO context, these are normally supplies such as stationery, medicines, construction material, etc. These will normally be used up or sold within one year.

Fixed Assets should not be recorded in stock register.

## Fixed Assets Register

Fixed Assets are items that will be used for a long time<sup>15</sup>. Fixed Assets Register is a record for such items.

Sometimes, this register is called the Dead Stock Register. This is not a suitable term, as fixed assets are not part of stock.

Stock items should not be recorded in the Fixed Assets Register.

## Final Accounts

Final Accounts are your financial statements. These are prepared at least once a

year. These normally include three items: 1. Balance Sheet; 2. Income & Expenditure Account; and, 3. Receipts & Payments Account. People sometimes casually call the entire set as Balance Sheet.

Financial statements are not very useful for public or authorities without an audit report.

## Audit Report

Audit Report is report of the auditors on your final accounts. It normally gives auditor's opinion on the accounts. It is different from the accounts. Auditors sign the accounts only for identification.

## Contingency

A contingency is uncertain. It is something that may or may not happen. Mostly, it is also unexpected. For example, a worker being injured in an accident is a contingency.

Some people keep a little money aside for contingencies. This may be a budget item or may be a fund. If it is a fund, it may be called 'contingency fund'.

Many Agencies now avoid contingency as a budget item. Reason? It seems they found that if one has a budget for contingency, then a suitable contingency is bound to occur!

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<sup>12</sup> Also called invoice, credit memo or charge memo

<sup>13</sup> The cheque must be made in the name of the shop.

<sup>14</sup> If required, the bank will give a letter proving the payment was made to the party.

<sup>15</sup> More than one year, at least