ACCOUNTING AND FINANCIAL MANAGEMENT GUIDE FOR CSOs IN BHUTAN

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PART I

FUNDAMENTAL CONCEPTS

1. INTRODUCTION

1.1 CSOs: Definition, characteristics and scope

According to the CSO Act 2007, CSOs are referred to as associations, societies, foundations, charitable trusts, not-for -profit organizations or other entities that are not part of the government and do not distributes any income or profits to their members, founders, donors, directors or trustee. A very important feature of a CSO in Bhutan is that it does not include trade, unions, political parties, cooperatives or religious organizations which are devoted primarily to religious workshop. CSOs are categorized under the categories of Public Benefit Organizations, and Mutual Benefit Organizations. Public Benefit Organizations are CSOs which are established to benefit certain section or whole of the society whereas Mutual Benefit Organizations are formed to advance the shared interest of their members or supporters[1].

Registered CSO may solicit funds through contributions, donations, grants, subsidies, financial assistance, bequests and transfers of funds or other properties as prescribed in the Civil Society Organizations Act, 2007 and Civil Society Organization Rules and Regulations 2010. Contributions and donations can be in form of cash, and in-kind (including properties both movable and immovable). However, CSOs should decline funds or in-kind donations that would bring about adverse conditions for the organizations and gifts given for uses outside the scope of its purpose, aims and objectives[2]. Any funds received by CSOs from foreign sources, whether public or private should be routed through an authorized Financial Institutions in Bhutan.

Rationale and Scope

The CSO Act 2007 outlines that CSOs must promote compliance with their legal obligations to exercise effective control and management over the administration of their activities and also promote the effective use of public and private financial resources. As per the law, registered CSO in Bhutan, particularly the Public Benefit Organizations are subjected to annual audit by the Royal Audit Authority. A certified audit report along with the Annual report and financial report has to be submitted to the CSO Authority on annual basis. Therefore, it is important for the CSOs to orient and maintain sound accounting and financial practices in their day to day operation.

Basic fundamental accounting principles are universally accepted and applied in any type of organization. However, the nature and peculiarities of organizations such as the CSOs demands specific and appropriate financial standards and guidelines.

[1] Civil Society Organizations Act of Bhutan, 2007
[2] Civil Society Organizations Rules and Regulations, 2010

The following are the basic differences between commercial organizations and CSOs :

1. CSOs do not operate primarily for profit but for specific needs of a community, group, organization or its membership.

2. Most of CSO's revenues come from funds contributed, donated, granted or given as other forms of support. Revenues from income generating activities, if any, are eventually plowed back to program operations.

3. Unlike in the business community where an exchange transaction occurs, in non-profit organizations such as CSOs, resource providers do not expect to receive either repayment or economic benefits proportionate to the resources provided. There is no defined ownership interest that can be sold, transformed or redeemed or that convey entitlements to a share to a residual distribution of resources in the event that the organization is dissolved.

4. CSOs have the responsibility to account for these funds designated for a specific purpose for a specified period of time. The nature of the revenues received requires ensuring that separate types of funds are properly tracked and reported.

In line with the existing framework on financial management specified in all the relevant policies of the nation, this Accounting and Financial Management Guide shall be applicable to all the CSOs in Bhutan which are operating with the unique mandate to benefit society. The scope of this Guide is simply to guide or help CSOs in their accounting and financial management processes.

This guide is not a substitute for and will not limit CSOs from having their own Administrative and Financial norms and procedures to promote effectiveness and efficient use of resources and strengthen transparency and accountability in accordance with the provisions of the Financial Rules and Regulations of the Royal Government of Bhutan.

1.2 CSO Governance and Accountability

For CSOs to fulfill their aims and objectives as well as to realize stakeholders' expectations efficiently and effectively, they must be governed by the principles of Fairness, Accountability, and Transparency[3]. Fairness - rights of stakeholders should be observed and respected; Accountability - Board and management should be answerable on their performance to stakeholders and has obligation to report in terms of annual reporting comprising both financial and non-financial; Transparency - timely, accurate and sufficient information must be openly disclosed to the public. The information disclosed should be accessible to the public.

The foremost responsibility for CSOs is to be accountable to the needs and aspirations of the society (community) it is working with since serving societal (community) interests is the stated primary goal of most CSOs. In practice, these communities lack mechanisms for holding CSOs accountable. Unlike donors, communities cannot withdraw their funding; unlike governments, they cannot impose conditionalities. CSOs are also accountable to its donors, who may be both external (for example, governments, foundations, or other CSOs) and internal (members who contribute smaller amounts). The simplest level of responsibility is that of spending money for the purpose to which it has been designated[4].

[3] Civil Society Organizations Rules and Regulations, 2010
[4] Civil Society Organizations Rules and Regulations, 2010

Proper Financial accounting and management in CSOs, the topic of this guide, hopes to contribute significantly to helping CSOs increase their capacity to express fairness, accountability, and transparency to their different stakeholders.

2. **FRAMEWORK**

2.1 Users and their Information Needs

EXTERNAL USERS

a. Donors/Grantors/Funding Agencies

- Degree of attainment of development objectives as indicated in financial statements and reports.
- Degree of compliance with agreed amount and manner of using funds.
- Degree of compliance with prescribed financial accounting and reporting system and procedures.

b. Creditors (Banks/Financing Institutions)

- Information on ability to pay as indicated by ratios of solvency, liquidity, and stability as well as status of their security.

c. Government Agencies

- Compliance with laws, government rules and regulations, payment of taxes (if any) and reportorial requirements.

d. General Public

- Effect of the activities of CSOs to the community and society in general.

INTERNAL USERS

e. Members

- Information on how fees, donations, grants, and proceeds from fundraising activities were used.
- Other information needs such as managerial remuneration, use of assets, management efficiency, etc.

f. Management Team

- Board of directors/trustees for policy-making, strategic decision-making, and fulfilling its trusteeship/stewardship role.
- Executive Director for operational decision-making.
- Program/project managers for project/program-related decision making.

2.2 Objectives of Financial Reporting

The primary objective of financial reporting by CSOs is to provide information about the financial position, performance, and cash flows of the organization that is useful, and indeed, necessary, for a wide range of users to engage in informed decision making. It is also mandated by the Civil Society Organizations Act of Bhutan 2007 as prescribed in the Civil Society Organizations Rules and Regulations 2010[5].

[5] Civil Society Organizations Rules and Regulations, 2010 pg. 52

Financial reporting prepared for this purpose meets the common needs of most users. However, financial reporting does not provide all the information that users may need to make decisions since they mostly portray the financial effects of past events. Financial reporting also shows the results of the stewardship of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make sound decisions. The financial reports of CSOs should compliment other non-financial, performance reports. The financial reporting is the means by which the information gathered and presented in financial accounting is regularly communicated to those who use it.

2.3 Basis of Accounting

Description

The basis of accounting affects the timing of recognition of income and expenses. When a cash basis of accounting is used, income is recognized once it is received while expense is recognized once it is paid. On the other hand, using an accrual basis means that income is recognized when it is earned, even when it has not yet been received, and expenses are recognized when they are incurred even when they have not yet actually been paid.

Basis of Accounting	Recognition of Income	Recognition of Expense
Cash Basis	When cash is actually Received	When cash is actually paid
Accrual Basis	When income is earned pertaining to the period	When an expense is incurred pertaining to the period even when not yet actually paid

The basis of accounting used, as discussed and summarized above, affects the presentation of the financial statements of the organization. In cash basis, a transaction is recorded only when actual cash has been received or spent. Basically, only the movement of cash can constitute a transaction. Under this basis of accounting, funds are recognized as receipts for the period if these are actually received within the current year. Expenses actually paid for in the current year are recognized for the period. This is regardless of whether the receipts or expenses pertain only to the current year, prior to or beyond it. This may result in an over/understatement of the net asset that make up a specific period.

In accrual basis, revenues and related assets are recognized when earned rather than when received while expenses are recognized when incurred rather than when paid. There is recognition of receivables and payables built up within a specific period.

The Recommended Basis of Accounting for CSOs

On consultation with the number of CSOs, it was quite clear that there is no standard basis being adopted by the even well established CSOs in Bhutan[6]. It was evident that not many finance and accounting personnel knew about the basis of accounting being adopted in their respective CSOs. However, the Financial Statements presented in their annual reports suggested that they

[6] Consultative interview with the CSOs in Bhutan

were into both cash and accrual basis. This indicates a strong need to adopt a standard basis of accounting for CSOs in Bhutan.

Considering the appropriateness of the of the basis, it is recommended that the Accrual Basis should be adopted by CSOs as this basis is considered to be more accurate aside from the preferred basis of the Accounting and Auditing Standards Board of Bhutan[7]. The use of the accrual basis of accounting helps present more fairly and accurately the financial status of CSOs. It is also required and helpful if an organization wanted to measure the cost of a project or activity or when comparative statements are required to be prepared. The accrual basis of accounting facilitates the use of the budget as part of control techniques.

However, if CSOs are small and if there is an insignificant difference between cash and accrual bases, there is still option to combine the simplicity of the cash basis and the accuracy of the accrual basis, i.e., cash basis in the interim and accrue transactions that need to be accrued when preparing periodic general-purpose financial reports. Thus, the financial reports are still presented in accrual form. When it comes to Donor-specific financial reports, being specific-purpose financial reports, may be presented using the cash basis upon the agreement between the CSO and the donor. As in the case of other specific-purpose reports, reconciliation between the specific reports prepared in cash basis and the general-purpose reports prepared in accrual basis, is necessary when required.

2.4 Assumption of Going-Concern

The financial statements are normally to be prepared on the assumption that a CSO is a going concern, and will continue to be in operation for the foreseeable future. It is thus assumed that the CSO has neither the intention nor the need to liquidate or scale back its operations; if such an intention or need exists, the financial statements may have to be prepared using a different basis, in which case, this basis should be disclosed. If a CSO is established as an ad hoc or its existence is limited to a specific period, the management of an ad hoc CSO should properly disclose its nature and terms of existence, as well as the implications of its ad hoc nature on its financial statements.

2.5 Qualitative Characteristics of Financial Statements

These are the attributes that make the information in financial statements useful to various CSO stakeholders, who are the users of the information. An essential quality of the information provided is its understandability by users.

a. **Relevance.** Information has the quality of relevance when it influences the decisions of users by helping them evaluate past, present or future events or confirming, or correcting their past evaluations.

    1. ***Materiality.*** Information is material if its omission or misstatement could influence the decision of users taken on the basis of the financial statements.

    2. ***Timeliness.*** Accounting information must be available on time when needed if it is to influence decisions. Lack of timeliness reduces relevance.

[7] Bhutanese Accounting Standard 2012 & IPSAS = International Public Sector Accounting Standards

b. **Reliability.** Information is reliable when it is free from material error and bias and can be depended upon by users to embody faithfully the representation contained therein.

   1. ***Faithful Representation.*** To be reliable, information must represent faithfully the transactions and other events that it either purports to represent or could reasonably be expected to represent.

   2. ***Substance over form.*** Transactions and other events are accounted for and presented in accordance with their substance and not merely their legal form.

   3. ***Neutrality.*** Information must be free from bias. Financial statements are not neutral if, by selection or presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

   4. ***Prudence.*** Some degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenues are not overstated and liabilities or expenses are not understated.

   5. ***Completeness.*** Information must be complete within the bounds of materiality. Omission may cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

c. **Comparability.** Users must be able to compare the financial statements through time in order to identify trends in its financial position and performance.

d. **Understandability.** An essential quality of the information provided in financial statements is that it is readily understandable by users.

Financial statements are frequently described as a fair presentation of an organization's financial position, performance, and changes in financial position. Although this framework does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as presenting fairly such information.

2.6 Accounting Elements

Financial Position

The elements directly related to the measurement of financial position are an organization's assets, liabilities, and equity.

a. Asset is resources controlled by the organization as a result of past transactions or events and from which future economic benefits or service potential are expected to flow to the organization.

b. Liability is a present obligation of the organization arising from past transactions or events, the settlement of which is expected to result in an outflow of resources from the organization embodying economic benefits or service potential.

c. Equity is the residual interest in the assets after deducting all its liabilities. In business enterprises, equity represents the net ownership of the enterprise. CSOs do not have specific owners, thus the remaining value of its assets does not go to its members. Assets and their residual values are intended for specific purposes; therefore, it is not appropriate to use the term "equity" in reference to CSOs. In place of "equity", CSOs use the term "**Net Assets**" to emphasize the outstanding value in the statement of financial position (assets less liabilities)[8].

Performance

The elements directly related to measurement of financial performance are revenue and expenses.

a. Revenue is the total inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in Net Assets.

b. Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumptions of assets or incurrence of liabilities that result in decreases in Net Assets.

2.7 Recognition and Measurement

Recognition is the process of incorporating in the financial statements an item that meets the definition of an element. An item that meets the definition of an element should be recognized if:

a. It is probable that any future economic benefit or service potential associated with the item will flow to or from the organization;

b. The item has a cost or value that can be measured with reliability.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the financial statements. A number of different measurement bases are employed to different degrees and in varying combinations in financial statements:

a. Historical cost. Pertains the original cost of an asset to an entity.

b. Fair value. The amount for which an asset may be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

c. Replacement cost. The amount it will cost to replace an asset at current prices.

d. Net realizable value. This refers to the net monetary gain of a transaction, i.e., the selling price of an asset less expenses.

e. Value-in-use. Represents the market value of an asset that reflects a value to a particular user, recognizing the extent to which the property contributes to that entity.

[8] IPSAS = International Public Sector Accounting Standards

3. THE ACCOUNTING EQUATION

The equation is based on the causal relationship principle and expressed as "Each resource has a source." Thus:

ASSETS = SOURCES

An asset is anything owned by the organization that has value. Sources may be categorized according to whether these were derived from external or internal sources, i.e., liabilities or equity. In CSOs, there is no equity in the real sense since there are no specific owners. The residual amount is then called Net Assets. Thus, the fundamental accounting equation is expressed in CSOs as:

$$A = L + NA$$

Asset = Liabilities + Net Assets

Net Assets has two nominal accounts, namely, Revenue/Support/Income that adds up to the net assets and Expenses that are deducted from the net assets.

Based on the equation, the five major accounts are: assets, liabilities, net assets (also known as real accounts), revenue/income/support, and expense (also called nominal accounts). All financial transactions are analyzed through the fundamental accounting equation:

$$A = L + NA$$

Debit is represented in the left side of the equation, while Credit is in the right side of the equation.

In increasing format (when the variables are positive), the equation expressed in Debit and Credit is:

$$A = L + NA$$

Debit	Credit

In decreasing format (when the variables are negative or transposed), the equation expressed in Debit and Credit is:

$$[- L] + [-NA] = [-A]$$

Debit	Credit

It is very important to express the equation in increasing and decreasing forms because in real life, the variables (A, L, NA) may increase or decrease for every transaction. Hence, assets, liabilities, and net assets always consist of left and right sides or what we call the T-accounts.

Combining the two equation formats (increasing and decreasing) above, we come up with the rules of Debit and Credit, as follows:

Assets

Debit	**Credit**
+	–

Liabilities

Debit	**Credit**
–	+

Net Assets

Debit	**Credit**
–	+
Expenses	Income

For every transaction, the fundamental accounting equation is used. Therefore, the rule can be re-stated as "For every transaction, total debits must equal total credits." The objective of accounting is not simply to have a balanced equation, but to have a proper analysis of transactions. A balanced equation is the result of proper analysis. In other words, balancing becomes automatic, if the analysis is correct.

4. THE ACCOUNTING CYCLE

Accounting starts with an event or transaction and ends in the preparation and interpretation of the financial reports. The phases from the recognition to report preparation are as follows:

4.1 Source Documents

Source documents are prepared to provide evidence of each transaction. The basic rule here is "a document is prepared for every transaction at the time the transaction occurs".

Transaction	Documents
For CASH Received	RECEIPT VOUCHER (accompanied by validated deposit slip, receipt or any other acknowledgement)
For CASH Disbursed	PAYMENT VOUCHER (accompanied by invoice/request for payment/cash advance request) and the check stub. In case of Petty Cash disbursement, the Payment voucher is the source document.
For OTHER Transactions	JOURNAL VOCHER (accompanied by supporting documents)

(Note: Voucher samples in Annexure)

The types of transactions and the representing documents are the basic requirements for CSOs. Other documents may be necessary if the transactions of a specific CSO become more complex such that there are more transaction types than the items enumerated above.

4.2 Journalizing

Transactions are recorded in the book of original entry called the Journal. The process of recording is termed "Journalizing." A transaction must be analyzed in its debit and credit elements before it is recorded in the books of accounts. Journalizing begins with the source document. The information in it tells the bookkeeper all that is needed for the entry.

The basic rule here is "every source document should be recorded in the appropriate journal on a daily basis or on a frequency which the CSO determines to be efficient". Following the categories of the transactions above, the primary books of original entry are:

Document	Journal
RECEIPT VOUCHER	Cash Book (Receipt side)
PAYMENT VOUCHER	Cash Book (Payment side)
JOURNAL VOUCHER	General Journal

4.3 Posting

Posting is the procedure of transferring entries from the journal to the general ledgers and subsidiary ledgers. Posting should be done on a regular (daily or monthly) basis, depending on the volume and frequency of transactions. The ledger is an account form where all accounts taken together as one group are recorded.

4.4 Trial Balance

When all journalizing and posting have been completed at the end of the period, the Bookkeeper or the accounts personnel checks the accuracy of that work. A list is made of all ledger accounts and their balances; this is called Trial Balance.

4.5 Financial Statements

Financial statements are prepared to summarize the financial operation of the organization. This information allows the management to see how financially efficient the organization has been, to compare one period with prior periods, and to determine future courses of action. Financial statements may be communicated to other interested parties such as the Board of Directors, members of the organization, donors, government, etc.

4.6 Use of Accounting Systems

For the purpose of increasing efficiency of Bookkeeping and accounting, CSOs can use any accounting system which best suits their needs. From consultation with CSOs, it was clear that majority of them have instituted Quick Books accounting system for Bookkeeping and accounting of their financial transactions. This Guide will not limit any CSOs from using any accounting systems. They can still use the same system that they have instituted.

5. ACCURAL BASIS – Guidelines

This guideline on accrual basis is being presented separately in recognition of the fact that many CSOs keep their records on a Cash Basis but record accrual entries at the end of each reporting period to convert these records to an accrual basis[9]. These accrual entries are recorded because financial statements will be distorted if unpaid bills or obligations actually incurred and uncollected income at the end of a period are not recorded.

Some small CSOs may want to keep their records as basic as possible by implementing a system that combines the simplicity of cash basis bookkeeping and the advantage of accrual basis reporting.

5.1 Moving from the Cash Basis to Accrual Basis

If a CSO follows the Cash Basis, it is encouraged to voluntarily disclose accrual-based information, although its core financial statements will nonetheless be prepared under the cash basis of accounting. An entity in the process of moving from cash accounting to accrual accounting may wish to include particular accrual-based disclosures during this process. The status and location of additional information (for example, in the notes to the financial statements or in a separate supplementary section of the financial report) will depend on the characteristics of the information (for example, reliability and completeness) and any legislation or regulations governing financial reporting.

5.2 Accrual of Revenue

Revenues are recognized when they are earned regardless of when the cash is actually collected. Revenues must also be realized, meaning that the organization must, at some time in the future, be able to convert any receivables resulting from revenue recognition.

Accrual of Grants and Donations

Accounting for grants and donations is a major concern of CSOs with regard to the accrual basis. CSOs record a donor's unconditional commitment to contribute as revenue (and receivable), provided that the contribution is realizable and enforceable. Grants and donations may be accrued subject to the following conditions:

- completed contract; and
- fulfillment of conditions/agreements previously set forth.

In many occasions, grants received (or a portion thereof) are intended for other periods other than the period that these are received. It may be that a grant remittance is intended to cover previous period activities or that it is intended for the next period/s.

5.3 Accrual of Expenses

Expenses recorded on the accrual basis of accounting follow three basic principles:

[9] CSOs Consultative interview reports

First, some expenses are recognized when they are “matched” to the revenue which they generate. For example, if a CSO sells an item, the costs and expenses related to that item is recognized at the same time as the revenue from the sale is recorded.

Second, some expenses are recognized in the fiscal year or accounting period in which they are used by the organization. These types of expenses are recognized when the organization has an obligation to pay the expense, which will generally correspond to the period in which the organization receives the benefit of the expense.

For example, rental expenses should be recognized in the month or period in which the CSO occupied the rented premises. Another example is personnel cost which is recognized in the period the employees rendered their services. The same applies to utility expenses such as electricity, telephone, water, etc. which are paid on a monthly or regular basis.

Third, some expenses are the result of a systematic allocation of costs to accounting periods. Depreciation expense related to the depreciation of fixed assets is the classic example of this type.

5.4 Accrual Basis and Liquidation of Cash Advances

One of the common problems in CSO accounting is the untimely liquidation of cash advances. When the accrual basis is used, it is paramount that liquidations should be prompt or immediately after the activity. Liquidation submitted very late defeats the benefits of the accrual basis described above.

As part of the accounting system, transactions to be accrued at the end of the reporting period should be documented in the CSO’s accounting manual. This will serve as a guide in the preparation of necessary accounting documents and records for accrual purposes. In considering the accrual basis of accounting, the time of the actual cash receipt or cash disbursement does NOT determine in which accounting period a revenue or expense is recorded. Rather, the principles described above guide the recognition of revenue or expense regardless of when the actual cash is collected or disbursed.

Among others, the following items are considered when preparing accrual entries:

- Accrued Revenues/Income
- Periodic Costs/End of the Month or Period
    a. Salaries and related costs
    b. Rentals
    c. Utilities
    d. Retainer fees and other periodic expenses
- Portion of Prepaid Expenses consumed for the period (Prepaid expenses are treated as assets)
    a. Consumed portion of supplies, inventories, prepaid insurances, etc.
    b. Completed portion of prepaid contracts
    c. Amortization of other prepaid expenses

- Recognition of expense or asset and related liability based on consumed or completed portion of an obligation.
- Provisions
  a. Depreciation, impairment and amortization
  b. Provision for doubtful accounts
  c. Unrealized gains or losses such as foreign exchange gain or loss as a result of changes in the foreign currency balances as of balance sheet date

PRACTICAL EXAMPLES and PRO-FORMA ENTERIES

	Debit	Credit
Accrued Revenues/Income		
1 _________________ receivables	xxxxx	
_________________ income		xxxxx
(To accrue ________ earned from _______ for the period)		
(all other accrual of revenues, income, contributions follow this entry format, recognizing the specific revenue and the corresponding receivables)		
2 Deferred Grants (liability)	xxxxx	
Grant (as revenue)		xxxxx
(To recognize the portion of grant received that is intended for the period)		
(this entry assumes that grant received was originally credited to Deferred Grant (a liability account) because the amount was intended for several periods)		
Periodic Costs/End of the Month or Period		
3 Salaries expense	xxxxxxx	
Employer PF contribution	xxx	
TDS payable		xxx
HC Payable		xxx
Employee PF payable		xxx
Employer PF contribution payable		xxx
Cash		xxxxx
(To record payroll expenses and set-up liabilities to government arising from the payroll)		
4 Retirement Benefit expense	xxxxx	
Accrued expenses		xxxxx
(To accrue retirement benefit expense for the period		

5 Rent expense *Accrued expenses* *(To accrue rent for the month of…………….)*	xxxx	 xxxx
6 Utilities expense *Accrued expense* *(To accrue utilities charges for the month of ……………)*	xxx	 xxx
7 Professional fee *Accrued expenses* *(To accrue retainer's fee for the month of …………..)*	xxx	 xxx
Consumed portion of pre-paid expenses (the following entry assumes that pre-paid expenses were treated as asset when this was paid in advance)		
8 ______________ expense Prepaid expenses (To record consumed portion of prepaid _____ expenses for the period)	xxx	 xxx
Recognition of expense or asset and related liability based on consumed or completed portion of an obligation		
9 Interest expenses Interest payable (To accrue interest incurred on Loans payable for the period)	xxx	 xxx
10 _______________ (Expense of Asset) Accounts payable (To recognize completed portion of _______ expense or asset during the period)	xxx	 xxx
Provisions		
11 Depreciation expense Accumulated depreciation (To record depreciation of assets for the period)	xxx	 xxx
12 Bad debts Allowance for bad debts (To record provisions for bad debts)	xxx	 xxx
13 Cash (foreign currency) Foreign exchange gain (To re-value foreign currency balance based on the current rate as of end of the period)	xxx	 xxx

6. INTERNAL CONTROL SYSTEM

6.1 Safeguarding of Assets

All CSOs must provide safeguards for all grant property, whether cash or other assets, and assure that it is used solely for authorized purposes through adequate internal controls. Internal Control is a method under which duties are arranged and segregated to enable effective accounting control over assets, liabilities, revenues and expenditures. Duties are subdivided so that no single employee performs a complete cycle of operations. This reduces the opportunity for any single person to both commit and conceal errors or irregularities in the normal course of business. Separation of duties also increases the likelihood that unintentional errors will be discovered through reconciliations and other normal work activities. Internal control is critical in the area of cash receipts, disbursements, Bank reconciliation, and procurement.

6.2 Cash Receipts

When it comes to cash receipts, no one person should be allowed to collect, handle or transport and deposit checks/currency without some additional control feature to ensure that all funds are accounted for.

Examples of such controls are as follows:

Maintain a log of all monies received. The log should contain the amount received, the name of the payer, purpose of the payment and its form (cash or Cheque).

- Provide a receipt. Ideally receipts should be pre-numbered and two-part. One copy should be provided to the payer while the other copy is kept on file. Total deposits can be verified independently by another person by accounting for each sequentially numbered receipt.
- If cash or Cheques are received regularly in the mail, two persons should be present when the mail is opened. One person should total the remittances and the other, the payments. The totals should then be agreed and the remittances forwarded to the appropriate area for data entry. A deposit slip should be prepared and forwarded with the cash/Cheque to Cash Operations. The deposit slips should be reconciled by a third person to the general ledger.
- Restrictively endorse Cheques immediately upon receipt with a stamp stating “For Deposit Only.
- Keep cash/Cheque in a locked and secure area until they can be deposited. Access to the area should be restricted to only two people, one serving as a backup. If a person with custody responsibilities leaves their position, any keys should be collected or combinations changed. Remember that while cash or checks are in your custody you are responsible for it.

- Make timely deposits. The sooner you deposit cash/Cheque the less exposure to theft or loss of funds. Ideally deposits should be made within 24 hours. If amounts are insignificant then deposits can be made weekly.
- Verify the deposit by agreeing deposit slip to the general ledger on a monthly basis.
- Duties should be segregated, meaning that the person recording the receipt should not be the same as that making the deposit. Additionally, a person independent of recorder and depositor responsibilities should reconcile the deposit to the general ledger. If there are only two people in the department, the reconciliation should be performed by the person collecting the receipts.

6.3 Disbursement

The following guidelines should be observed for cash disbursements.

- The person who authorizes or enters disbursement documents should not reconcile the resulting reports.
- A person preparing reports on goods received cannot process an invoice for payment for those goods.
- The person authorizing an invoice for payment cannot sign a Cheque for the disbursement.
- The person who prepares Cheques should not sign them.
- The person who signs Cheques should not have access to the blank check stock.
- The person who signs Cheques should do so only after comparing them with authorizations and supporting documents.

6.4 Bank Reconciliation

Bank reconciliation is an essential internal control tool to help identify accounting and banking errors. The bank reconciliation ensures that all transactions that have gone through the Bank statements have been reviewed and checked, and has been recorded in the accounting records.

The following guidelines should be observed for bank reconciliation.

- A person who signs Cheque cannot prepare the bank reconciliation.
- The person receiving and depositing cash should not do the bank reconciliation.
- A person who authorizes cash disbursements should not do the bank reconciliation.
- The sequence of check numbers must be verified when the bank reconciliation is prepared.
- The bank reconciliation must be reviewed by a second person. Both the preparer and the reviewer must sign and date the completed reconciliation.

- Depending on the size of the transactions of the organization, bank reconciliation should be done on a monthly basis.

6.5 Procurement

In addition to following the Procurement Rules and Regulations 2009 of the RGoB (PPPD)[10], a civil society organization must design a procurement procedure which suits its own needs. The following are the typical stages in the procurement process to illustrate separation of duties as internal controls over the procurement process.

a. Specify goods or services to be purchased, check budget

The standard, quantity and price of goods or services required, as described in the activity plans, is clarified so that it is clear what needs to be purchased. The amount currently available in the budget for the item to be purchased should be checked at the specification stage in case the price has changed since the budget was prepared.

b. Prepare Purchase Requisition

An internal request is prepared – usually on a standard form for that purpose – to formally request the purchase of the goods or services specified. The request will include a description of the purchase and state why it is required.

c. Authorize Purchase Requisition

The purchase requisition will usually be checked and authorized by the budget holder or other nominated person to verify that there is a genuine reason for the purchase. The available budget will usually be checked again at this stage.

d. Obtain Quotations

Quotations from reputable independent suppliers are requested (in accordance with internal procedures and donor rules) to make sure the organization gets best value for money and to minimize the risk of collusion.

e. Select Supplier

Quotations are reviewed and a supplier is selected based on price, quality, delivery times, and ‘after sales’ terms to ensure value for money. For larger purchases, it is usual to have a tender committee – a small group of people who take responsibility for selecting the supplier.

f. Issue Purchase Order (PO)

A Purchase Order is sent to the selected supplier with a copy kept on file with the supplier’s quotation. This is a legally binding contract.

[10] PPPD = Public Procurement Policy Division, Ministry of Finance, Royal Government of Bhutan

g. **Receive Goods from Supplier**

When supplies are delivered and received, a Goods Received Note is usually signed to confirm receipt and a copy filed for later reference.

h. **Receive and Check Supplier Invoice**

The invoice should be checked and matched up with the quotation, usually by the finance team.

i. **Prepare and Authorize Payment Authority**

The Payment Authority is attached to the invoice and all the supporting documents. It includes budget and accounting codes and must be checked and authorized by the budget holder or other nominated person.

j. **Pay Supplier Invoice**

Payment should be made to the supplier within the specified payment terms.

k. **Enter Payment into Cashbook**

The final stage is to record the payment in the organization's books of account

l. **Specific control procedures over the process**

- The responsibilities for the requisitioning, purchasing, and receiving functions are adequately segregated from those for the invoice processing, accounts payable, and general ledger functions.
- The responsibilities for the invoice processing and accounts payable functions adequately segregated from those for the general ledger functions.
- The responsibilities for the disbursement functions are adequately segregated from recording cash disbursements and general ledger entries.
- The responsibilities for the disbursement approval function are adequately segregated from the disbursement preparation function.
- Purchases of goods and services should be properly authorized by an officials designated to authorize requisitions.
- Prenumbered requisition forms should be used to initiate purchase of goods and services and prenumbered requisition forms shall be accounted for on a periodic basis.

PART II

FINANCIAL REPORTING AND CHART OF ACCOUNTS

7. FINANCIAL REPORTS AND DISCLOSURES

An organization should prepare a set of financial statements which includes- a statement of financial position, statement of comprehensive income, statement of Changes in Equity, statement of Cash Flows, and Note Disclosures[11]. However, an organization that uses the cash basis of accounting need not prepare the statement of cash flows, as the statement of receipts and payments serves the same purpose.

This Accounting Guide attempts to attain uniformity in the presentation and interpretation of the financial statements of CSOs. This will also help in properly comparing reports of similar organizations for the purpose of analyzing financial statements.

This Guide focuses on the general-purpose financial statements, as specific purpose financial statements may differ based on the concerns of each individual CSO. The general-purpose financial statements include the following:

7.1 Statement of Financial Position or Balance sheet

This statement presents the financial position of the organization at a certain date. It may be used as a tool to evaluate the resource controlled, solvency, liquidity and stability of the Organization's financial standing.

For CSOs, Net Assets is the equivalent of Equity and it is divided into Unrestricted and Restricted. Restrictions may be imposed by the donor or by legal requirements. Unrestricted Net Assets represent the resources of a CSO that are not controlled by the donor or limited by legal requirements.

Restricted Net Assets are those whose use is limited by either a time restriction or a purpose restriction. A time restriction requires that the resources be used during a certain period of time. Sometimes time restrictions specify that the resources cannot be used until after a specific point in time. A purpose restriction, as its name suggests, requires that resources be used for a specific purpose, such as a specific program/project of the organization.

7.2 Statement of Activities or Performance Statement

This financial statement reports on the sum all support & revenue received and expenses disbursed for a given period. It measures how financial resources were derived and utilized.

7.3 Changes in Net Assets

The changes in Net Assets may not be very complicated for CSOs. This may be reflected in the Statement of Financial Position or in the Statement of Activities.

[11] Bhutanese Accounting Standard 1

Option 1: In the Statement of Financial Position under Net Assets
NET ASSETS Beginning Balance Add (Deduct): Net Excess (Deficit) for the period (from the Statement of Activities) Ending Balance

Option 2: In the Statement of Activities after Net Excess (Deficit)
NET EXCESS (DEFICIT) FOR THE PERIOD Add: Net Asset – Beginning NET ASSET – Ending (forwarded to the Statement of Financial Position)

7.4 Statement of Cash Flow

The statement of cash flows provides users of financial statement with a basis to assess the ability of the entity to generate cash and cash equivalent and its use during the accounting period. It also shows the information about methods of financing activities and use and investment of resources during the period. (This statement can be called "Statement of Receipts and Payments" if the cash basis is allowed and used.)

It classifies cash flows according to whether they stem from operating, investing, or financing activities and provides definitions of each category.

Operating Activities

The operating activities reflect all cash transactions that are not classified as either investing or financing activities.

Cash inflows from operating activities include:

- Grants,
- Contributions(other than long-term restricted contributions), and
- Receipts from the sales of goods or services.

Cash outflows for operating activities include:

- Disbursements made for program/project activities,
- Disbursements to employees, vendors, and contractors, and
- Grants made by the organization to other organization, if any.

Investing Activities

Investing activities include acquiring and disposing of debt and equity investments, making and collecting loans, and acquiring and disposing of property, plant, and equipment.

Cash inflows from investing activities include:

- Sales of property, plant, and equipment, and
- Collections on loans.

Cash outflows for investing activities include:

- Purchase of property, plant, and equipment, and
- Disbursements of loans.

Financing activities

Financing activities include borrowing money and repaying amounts borrowed, and obtaining and paying for other resources obtained from creditors using long-term credit. This category would also include cash received for contributions from donors that is restricted for long-term purposes for which the restrictions have yet been satisfied and the cash is still being held.

Cash inflows from financing activities include:

- Receipts of contributions from donors that are restricted for long term purpose,
- Interest and dividends restricted for long-term use, and
- Short-and long-term borrowings.

Cash outflows for financing activities include:

- Repayment of short-and long-term debt, and
- Repayment of capital leases.

Methods of preparing Statement of Cash Flows

Statement of cash flows can be presented using one of two methods: the direct method or the indirect method. The direct method reports actual receipts and disbursements for each item of cash inflows and outflows. The indirect method begins with the result of operating activities reported in the statement activities and then adjusts this amount to convert it to a cash receipts/ disbursements basis. Most CSOs use the direct method, while auditors prefer the indirect method.

A pro forma of the statement of cash flows using the direct method and the indirect method can found on page 32&33.

Non-Cash Activities as Supplementary Information

While the title is Statement of Cash Flows, the statement is required to report non-cash transactions as well. The cash flow statement should include significant non-cash investing and financing activities either by narrative or by including a schedule of non-cash transactions as part of the Statement of Cash Flows.

7.5 Notes to Financial Statements and Supporting Schedules

Note Disclosures

The minimum disclosure requirements include the following.

- Nature and purpose of the organization, including the domicile and legal form of the organization.
- Description of funds/projects/services.
- Number of members of the governing board/body, general assembly/membership and employees and changes during the reporting period.
- Basis of preparation of the financial statements.
- Accounting policies to be disclosed will assist users in understanding the way in which transactions and events are reflected in the financial statements.
- Major donors/sources of funds and explanation to the restricted assets imposed by the resource providers.
- Recipients of material donations given, if any.
- Related party transactions, if any.
- Explanation to significant impairments of assets.
- Liens on assets and other restrictions.
- Explanation to main items of the financial statements and their changes.
- Explanation of agency transactions/pass-through accounts/ funds-held-in-trust.
- Contingencies, commitments, and other financial disclosure.
- Non-adjustment events incurred after balance sheet date.
- Non-financial disclosures relevant to the financial statements.
- All other necessary disclosure. *Note: the presence or absence of an explanatory note may alter the reader's interpretation of financial information.*

Additional Disclosures for Income-Generating Activities

- Nature and description of the commercial activities.
- Particulars of income and expenses of the commercial activities.
- For CSOs engaged in microfinance activities: Portfolio Report, Loan Aging and Key Ratio Analysis.

7.6 Some Supporting Schedules and Statements Prepared by CSOs include the following

- Bank Reconciliation Statement wherein all cash in bank balances are reconciled with the bank records monthly or as the need arises.
- Daily Cash Position Report which is prepared for cash in bank, cash on hand and petty cash/revolving funds at the end of the day to provide information on receipts and payments as well the amount of cash still available for use the following day.
- Various Assets and Liabilities Schedules, or listings, to support the balances reflected in the financial statements.
- Ageing of Receivables and Payables.
- Schedule of Grants Received.

7.7 Sample financial statements and disclosures

(NAME OF THE ORGANIZATION)
STATEMENT OF FINANCIAL POSITION
(DATE)

	Notes	Current Year	Previous Year
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents		xxx	xxx
Receivables, net		xxx	xxx
inventories and office supplies		xxx	xxx
Investments, current portion		xxx	xxx
Prepayments and other current assets		xxx	xxx
Total current assets		xxx	xxx
NON-CURRENT ASSETS			
Investments, net of current portion		xxx	xxx
Property and equipment, net		xxx	xxx
Other non-current assets		xxx	xxx
Total non-current assets		xxx	xxx
Total assets		xxx	xxx
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Payables and accrued expenses		xxx	xxx
Deferred support, current portion		xxx	xxx
Funds held in trust		xxx	xxx

Total current liabilities	xxx	xxx
NON-CURRENT LIABILITIES		
long term loans	xxx	xxx
capital lease	xxx	xxx
Total non-current liabilities	xxx	xxx
Total liabilities	xxx	xxx
NET ASSETS		
Unrestricted	xxx	xxx
Restricted	xxx	xxx
Total net assets	xxx	xxx
Total Liabilities and net assets	xxx	xxx

(NAME OF THE ORGANIZATION)
STATEMENT OF ACTIVITIES
(DATE)

		Current period		Previous period	
	Notes	unrestricted	restricted	unrestricted	restricted
REVENUES					
Membership fees and contributions		xxx	xxx	xxx	xxx
Grants and donations		xxx	xxx	xxx	xxx
In-kind contribution-goods		xxx		xxx	
Dividend income		xxx		xxx	
Program service fees		xxx		xxx	
Other income		xxx	xxx	xxx	xxx
Total income		xxx	xxx	xxx	xxx
Program/Project Expenses					
Project development and monitoring		xxx	xxx	xxx	xxx

Project Audits		xxx		xxx
General and administrative expenses	xxx		xxx	
Fund-raising expenses	xxx		xxx	
Other expenses				
provision for losses on loan receivables	xxx		xxx	
Total expenditure	xxx	xxx	xxx	xxx
Excess of support and income over expenditures for the year	xxx	xxx	xxx	xxx

(NAME OF THE ORGANIZATION)
STATEMENT OF CHANGES IN NET ASSETS
(DATE)

	Notes	Current Year	Previous year
Unrestricted			
January 1		xxx	xxx
Excess of income over expenditures for the year		xxx	xxx
Net transfer to restricted		(xxx)	(xxx)
December 31		xxx	xxx
Restricted			
January 1		xxx	xxx
Excess income over expenditures for the year			
Net transfer from unrestricted		xxx	xxx
December 31		xxx	xxx
Total Net assets		xxx	xxx

(NAME OF THE ORGANIZATION)
STATEMENT OF CASH FLOWS (indirect method)
(DATE)

	Notes	Current Year	Pre-vious Year
Cash flows from operating activities:			
Excess of income over expenditures for the year		xxx	xxx
Adjustments for:			
Depreciation and amortization		xxx	xxx
Provision for possible losses on loans receivable		xxx	xxx
Amortization of unamortized fees and interest		xxx	xxx
Unrealized loss in market value of investments		-	xxx
Dividend income		(xxx)	(xxx)
Interest income		(xxx)	(xxx)
Interest expense		xxx	xxx
Net cash used before changes in working capital		(xxx)	(xxx)
Changes in assets and liabilities:			
Receivables		xxx	(xxx)
Office supplies		xxx	xxx
Other current assets		(xxx)	(xxx)
Payables and accrued expenses		xxx	(xxx)
Net cash used in operating activities		xxx	
Cash flows from investing activities			
Acquisition of property and equipment		(xxx)	(xxx)
Proceeds from sale of property and equipment		xxx	-
Increase (decrease) in investments		(xxx)	xxx
Increase in other assets		(xxx)	(xxx)
Dividend income received		xxx	xxx
Interest received		xxx	xxx
Net cash provided by (used in) investing activities		(xxx)	xxx
Cash flows from financing activities			
Payment of long term borrowings		(xxx)	xxx
Increase (decrease) in funds held in trust		xxx	-
Net cash used by financing activities		(xxx)	xxx
Net increase (decrease) in cash and cash equivalents		(xxx)	xxx
Cash and cash equivalents at January 1		xxx	xxx
Cash and Cash equivalent at December 31		xxx	xxx

(NAME OF THE ORGANISATION)	
STATEMENT OF CASH FLOWS (DIRECT METHOD)	
(DATE)	
Cash flows from operating activities:	
Cash received from service recipients	xxxxxxxxx
Cash received from donors	xxxxxxxxx
Cash collected on contributions receivable	xxxxxxxxx
Interest and dividends received	xxxxxxxxx
Interest paid	(xxxxxxxx)
Cash paid to employees and suppliers	(xxxxxxxx)
Net cash provided by operating activities	xxxxxxxxx
Cash flows from investing activities:	
Purchases of equipment	(xxxxxxxx)
Proceeds from sale of investments	xxxxxxxxx
Investments made	(xxxxxxxx)
Net cash used by investing activities	(xxxxxxxx)
Cash flows from financing activities:	
Proceeds from contributions restricted for:	
Investment in endowment	xxxxxxxxx
Investment in plant	xxxxxxxxx
Other financing activities:	
Payments on long-term debt	(xxxxxxxx)

Net cash used by financing activities	(xxxxxxxx)
Net increase in cash and cash equivalents	xxxxxxxxx
Cash and cash equivalents at beginning of year	xxxxxxxxx
Cash and cash equivalent at end of year	xxxxxxxxx
Reconciliation of change in net assets to net cash provided by operating activities	
Change in net assets	xxxxxxxxx
Adjustments to reconcile change in net assets to net cash used by operating activities:	
Depreciation	xxxxxxxxx
Increase in accounts and interest receivable	(xxxxxxxx)
Decrease in contribution receivable	xxxxxxxxx
Decrease in accounts payable	xxxxxxxxx
Decrease in grants payable	(xxxxxxxx)
Contributions restricted for long-term investment	(xxxxxxxx)
Net cash provided by operating activities	(xxxxxxxx)
Supplemental data for non-cash investing and financing activities:	
Gift of equipment	xxxxxxxxx

8. CHART OF ACCOUNTS

The Chart of Accounts is designed to have a uniform classification and interpretation of financial transactions. It facilitates the recording and summarizing of transactions and the preparation of financial reports. The chart of accounts of every organization can be unique based on the nature of its operation, organizational structure, and flow of operations. However, the major account categories of a CSO are:

- Assets
  - Current Assets
  - Non-current Assets
  - Other Assets
- Liabilities
  - Current Liabilities
  - Non-current Liabilities
  - Other Liabilities
- Net Assets
  - Restricted
  - Unrestricted
- Revenues
  - Support
    - Grant and Donations
      - Unrestricted
      - Restricted
    - Membership Fees and Contributions
  - Income
    - Financial Income
    - Other Income
- Expenses
  - Program/Project expenses
  - Administrative Expenses
    - General expenses
    - Human resource development (includes Training Expenses)
  - Fund-raising expenses

8.1 Chart of Accounts

The accounts in the chart are grouped under the following code range.

Codes	Account title
1000-1999	Assets
2000-2999	Liabilities
3000-3999	Net Asset
4000-4999	Income
5000-5999	expenses

For the purpose of presenting an example, below is a sample chart of accounts.

Financial Statement titles	Account Number	Account title
ASSETS	1000-1999	
Current Assets		
Cash and cash equivalents	1000	Cash on Hand
	1010	Cash in Bank
	1011	Cash in xxxx Bank
	1020	Short term investments
Receivables	1100	Contributions Receivable
	1120	Accounts Receivable-rent, etc
	1126	Allowance for doubtful accounts
	1130	Grants receivables
	1140	Advances to officers & staff
	1150	Accounts Receivable-others
	1160	Accrued income
Prepayments and other current assets	1200	Prepaid insurance
	1210	Prepaid rent, etc
	1220	Inventory and supplies
Inventory and supplies	1300	
Non-current Assets		
Long term investments	1500	Long term investments-ABC bank
Property plant and equipment	1600	Land
	1615	Land improvements
	1616	Accumulated depreciation- Land improvements
	1620	Building

	1621	Accumulated depreciation-Building
	1630	Building improvements
	1631	Accumulated depreciation-Building improvements
	1640	Furniture
	1641	Accumulated depreciation-furniture
	1650	Office Equipment
	1651	Accumulated depreciation-office equipment
	1670	Vehicles
	1671	Accumulated depreciation-vehicles
LIABILITIES	2000-2999	
Current liabilities		
Payables	2000	Accounts payables
Payroll, payroll taxes and withholding	2100	Salary payable
	2120	Health contribution payable
	2130	TDS payable
	2140	Group insurance payable
	2150	PF payable
Accrued expenses	2200	Accrued fees
	2220	Accrued interest
	2230	Accrued rent
Other current liabilities	2300	Refundable advances
Non-current liabilities		
Long term loans payable	2500	Long term loans payable
Capital lease	2600	Capital lease
Mortgage payable		Mortgage payable
NET ASSET	3000-3999	
Net assets	3000	Restricted net assets
	3100	Unrestricted net assets
REVENUES	4000-4999	
Contributions	4000	Grants and donations
	4010	Membership fees and contributions
In-kind contribution	4100	In-kind contribution-goods
	4110	In-kind contribution-services
Financial Income	4200	Dividend income
	4210	Interest income
	4220	Income from bank deposits
Program service fees	4300	Program service fees

Other income	4400	Income from rental property
	4310	Miscellaneous income
EXPENSES	5000-5999	
Program and project expenses	5000	Project development and monitoring
	5010	Project development and appraisals
Project support expenses	5200	Technical Assistance
	5210	Development Communication
	5220	Research and Development
	5230	Project Audits
General and administrative expenses		
Payroll expenses	5300	Salaries and wages
	5310	Employer PF expense
	5320	TDS expense
	5330	Group insurance
	5340	Employee PF contribution
	5350	Health contribution
Operating expenses	5400	Professional fees
	5410	Light and power
	5420	Office rental
	5430	Telephone and internet
	5440	Office supplies
	5450	Water
	5460	Property insurance and registration
	5470	Repairs and maintenance
	5480	Fuel and oil
	5490	Depreciation expense
	5500	Doubtful accounts expense
	5510	Bank service charges
	5520	Legal fees
	5530	Transportation and travel
	5540	Newspaper and journal subscriptions
	5550	Interest expense
	5560	Printing
	5570	Miscellaneous
Human Resources development	5600	Human Resources development expenses
Fund raising expenses	5700	Fund raising expenses

8.2 Commonly used Account title by CSO

Below are descriptions of significant commonly-used CSO accounts which will serve as a guide and starting point in preparing more detailed charts of accounts of a specific CSO. As discussed earlier, a CSO should define its comprehensive chart of accounts.

ACCOUNT TITLE AND DESCRIPTION

A. ASSETS

1. ***Cash and Cash equivalents***

Cash comprises cash on hand, petty cash funds as well as local or foreign currency deposits in banks that are immediately available for use in the current operations.

1.1 Cash On Hand

This account represents un-deposited Cash and Cheque collections. It is good practice to deposit collections/amounts received intact the following day. The deposit of the Cash and Cheque collections could be done simultaneously with other banking transactions.

1.2 Petty Cash Fund

This account represents cash set aside for paying incidental expenses. The size of the fund should be sufficient for at least two weeks' requirements. The fund shall be initially set at a fixed amount and subsequently increased or decreased depending on the needs of organization.

This account is debited for the amount set up when the fund is established and for any subsequent increase in the size of the fund. A credit to this account is made when the amount of fund is decreased.

The maximum amount that can be paid out of the fund is set. Disbursements exceeding the set limit should be made through Cheques. Replenishments of the fund are made through Cheques and should be made weekly or as soon as the actual balance becomes low.

1.3 Cash in Bank

This account is credited for all collections/amounts deposited and other transactions credited by the bank. It is debited for all Cheque disbursements or withdrawals and debit memos from the bank. A separate bank account should be set up for each program as required by donors. At the end of each month, cash in bank balance per general ledger is reconsidered with the balance shown in the bank statements or savings account passbooks.

1.4 Cash equivalents

This account represents funds available for current operational requirements, which are temporarily invested with financing institutions on a short-term arrangement. These short-term highly liquid investments are readily convertible to cash with maturities of three months or less.

2. *Receivables*

Receivables are generally defined as claims held against others for future receipt of money, goods or services. Receivables arise when adopting the accrual method of accounting. This is significant to CSOs because the collection from these transactions provides funding for programs and services. There are two basic considerations in recognizing receivables of this nature: first, a receivable (and the related revenue) should be recognized when the CSO actually earns the revenue and the right to receive the money; second, that the receivables are ultimately collectible, i.e., enforceable on the part of the CSO.

Receivables are valued at the outstanding balance at which they are to be collected. The amount is reduced by an estimated allowance for doubtful accounts determined based on net realizable value of the receivables. Other receivables include cash advances for operating expenses, salary loans, and other advances to officers and staff. This category also includes advances to individuals or organizations that are not intended for the normal operations of the CSO. Because these receivables come from the operational fund of the CSO, intended for the delivery of programs and services, these are expected to be collected or can be an offset to other activity costs. No allowance for doubtful accounts is recognized for this type of receivables.

2.1 Advances to Officers and Employees

The Advances to Officers and Employees account represents cash and other forms of advances (like telephone bills etc.) to the officers and employees, subject to liquidation or payroll deductions.

2.2 Accounts Receivable-Others

This represents claims arising out of advances by the program to other programs for which it expects reimbursement.

2.3 Loans Receivable-Term Loan

These are loans made to borrowers beyond one year but not exceeding three (3) years, inclusive of the six (6) month grace period on principal payment. Payments (Principal and Interest) of these loans are amortized on a monthly, quarterly or semi-annual basis. Interest is computed based on the diminishing balance.

Loans Receivable- Bridge Financing

These are short-term loans made to borrowers for a maximum period of six (6) months with no grace period. Payment (Principal and Interest) is made on time, upon maturity.

2.4 Loans Receivable-Credit Line

These are loans made to borrowers for a maximum period of one (1) year during which period loan draw-downs are made. Draw-downs are revolving and can be paid depending on the borrowers' request or capacity to pay over a chosen term period, i.e., 30 days, 60 days, 90 days, etc., but which should not exceed the term of the credit line.

2.5 Allowance for Doubtful Accounts

To cover possible losses due to default in payment of loans, a portion of the outstanding balance shall be provided with allowance for doubtful accounts at year-end. The allowance provision shall be based on the age of the amount that remains unpaid. Allowance for doubtful accounts shall be provided in an amount equal to the total receivables reasonably estimated to be doubtful of collection. The amount of allowance should be based on past experiences and on continuing review of receivable aging reports and other relevant factors.

3. *Inventory*

Inventory comprises materials or supplies to be consumed in the process of rendering services. These may be manufactured or donated goods for distribution to beneficiaries. Inventories will be recognized as assets if the future economic benefits associated with the inventory will flow to the organization and the cost can be reliably measured. Inventories held for distribution are to be valued based on historical cost; while inventories held for production, should stated based on fair value.

4. *Prepaid expenses*

Prepaid Expenses account represents expenditures, often recurring, paid in advance for benefits yet to be received such as insurance, rent, interest and others. The account is debited for the portion of expenses paid in the current month but which applies to the succeeding months. Credit to this account is made for the portion of the expenses that has expired.

5. *Investments*

Investments are assets not directly identified with the operating activities of the CSO. Investments are expected to provide the revenues needed for operations over the long term. Investments may be classified either as temporary investments or long-term investments. Short-term investments imply that the investments may be converted to cash within a relatively short period and that they are funds available for current operations. Long-term investments are acquired in accordance with financial policies looking to the accumulation of funds.

Investments acquired with the intention of disposing the same after one year or less from the acquisition are to be classified as current investments. Investments classified as current, as distinguished from cash equivalents are those that are acquired with original maturities of more than three months but not exceeding one year.

Investments acquired with the intention of keeping the same for more than a year from the acquisition date are to be classified as long-term investments.

6. *Property and equipment*

Property and Equipment are tangible assets with an estimated useful life beyond one year, used in the conduct of the business and not intended for sale in the ordinary course of business. Assets of this nature include:

a. property not ordinarily subject to depreciation such as land used for office sites;

b. property subject to depreciation or amortization such as buildings, office and transportation equipment, furniture and fixtures, and improvement to leased facilities.

Each class of assets is debited for additional acquisitions made and credited for disposals, retirements or write-offs. Acquisition of property and equipment is recorded using the asset method.

Property and equipment may be acquired through purchase, construction, grant or donation. Property and equipment acquired from a restricted grant or donation will be recognized as an asset at its net book value, when ownership is passed on with a corresponding credit to Property and Equipment Fund. In case the ownership of the property remains with the donor until the fulfillment of certain requirements, a disclosure in the financial statements of these possessed but not owned assets should be made in the financial statements.

6.1. Accumulated depreciation

Depreciation is the cost of using up the future economic benefit or service potential of fixed assets. Except for non-exhaustible assets such as land and art collections, all fixed assets are depreciated on a rational and systematic basis over the life of the asset. Depreciation may be physical or functional. *Physical depreciation* is related to a depreciable asset's wear and tear and deterioration over a period. *Functional depreciat*ion arises from obsolescence or inadequacy of the asset to perform efficiently.

All property and equipment, except land, are subject to a depreciation allowance. The method and rate of depreciation to be used should be applied consistently from year to year. Depreciation allowance is credited to the related accumulated depreciation of the capital assets. This account is debited for amounts previously provided for on assets sold, disposed, retired or written-off.

B. LIABILITES

Current liability is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classified as current assets or the creation of another current liability.

Long-term liability represents the portion of any long-term obligation maturing or scheduled to mature after an uninterrupted period extending beyond one year from the date of the statement of financial position.

1. Accounts Payable-Trade

The Accounts Payable-Trade account represents the total of unpaid bills due to suppliers and others at the end of each month for support, services and/or materials received but not yet paid for.

This account is credited for purchases of materials, supplies and equipment on credit, or for services received which remain unpaid at the end of each month and debited for payments made and discounts granted by suppliers.

2. *Accounts Payable-Employees*

Employees' Payables account includes unpaid salaries and bonuses, vacation leave credits incurred during the year.

3. *Accrued Expenses*

The Accrued Expenses account represents estimated amounts due for services and/or supplies/ materials already received but which remain unpaid for at the end of the month or at year end, such as salaries and wages, rent and interest, which are credited to this account. Subsequent payments or reversal of previous liability set up in the preceding month are debited to this account.

4. *Advances from Officers/Employees*

The Advances from Officers account represents cash or other forms of advances made by the officers/employees. This account is credited for the amount advanced by the officers/employees and debited for any payment made to them.

5. *Other Current Liabilities*

Other payables include other liabilities incurred which amount are readily determined from available documents, i.e., billings, amounts withheld from employees, or other parties for taxes and for contributions to pension funds. It also includes other liabilities that cannot be properly classified under other specific current liabilities account groupings in the chart of accounts.

6. *Deferred Revenue/Support*

This account is credited when cash is received prior to either having earned the revenue or the right to keep the revenue. It is debited when earned and the corresponding credit to revenue or support is made.

7. *Funds Held in Trust*

This refers to funds held in trust for various project proponents provided by donors in which the CSO is only the custodian of the funds, and has no control over its use. Funds-held-in-trust occurs when an entity-the donor- deposits an amount, that is intended for a specified beneficiary, to the recipient CSO's bank account. The CSO is not the Don ee and therefore, this account should be treated as a liability.

However, if the donor explicitly grants the recipient organization variance power or if the recipient organization and the specified beneficiary are financially interrelated organizations, the recipient organization should recognize the amount as a contribution received. CSOs are financially interrelated if (a) one organization has the ability to influence the operating and financial decisions of the other and (b) one organization has an ongoing economic interest in the Net Asset of the other.

C. NET ASSETS

1. *Unrestricted Funds or General Funds*

This is used to record activities that are supported by resources over which the CSO has discretionary control and the principal sources of which are donations from donors, membership dues, and unrestricted investment/interest, income. Its use is not restricted even though their use may be limited in other respects, such as by contract or by board designation. Any excess of revenues over expenditures forms part of the Unrestricted Net Asset.

2. *Restricted Funds*

This is used to record the Foundation's activities which are supported by resources whose use is limited to specific operations by donors. The principal sources of restricted funds are contributions from donors, contracts, grants, endowment income and other sources where resource providers stipulate the specific operating purposes for which the resources have to be used. Its economic benefits neither expire with the passage of time nor can be removed by the organization.

Restricted Funds may be Temporarily Restricted Funds or Permanently Restricted Funds. The former is limited by either a donor-imposed time period or purpose restrictions while the latter has to be maintained in perpetuity or permanently as instructed by the donor as in the case of an endowment fund.

D. REVENUES

Revenues represent actual or expected cash inflows (or the equivalent) that have occurred or will materialize as a result of the entity's ongoing central or major operations during the period

Each source of revenue generally refers to an inflow that is distinct from all others.

1. Grants

This refers to funds (or equivalent) given by donors for a specific program/project with certain conditions relating to the operating activities of the CSO.

Grants, including non-monetary grants, valued at fair value, should not be recognized until there is reasonable assurance that:

a. the CSO will comply with the conditions attaching to them; and

b. the grants will be received.

Mere receipt of the grant is not conclusive evidence that the conditions attached to the grant have been or will be fulfilled.

Grants should be recognized as revenue or support over the periods necessary to match them with the related costs or expenses incurred for the purpose for which they are intended.

2 Donations

This refers to unrestricted contributions in cash or in kind or services from donors to be used in accomplishing the purposes for which the CSO has been created or organized and over which the Board has discretionary control.

3 Non-Cash Donations/Contributions

Contributed services should be recognized in the financial statements if the services received meet these criteria:

- Create or enhance the value of an activity
- Required specialized skills are provided by individuals or organizations possessing those skills and would typically be purchased if not provided by way of donation.

Non-cash assets received by CSOs should be recorded as contributions at their fair market value, at the time the service or asset is received, in the same way that cash contributions are recorded.

4 Other Income

This account represents income earned from sources other than from operations. Examples include interest from savings accounts and other money market placements or investments, gain on sale of fixed assets and foreign exchange gain or losses and other miscellaneous items.

E. EXPENSES

1. Functional reporting, as its name implies, describes the activity for which the CSO incurs an expense. Expenses may be classified per function, as follows:

a. Program/Project Expense

b. Administrative Expenses, further classified as:

i. General expenses

ii. Human resource development

iii. Fund raising expenses

Program/Project Expenses

This refers to all program implementation costs or those expenses relating to program/project service activities that result in services (or goods) being given to beneficiaries or members that fulfill the basic mission of the CSO. There can be more than one category of program services.

Program/Project Support Activities Expenses

This pertains to expenses incurred for activities necessary to support or assist program implementation which include capability building, information management, policy advocacy, networking of project proponents, partnership building, investment promotion, project development, assessment, approval, monitoring, and evaluation; and provision of technical assistance for CSO's, among others.

Administrative Expenses

General expenses relate to activities such as oversight management, general recordkeeping, office maintenance, and similar expenses.

Human resource development pertains to expenses incurred for the purpose of developing and consolidating the CSOs' board of trustees, management, and staff such as those expenses incurred for staff training and development.

Fund raising Expenses

These are expenses incurred in encouraging donors to support the CSO.

2. Natural classification of expenses, as distinguished from functional classification, indicates the type of expenses incurred by a CSO, such as salaries, rent, electricity, depreciation. While functional classification reflects the activity (function) for which the CSO incurred the expenses, natural classification indicates the type (nature) of the expense that is incurred.

Expenses should be recorded and reported using the functional and natural classification of expense where the latter becomes a sub-category of the former.

F. GAINS OR LOSSES

Revenues of CSOs increase their Net Assets, expenses decrease Net Assets. All other transactions that increase or decrease the net assets of a CSO are referred to as gains or losses, respectively. Gains and losses are auxiliary to the CSO's revenues and expenses. In presenting gains and losses, the Net Basis should be used, i.e., only the net gain or loss arising from a single set of transactions is presented.

G. JOINT COSTS

These are expenses incurred by a CSO for activities involving two or more different programs and support services. Cost allocation is proper if the purpose, audience and content criteria are met that indicate that the joint activity included two or more programs or support services. Allocation of costs may use any of the following methods but should be applied consistently for the same type of transaction:

- Physical units method, which allocates costs based on the physical materials that make up the joint cost.
- Relative direct method, which allocates joint costs in relation to the direct costs of each of the activities.
- Stand alone cost method, which allocates joint costs to each component of the joint activity on a ratio that estimates the costs that would have been incurred had each activity been performed separately.

PART III

SPECIFIC ACCOUNTS

9. CASH AND EQUIVALENTS

9.1 Description

Cash and cash equivalents are defined as cash on hand, deposits in banks and short-term highly liquid instruments readily convertible to known amounts of cash and which are subject to insignificant risks of changes in value. Cash equivalents are temporary investments, usually in the form of time deposits in banks and other financial institutions with original maturity of three months or less from date of acquisition, which CSOs places very temporarily, while awaiting proper disbursement to fund approved projects.

Cash on hand accounts consist of currency, coins or negotiable instruments such as bank Cheques or postal money orders, in the custody of the cashier or accountants. This may consist of receipts of donations or collection of receivables or advances, in the form of cash or Cheque, received awaiting deposit. This account should be treated as temporary account and should be zeroed-out regularly when the cash on hand items are deposited. Because of the vulnerability of cash to theft or misappropriation, the CSO should adopt a policy to minimize cash on hand and to deposit receipts or collections regularly or upon reaching a pre-defined amount. Such policies can be reflected in CSO's Administrative and Finance Manual which is mandatory for registration[12].

Cash in bank accounts consist of deposits, either in savings or checking accounts, in banks which have been identified by the Board of Trustees (Directors) as the CSO's depository banks. Grants and donations or funds from various funders or donors, or collections of receivables or advances should be deposited in specific bank accounts for easier identification and monitoring. The CSO should also identify a bank account from which disbursements can be withdrawn by Cheque, and replenishment done through transfers from depository banks. Restricted funds should also be segregated from unrestricted funds.

9.2 Cash Transaction Cycle

a. Receipt of cash or Cheque from donors, funding agencies or collections of receivables or advances

b. Deposit to bank accounts

c. Disbursement for expenses or release of funds to agencies or beneficiaries for approved projects

d. Liquidation by agencies or by beneficiaries and receipt of excess funding

[12] Civil Society Organizations Act of Bhutan 2007 & Civil Society Organizations Rules and Regulations 2010.

Sample entries for different types of cash receipts and disbursements and other cash transactions:

1. Receipt of grants Cash in bank Grant from ABC *To record first remittance from ABC.*	 xxx	 xxx
2. Collection of donations Cash on hand/Bank Donations *To record collection of donations.*	 xxx	 xxx
3. Collection of receivables Cash on hand/Bank Receivables *To record collections of receivables.*	 xxx	 xxx
4. Collection of excess from operational advances up on liquidation Cash on hand/Bank Expenses (all expenses) Advances for liquidation *To record receipt of excess cash up liquidation of advances.*	 xxx xx	 xxxxx
5. Receipt of excess funds from training project Cash on hand/Bank Training expenses Training Fund (Advance) *To record receipt of excess funds from training projects.*	 xxx xx	 xxxxx
6. Deposit of cash on hand for collections (bank deposit of the cash) Cash in Bank Cash on Hand *To close cash on hand by depositing in the Bank.*	 xxx	 xxx
7. Transfer of funds from savings to current account Cash in Bank (Current Account) Cash in Bank (Saving Account) *To record transfer of funds from savings to current account.*	 xxx	 xxx
8. Recording of interest income Cash in Bank Interest income *To record interest income for the month based in the bank reconciliation made.*	 xxx	 xxx
9. Recognition of foreign exchange gain or loss Cash in Bank Foreign exchange gain.	 xxx	 xxx

Note:

1. *Cash Disbursements*

   Disbursements made by a CSO should be made in accordance with a budget or annual workplan. In addition, they should undergo a process involving the preparation of a voucher, properly supported by invoices, contracts and other documents, and approved for payment by authorized officers. The voucher should also indicate the accounts to be charged as specified in the budget or workplan. A Cheque is then prepared and approved and signed by officers or signatories authorized in a resolution by the Board of Trustees (Directors).

2. *Bank Reconciliation*

   Maintaining bank accounts entails monthly reconciliation of the CSO's book balance with the bank balance as reflected in the bank statement (passbook). The bank sends monthly bank statements together with the paid Cheques. To reconcile, deposits and fund transfers and withdrawals in the bank statements should be compared with the deposit and withdrawal slips, debit and credit memos from the bank and entries in the Cash Book (receipts and cash disbursements). Open items should be summarized in a bank reconciliation statement, and followed up in the following month. Long outstanding items should be the subject of further scrutiny.

9.3 Petty Cash Fund/Revolving Fund

Small disbursements not paid by Cheques are paid using petty cash funds or revolving funds. The CSO should determine what day-to-day, small expenses are incurred, the amounts and frequency of incurrence to form a basis for establishing the so-called petty cash or revolving fund. The purpose is to enable the CSO to meet these operational expenses without going through the rigors of Cheque preparation. The fund should be just enough, not too small that replenishment has to happen very often, but not too big that it allows such fund to lie idle for long enough to invite unauthorized borrowings by the custodian or anyone close to him.

Expenses should be authorized by the as reflected in the delegations of financial powers within the CSO and should be presented with the supporting documents in amounts not to exceed a certain pre-defined level. The fund to be established shall remain fixed in the books. It shall be replenished upon reaching a minimum level with the presentation of a summary of expenses submitted to the custodian for payment together with the supporting documents. The total amount of the expenses and the cash left with the custodian should always equal the amount of the petty cash/ revolving fund. Details of the expenses shall be recorded and the supporting documents shall be properly stamped "PAID" to prevent double payment.

1. Upon establishment of the fund (on withdrawal of the cash):

Petty cash fund (cash on hand)	xxxx	
Cash in Bank		xxxx

(*To record establishment of petty cash fund)*

10. RECEIVABLES

10.1 Description

A receivable is recognized first, when the CSO actually earns the revenue, the grant or donation, and the right to receive the money; and second, when the receivables are ultimately collectible or enforceable on the part of the CSO. The recognition of a receivable is recorded in the General Journal and in the receivable subsidiary ledgers, while collection is recorded in the Cash Book.

Receivables are stated at the net realizable value, or the amount certain of collection. Management should continually assess collectability and determine possible losses from non-collection of unpaid receivable.

10.2 Contributions Receivables

A CSO recognizes the certainty of a grant or donation based on the commitment of the donor and the fulfillment by the CSO of the conditions set by the donor and sets up a receivable. Receivable is collected either totally or partially. The CSO continually assesses the collectability of the unpaid receivable, and determines whether it should set up a provision for doubtful accounts or not.

Practical Illustration:

On April 15, 2013, ABC Foundation (BF) committed through a ***contract***, to donate to XYZ Foundation Nu.50,000 to be credited to XYZ Foundation's bank account with Druk PNB at the end of the month.

April 15	Contribution receivable	50,000	
	Grant		50,000

To record receivable from ABC Foundation.

On April 30, XYZ Foundation checked its balances with Druk PNB and found out that Nu. 45,000 was credited to its savings account

March 31	Cash in Bank	45,000	
	Contributions receivable		45,000

To record collection of receivable from ABC Foundation.

XYZ Foundation received no further notice from ACB Foundation that it would fulfill its commitment. On June 30, 2013, the Board of Directors of XYZ Foundation decided to recognize the probability that it may no longer collect the balance of Nu.5,000 and advised management to set up an allowance for that amount.

June 30	Provision for doubtful accounts	5,000	
	Allowance for doubtful accounts		5,000

To set up an allowance for doubtful accounts

10.3 Accounts Receivables

Accounts receivable are funds that individuals or other organizations owe the CSO due to services provided or goods sold. For example, a CSO may provide services to a local community for a minimal fee. Once the services are provided, the CSO has a receivable from the local community until it is paid for those services. Also, a CSO may bill its members for services that have been provided and are due to the members but have not yet been paid.

Pro-forma Entries:

Date	Accounts receivable.	xxxxx	
	_________ income (or fees)		xxxxx
	To record billing of _______ services rendered to community for the month………		
Date	Cash	xxxxx	
	Accounts receivable – C.B.A.		xxxxx

To record collection of AR from community per billing statement number __

10.4 Advances and Other Receivables

Other receivables consist of cash advances for operating expenses, salary advance and other advances to officers and staff. This category also includes advances to individuals or organizations that are not intended in the normal operations of the CSO. As these receivables come from the CSO's operational fund, intended for the delivery of programs and services, these receivables should be collected or may be offset against other activity costs' fund approved projects.

Cash Advances

Officers attending to assigned projects may be given specific amounts of cash advances which they can spend for the duration of their visit to these projects. These advances are computed based on the CSO's administrative and financial policies (manual). Upon their return to the office, they should liquidate their advances by presenting a summary of their actual expenses together with the excess money, or a computation of the amount the CSO still owes them. This is not a problem though when advances equal the actual expenses.

Practical Illustration:

XYZ Foundationsis based in Thimphu. On May 1, 2013, Mr. Tashi, a project officer of XYZ Foundation obtained a cash advance for his out-of-town meeting with Community beneficiaries to be held in Trashigang. A Druk PNB Cheque amounting to Nu.10,000 was issued to him.

May1	Advances to officers and employees	10,000	
	Cash in bank		10,000

To record advances to Mr. Tashi for his trip to Tashigang.

Assumption A. Actual Expenses < Cash Advance Amount

On May 15, 2013 Mr. Tashi came home from his assignment and prepared a liquidation of his expenses, as follows:

Transportation	Nu.2,000
Meal allowance	675
Hotel accommodation	4,500
Laundry	500
Total expenses	7,675
Cash advance	10,000
Advances still due	Nu. 2,325

Assuming that Mr. Tashi pays in cash and XYZ Foundation deposits it to Druk PNB, the entry would be:

May 15	Cash in bank	2,325	
	Transportation expense	2,000	
	Meal allowance	675	
	Hotel accommodation	4,500	
	Laundry	500	
	Advances to officers and employees	10,000	

To record expenses incurred by Mr. Tashi and receipt of excess cash upon liquidation.

Assumption B. Actual Expenses < Cash Advance Amount

In case Mr. Tashi spent more than his cash advance and prepared instead the following liquidation summary:

Transportation	Nu. 3,000
Meal allowance	1,450
Hotel accommodation	6,000
Laundry	800
Total expenses	11,250

Cash advance	10,000
Refundable amount	Nu. 1,250

The entry would instead be as follows:

May 15	Transportation expense	3,000	
	Meal allowance	1,450	
	Hotel accommodation	6,000	
	Laundry	800	
	Advances to officers and employees		10,000
	Accounts payable – Mr. Tashi		1,250

To record expenses incurred by Mr. Tashi and amount payable to him for his trip to Tashigang.

Salary Advance

Another form that receivables may take is salary advance given by CSOs to its officers and employees. This is to be done with the blessing of the Board of Trustees (Directors) and is governed by policies that are uniformly applicable to all.

Practical Illustration:

On April 15, 2013, Mr. Karma obtained a salary advance amounting to Nu.10,000 to be adjusted with month end's salary. In this case, there are two relevant entries – first when advance is availed; and second entry for adjustment at the time of salary payment - needed for proper recording.

The first entry would be:

April 15	Salary Advance – Mr. Karma	Nu. 10,000	
	Cash in Bank		Nu. 10,000
	To record salary advance against Mr. Karma		

The second entry (end of the month adjustment) would be:

April 30	Salary Expenses	Nu. 30,000	
	Employee PF payable		Nu. 1,200
	TDS payable		Nu. 1,500
	HC payable		Nu. 300
	Salary advance		Nu. 10,000
	Cash in Bank Nu.		Nu. 17,000
	To adjust advance salary at the time of paying salary		

11. **INVENTORIES**

11.1 Description

Inventories are assets that are held for sale in the ordinary course of business; in the process of production for such sale; or in the form of materials or supplies to be to be consumed in the production process or in rendering services[13]. Normally, the CSOs' inventory comprised material or supplies to be consumed in the process of rendering services. Some CSOs may manufacture goods for the purpose of distributing these to the beneficiaries or as means of maintaining financial sustainability.

The inventories are to be valued at a lower cost or net realizable value[14]. Based on the framework, all the resources should be recognized as assets if they meet the definition of assets and the recognition criteria. However, there are two specific situations where a CSO holds an inventory: if a CSO has inventories held for distribution and if inventories are held for production.

11.2 Inventories Held for Distribution

In many instances, CSOs purchase goods or receive donated goods that are intended for distribution to beneficiaries. However, at balance sheet date, some of the items may still be in the possession of the CSO because, for one reason or another, these may have to be released after the balance sheet date. The remaining inventory should be valued based on historical cost.

Illustrative Entries:

On July 10, 2013, ABC Foundation purchased clothes and canned goods to be given to the victims of floods and landslide amounting to Nu. 100,000.

July 10	Relief goods	100,000	
	Cash in bank		100,000

To record purchase of clothes and canned goods for victims of floods and landslides

On July 11, 2013, ABC Foundation launched campaigns for people to support its relief operations. Immediately, it received 200,000 worth of various donated goods from several donors.

July 11	Relief goods	200,000	
	Donations received		200,000

To record of various goods received for victims of floods and landslides.

From July 12 to 31, 2013, ABC Foundation distributed the relief goods to the intended beneficiaries amounting to 250,000. The remainder, 50,000 worth of goods which are still with Foundation will be distributed in the following month/s in other areas.

July 31	Relief operations expenses - Goods	250,000	
	Relief goods		250,000

To record distributed goods to victims of floods and landslides.

[13] IAS= International Accounting Standards

[14] IAS= International Accounting Standards

NOTE: The balance of relief goods inventory should be stated at 50,000 (100,000 plus 200,000 less 250,000)

11.3 Inventories Held for Production

In some instances, instead of purchasing goods for its beneficiaries, CSOs engage in the process of production. For example, a CSO may produce organic fertilizers to be distributed to farmers practicing sustainable agriculture concepts. In this case, the practice of production accounting should be followed in as far as costing is concerned. Purchases of raw materials, recognition of labor, and application of overhead costs should be similar to that of production accounting. At balance sheet, however, the remaining raw materials, work-in-process, and finished goods have to be valued in the balance sheet or statement of financial position. Inventories held for production should be stated based on fair value.

12. INVESTMENTS

Accounting of investments in CSOs is similar to that of other types of organizations. In many CSOs, investments form a significant part of their assets, especially those arising from endowments, in which the CSO invests funds in perpetuity. The income from the investments is then used by the CSO for its operations. Sometimes, the Board designates certain funds to be set aside as long-term investments which may be used to assist the CSO in collecting funds for use in major projects. However, some investments of CSOs are so liquid and have such maturities that they are classified as cash equivalents rather than investments.

Basically, there are two things to consider in accounting for investments: valuation and the recognition of investment income/gain (or loss).

Initial Recognition

Upon placement of the investment, the asset is recorded at the face amount of the investment instrument which is acquired in exchange of another asset, usually cash.

Entry:

Investment in ______	Nu. 100,000	
Cash		Nu. 100,000

To record investment in _______ .

Period-End

Investments (stocks, bonds, etc.) are reported in the statement of financial position at their fair value. Supposing that the fair value of the above investment on December 31, is Nu. 110,000, the entry on December 31, should be:

Investment in _______	Nu.110,000	
Unrealized gain(loss) from investment		Nu.110,000

To record unrealized gain from investment based on its fair value on December 31.

Assuming that there may be a decrease in fair value in the succeeding period, such that the investment is valued at Nu.105,000 only on December 31, the unrealized loss from investment should be recognized.

Unrealized gain(loss) from investment	5,000	
Investment in _______		5,000

To record unrealized loss from investment based on its fair value on December 31.

The unrealized gain (loss) should be presented at the net amount for the entire period. In the above example, the unrealized gain is 5,000 (10,000 less 5,000)

Income

Periodically, income from investments is recorded in the books of the CSO based on the declaration by the issuer of the investment instrument, e.g. dividend income of Nu. 2000 can be recorded as below:

Cash (or other form of asset as the case may be)	2,000	
Income from investment		2,000

To record ____________ income from investment in _____

Note: The overall income and gain (net of losses) should be credited to the intended project fund or operations as defined by either the specific donor or the governing board.

13. PROPERTY & EQUIPMENT AND DEPRECIATION

13.1 Description

Property, plant and equipment (PPE) are tangible assets that are expected to be used during more than one period and that are held for use in the operations of the organization[15]. PPE are recognized when it is probable that the future economic benefits associated with the asset will flow to the organization and its cost can be reliably measured. The asset is initially measured at cost and subsequently can be measured at cost or on revaluation basis.

In the business sector, the asset method is prescribed because of the principles of fair presentation of balance sheet and "matching principle", i.e., only the depreciated portion of the property and equipment is recognized as an expense because only this is portion was consumed in generating income during the accounting period. This is basically the reason why all available accounting standards prescribe the asset method.

13.2 Acquisition of PPE by CSOs

CSOs receive grants intended for specific purpose/s. In many cases, the grant is intended for the purchase of property or equipment. The donor will require the accounting of its grant against its intended use. To properly monitor the specific grant activities, the acquisition will be deducted against the said grant, thereby presenting the actual grant balance at the end of the period. The matching of grant against its intention is achieved here. However, for a fair presentation of the financial position of the CSO, the property and equipment should be reflected in the balance sheet.

These two accounting objectives should be met – matching of source against its intention and fair presentation of balance sheet. Sometimes, only one of these is reflected in the financial statements.

Acquisitions from Unrestricted Funds (General or common Fund)

The asset method is proposed as this is the prescribed method in the current pronouncements.
Entry up on acquisition:

Property and equipment	50,000	
Cash		50,000
To record acquisition of……………….. equipment		

Provision on depreciation:

Depreciation expenses	10,000	
Accumulated depreciation		10,000
To record depreciation for the period		

[15] Bhutanese Accounting Standard 2012

Upon Retirement, Sale or Disposal

Assuming that after 80% of its cost is fully-depreciated or its net book value is only 10,000, the equipment was sold at 12,000. The entry to close the equipment accounts and to recognize the sale is:

Cash	12,000	
Accumulated depreciation	40,000	
Property & equipment		50,000
Gain from sale of equipment		2,000

To record the sale of _________ equipment.

If, on the other hand, the selling price is lower than the net book value, say 9,000, the loss from sale (1,000) should be debited.

In some instances, the old equipment is donated to another CSO or to beneficiaries.

Donation	10,000	
Accumulated depreciation	40,000	
Property & equipment		50,000

To record donation of _________ equipment to ___________.

Acquisitions from Restricted Funds (Specific Project Fund)

When property and equipment are acquired from restricted grant funds, it is proposed to treat property and equipment as follows:

> To meet the requirements of fair presentation of balance sheet and proper matching of sources against its intentions, the accounting entries and presentation should provide for both. Corollary entries are made to record the acquisition as deduction from grant and recognizing the property as asset and crediting to Property and Equipment Fund (a net asset account). Depreciation will then be charged against the Property and Equipment Fund.

It is worthwhile to note that the above treatment of property and equipment requires a separate budget for capital outlay is formulated and approved.

Example: Purchase of a computer set charged against ABC grant:

a. **Acquisition**

In ABC Operational Fund

	Dr.	Cr.
Office Equipment Acquisition or		
Capital Outlay or Fund Transfer to		
Property & Equipment Fund	5,000.00	
Cash		5,000.00

In Property & Equipment Fund

Office Equipment (as Asset)	5,000.00	
Property and Equipment Fund		5,000.00

Note: The above two sets of entries should be made at the same time for every property acquisition.

<u>Presentation in the Statement of Changes in Net Asset</u>

	Restr. Fund ABC	Property & Equipt Fund	TOTAL
Office Equipment Acquisition or Capital Outlay or Fund Transfer to Property & Equipment Fund	(5,000)	5,000	-

b. Depreciation

This is an expense of the Property & Equipment Fund; it is not an expense of the grant fund (ABC) because the total amount of the acquisition has been deducted from the ABC fund already.

	Dr	Cr
Depreciation Expense	1,000.00	
Accumulated Depreciation		1,000.00
To record depreciation for the period		

<u>Presentation in the Statement of Activities</u>	Property & Equipt Fund
EXPENSES:	
Depreciation Expense	1,000.00

Presentation in the Statement of Financial Position	Property & Equipt Fund
ASSETS	
Office Equipment	5,000.00
Less: Accumulated Depreciation	1,000.00
Net Book Value	4,000.00
NET ASSETS	
Net Asset	4,000.00

c. Disposition of Property

This is recorded and presented following the reciprocal of the above entries, i.e., to close the cost of the property, related accumulated depreciation, and the net book value under the Property and Equipment Fund. Proceeds or cash value, if any, is recognized as Other Income in the Operational Fund (not in the Property and Equipment Fund).

13.3 Ownership

Another issue here is the question of transfer of ownership from the donor to the CSO. In some instances, transfer of ownership from the donor to the CSO is deferred until the end of the project term or is dependent on meeting the agreement within the project period.

Property and equipment should be recognized at the time of ownership. The value of the property can be based on historical cost less depreciation or re-valued at the time of transfer of ownership. In the case of a property acquired from restricted grant/donation and ownership of the property remains with the grantor/donor until the fulfillment of certain requirements, then there should be a disclosure in the financial statements that there are these assets that are in the possession of the CSO but not yet in its name.

13.4 Valuation of Received Donated Properties

Many CSOs receive donated property and equipment[16]; however, the historical record of the property may not be readily available, so donated properties are usually valued at fair value at the time of donation or transfer of ownership.

13.5 Depreciation Method

There are various methods of depreciation. Every method has its own justification. Generally for CSOs, the straight-line method is used over the estimated useful life of the property as most properties are identified with its usage over a specific period. An option is to use the written-down value or impaired value method. However, as based on the existing legal framework[17] and polices of the nation, it is recommended that CSOs adopt straight-line method of depreciation.

[16] CSOs Consultative interview reports

[17] Income Tax Act of Bhutan 2001

14. LIABILITIES

14.1 Description

A liability is a present obligation of the CSO arising from past transactions or events, the settlement of which is expected to result in an outflow of resources from the organization embodying economic benefits or service potential. Liabilities may include: amounts payable to suppliers for the purchase of goods or services; accounts withheld from employees or other parties for taxes and for contributions to as employer contribution; accruals of expenses; deposit and advances from suppliers, officers; debt obligations for borrowed funds.

Recognition and treatment of the above-mentioned forms of liabilities in a CSO is very similar to that of the business organizations. However, a very specific type of liability in a CSO arises from the recognition of a grant received, or portion thereof, that is intended for future period/s. Other specific types of liability are “funds-held-in-trust”.

14.2 Deferred Grant

Deferred grants represent support received that is applicable to succeeding years. The funds are to be used only for the specific projects and in compliance with the terms and conditions of the support. Under this category, unused funds at the end of the project are returned to the donors.

Since this is related directly to the accounting of grant received, discussions and examples are “deferred” and presented under section 17.1 – Grants and Donations.

14.3 Accounts Payable

Accounts payable represent amounts that are owed by the CSO to individuals or other organizations because of services provided or goods purchased from these entities.

For example, a supplier delivered office supplies and equipment to the CSO accompanied by a billing statement with specific terms of payment and delivery receipt. After the CSO accepted the goods, the CSO prepares these entries:

Date	Office supplies	10,000	
	Office equipment	50,000	
	Accounts payable		60,000
	(To record purchase of office supplies and equipment)		
Date	Accounts payable	60,000	

TDS payable (2% TDS)[18]		1,200	
	Cash/Bank		58,800
	(To record payment of accounts payable)		
Date	TDS payable (2%TDS)	1,200	
	Cash/Bank		1,200
	(To record to remittance of tax deducted at source (TDS) to RRCO[19])		

[18] For supplies and others, Income Tax Act of Kingdom of Bhutan 2001 requires deduction of 2% tax at the source.

[19] RRCO = Regional Revenue and Customs Office (An office responsible for collection of Tax under the Department of Revenue and Customs, Ministry of Finance).

14.4 Other Liabilities

Other liabilities such as collections of employee contributions to Group insurance, Health contribution, and taxes from employee compensation which are later on remitted to the respective agencies are treated as liabilities upon collection or deduction from the payroll. These are subsequently closed upon paying or remitting the amounts.

In CSOs, amounts refundable to employees arising from the liquidation of cash advances, i.e., actual expense is greater than the original cash advance amount, also fall under this category. These liabilities are credited upon incurrence and debited when paid. Sample entries related to this type have been presented in section 10.4.

14.5 Long-term Liabilities

Long-term liabilities are obligations of the CSOs to be paid over several years or at least after more than one year. CSOs usually incur these when there are cash flow problems such as delayed remittance from donors. Long-term liabilities may also be incurred when the CSO is engaged in a long-term project, such as construction of a building, in which cash inflows from sources or donors are expected to be received over several years. The CSO borrows funds to finance the construction and repay these from the expected cash inflows.

Pro-forma Entries

Upon Incurrence

Cash (or other form of asset received)	500,000	
Long –term loans payable		500,000

(To record loan received ……………………….)

Reclassifying the short-term portion of the loan at end of period.

Long-term loans payable	100,000	
Loans payable-current		100,000

(To recognize the current portion of loans payable to…………)

Interest expense related to the loans should also be recognized at period end

Interest expense	10,000	
Interest payable		10,000

(To recognize the interest expense on the loans for the period……………….)

Payment of maturing portion of the principal and the interest

Payment payable-current	100,000	
Interest payable	10,000	
Cash		110,000

(To record partial payment of loans and payment of interest payable)

15. FUNDS HELD IN TRUST

These are advances made to an organization for custody which would later be used for a specific purpose not necessarily administered by the organization and it is called Funds-Held-in-Trust.

These are resources received in transactions in which a CSO is acting as an agent, trustee, or intermediary for a resource provider. Fund held in trust, when received should be reported as increases in assets and liabilities and distributions to third party recipients should be reported as decreases in these accounts. Amounts held under agency transactions should be included as liabilities in the Statement of Financial Position. Cash received and paid in such a transaction should be reported as cash flows from operating activities in a Statement of Cash Flows[20]. Transactions that fall under this type should be properly disclosed.

16. PROVISIONS AND CONTINGENCIES

Provisions are recognized as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations.

Contingent Liabilities are not recognized as liabilities because they are either:

a. A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the organization.

b. A present obligation that arises from past events but not recognized because it is not probable that an outflow of resources will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability.

The basic principles and requirements stated in BAS 37[21] should be adopted. Basically, provisions are recognized as a liability if a reliable estimate can be made; contingent liabilities are not recognized as liability, however, disclosures about the contingent liabilities are required.

[20] AICPA (American Institute of Certified Public Accountants) Audit and Accounting Guide

[21] Bhutanese Accounting Standards

17. CONTRIBUTIONS AND INCOME

17.1 Grants and Donations

There is no provision in the IAS for Grants Received by CSOs. Contributions are defined as transactions in which one entity makes an unconditional voluntary transfer to another entity without directly receiving equal value in exchange[22]. The transfer may involve cash or any other asset such as securities, land, buildings, use of facilities or utilities, material and supplies, intangible assets, services, and unconditional promises to give those items in the future.

In determining whether a transaction is a contribution or not, the guide provides that the organization needs to assess the extent of discretion it has over the asset received and whether it has given up assets, rights, or privileges approximately equal to the assets, rights, or privileges received. If it has little or no discretion, the transaction is a funds held in trust (discussed separately in section 15). If it has discretion over the asset's use, the transaction is a contribution, an exchange or a combination of the two.

Accounting for donations and grants is one of the major and specific issues for CSOs.

Unrestricted Grants and Donations

Unrestricted grants and donations should be treated as Revenue of the CSO. Project grants are treated as revenues for the period and presented as such in the statement of activities. Project expenses are deducted from the grant resulting in excess or deficit which will then be added or deducted from the Net Asset. However, unless otherwise stipulated in the agreement with the grantor, grant and the resulting net asset should be treated as Restricted Fund. Many CSOs treat grants as revenue because these are the principal sources of resources for its operations.

Illustration:

On July 1, 2015 ABC Foundation received a grant from XYZ Foundation for Nu. 1,000,000.

Journal Entries to record the above transactions in the books of ……………..:

	Debit	Credit
Cash in Bank	1,000,000.00	
Grant – ……..		1,000,000.00

ABC Foundation
Statement of Activities
For the year ended December 31, 200X

RevenuesNu. 1,000,000

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22 AICPA (American Institute of Certified Public Accountants) Audit and Accounting Guide

Restricted Grants and Donations

Many grants and donations have a stipulation that unspent portion shall be returned, or effectively returned, to the grantor/donor thereby creating a possibility of resource outflow. In this case, grants and donations are recognized as a liability - Deferred Grant - upon receipt. Periodically, a portion of the Deferred Grant is recognized as revenue based on the expenses incurred for the period. This method follows the proposition that the CSO earns its revenue based on its activities or performance, as expressed in its expenses. The revenue is always equal to expenses; unspent portion of the grant remains as a liability.

Illustration

On July 1, 2015, ABC Foundation received a grant from XYZ Foundation in the amount of Nu. 2,000,000.00. Based on their Grant Agreement, an amount of Nu. 1,100,000.00 shall be spent for January 2016 for Monitoring and Evaluation (M&E) Activities.

a. *To record the receipt of the grant on July 1, 2015*

	Debit	Credit
Cash in Bank	2,000,000.00	
Grant		900,000.00
Deferred Grant		1,100,000.00

Note: The Grant of Nu. 900,000.00 will be shown in the Statement of Activities for the calendar year ended December 31, 2015 under the caption REVENUE; the unspent portion of the Grant which is Nu. 1,100,000.00 at the end of the calendar year 2015 will be shown in the Statement of Financial Position under the caption

LIABILITIES.

b. *To record the expenses incurred for M&E activities on January 25, 2016.*

	Debit	Credit
M&E expenses	1,1000,000.0	
Cash in Bank		1,100,000.00

c. *To record the recognition of the Deferred Grant as Revenue in 2016.*

	Debit	Credit
Deferred Grant	1,100,000.00	
Grant		1,100,000.00

17.2 Contributions in Kind

Contributions in kind may be in the form of goods, equipment, use of facilities, and services rendered.

Valuation

Non-Cash Contributions are valued at fair value if the fair value can be measured reliably, but whenever this is not possible, any of the following alternatives, which should be disclosed in the notes to financial statements were suggested:

- Quoted market prices for similar assets
- The assets replacement cost
- Independent appraisal of the asset's fair value
- Other valuation techniques, such as discounting the estimated future cash flows.

Fair Value means "the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction" If the contributions have no value, these should not be recognized. "No value" means that these cannot be used by the Organization.

Illustration

ABC Foundation received equipment from MBM with the following information:

Equipment	Nu. 1,000,000.00
Accumulated Depreciation	400,000.00
Book Value	600,000.00
Fair Value as independently appraised	700,000.00

To record the receipt of above equipment

	Debit	Credit
Equipment	700,000.00	
Grant		700,000.00

Contributed Services are reported as contribution revenue and as assets or expenses on the following conditions:

- if the services create or enhance a non-financial asset,
- if the service would typically be needed to be purchased,
- if the service requires specialized skills,
- if these services are provided by individuals with such skills.

For contributed services that do not meet the criteria above, such as "walk-in" volunteer services, it is recommended that these are disclosed in the notes to financial statements.

Illustration:

Mr. A, had approached the Executive Director of ABC Foundation and had offered his services as an IT Specialist for the project of ABC Foundation for free. The latest proposal received by ABC from an IT Company was Nu. 100,000.00 for the consultancy.

To record the Non-cash contribution/donation received

	Debit	Credit
Consultancy –IT Specialist	100,000.00	
Non-cash contribution/donation		100,000.00

17.3 Membership Fees

Imagine the following situation: a new professional membership organization is offering a one-year membership fee for Nu. 6,000.00. How should this organization account for these revenues? In accrual accounting, an organization recognizes that it has rights to payments that have not yet been received. These rights are called Accounts Receivable. The organization also recognizes that it does not have rights to cash that has been received in advance or providing the related services. These amounts are called Deferred Revenue.

In the above example, the Nu. 6,000.00 membership fee is for one year's worth of services, or Nu. 500.00 a month. Under both cash and accrual accounting, the cash increases by 6,000.00 when the membership fee is received. With cash accounting, the full Nu. 6,000.00 is shown as revenue on the day that the cash is received. In contrast, an organization using accrual accounting would recognize the revenue as it was earned, which would be Nu. 500.00. In the first month, the organization would have just Nu. 500.00 in revenue, and the remaining Nu. 5,500.00 would be shown as deferred revenue. Each month, an additional Nu. 500.00 would be recognized as revenue, reducing the deferred revenue.

17.4 Government Grants

Accounting Guide presents illustrations on Government Grants as some CSOs may have transactions regarding this item. Government grants are assistance by government in the form of transfers of resources to an enterprise in return for part or future compliance with certain conditions relating to the operating activities of the enterprise[23]. Government grants, including non-monetary grant at fair value, should be recognized when there is reasonable assurance that:

a. The enterprise will comply with the conditions attaching to them.

b. The grants will be received.

[23] Bhutanese Accounting Standards 20

Classification of government grants:

a. Grants related to assets – These are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

b. Grants related to income – These are government grants other than those related to assets.

Accounting for government grants:

a. Income approach – Government grants should be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. In other words, the grant is taken to income over one or more periods. This is the more acceptable approach.

b. Capital approach – Government grants should be credited directly to shareholders ‘equity. The reason for this is that government grants are not earned but represent an incentive provided by government without related costs. This does not apply to CSOs.

Illustration A:

Community Based Network (CBN) receives a grant of 30,000,000.00 from the Royal Government, through the National environment commission, for the purpose of reforestation of the portion of Jigme Dorji Wangchuk national park over the period of three years. The reforestation expenses that will be incurred by CBN are as follows:

First year	4,000,000.00
Second year	6,000,000.00
Third year	10,000,000.00
	20,000,000.00

The standard provides that “grants” in recognition of specific expenses should be recognized as income over the period of the related expense. Accordingly, the grant of 30,000,000.00 is allocated as income over three years in proportion to the costs incurred.

	Debit	Credit
<u>First year</u>		
Cash/Bank	30,000,000.00	
Deferred income – government grant		30,000,000.00
(To record the grant received from RGOB)		
Deferred income – government grant	6,000,000.00	
Income from government grant		6,000,000.00
(To record the deferred income (4/20 x 30,000,000.00))		
Reforestation expenses	4,000,000.00	
Cash/Bank		4,000,000.00
(To record the 1st year reforestation expense)		
<u>Second year</u>		
Deferred income – government grant	9,000,000.00	
Income from government grant		9,000,000.00
(To record the 2nd year deferred income (6/20 x 30,000,000.00))		
Reforestation expenses	6,000,000.00	
Cash		6,000,000.00
(To record the 2nd year reforestation expense)		
<u>Third year</u>		
Deferred income – government grant	15,000,000.00	
Income from government grant		15,000,000.00
(To record the 3rd year deferred income (10/20 x 30,000,000.00))		
Reforestation expenses	10,000,000.00	
Cash		10,000,000.00
(To record the 3rd year reforestation expense)		

Illustration B:

Coco Power Society (CPS) receives a grant of 50,00,000.00 from the government for the construction of a rehabilitation center with an estimated cost of 60,00,000.00 and useful life of 25 years. The standard provides that “grants related to depreciable assets should be recognized as income over the periods and in proportion to the depreciation of the related assets.”

Accordingly, the grant of 50,00,000.00 should be allocated as income over 25 years. The pertinent entries in the first year are:

		Debit	Credit
1.	Cash	50,00,000.00	
	Deferred income – government grant		50,00,000.00
2.	Building	60,00,000.00	
	Cash		60,00,000.00
3.	Depreciation	2,40,000.00	
	Accumulated depreciation (80,000,000/25)		2,40,000.00
4.	Deferred income (Government grant)	2,00,000.00	
	Income from government grant (50,00,000/25)		2,00,000.00

Illustration C:

ABC foundation receives grant of 50,000.00 from the government to compensate for massive losses incurred because of a recent natural disaster. The standard provides that "a government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the enterprise with no further related costs should be recognized as income of the period in which it becomes receivable, as an extraordinary item if appropriate."

Accordingly, the grant of 50,000.00 is recognized as income immediately as follows:

Cash	50,000.00	
Income from government grant		50,000.00

Since the losses suffered are extraordinary in nature, the income from the government grant should be presented also as an extraordinary item.

18. EXPENSES

18.1 Description

Expenses are gross decreases in assets or gross increases in liabilities (or a combination of both) recognized and measured from rendering services, delivering or producing goods, or carrying out other activities that constitute the CSO's ongoing major or central operations. While revenues increase net assets, expenses decrease the net assets of a CSO.

When determining the net excess or deficit for the period, the following pervasive principles are considered:

a. Associating cause and effect – where costs are recognized on the basis of a presumed direct association with specific revenue which means that costs are charge to expense in the period that the revenue with which they are associated is recognized.

b. Systematic and Rational allocation – wherein the absence of a direct means of associating cause and effect, some costs are associated with specific accounting periods as expenses on the basis of an attempt to allocate costs in a systematic and rational manner among the periods in which benefits are provided.

c. Immediate recognition – the cost is immediately expensed.

18.2 Classification of CSO Expenses

Natural Classification of Expenses

This refers to the enumeration of expenses that includes expense categories such as salaries, rent, electricity, etc. This may not reflect the services, programs, projects of a CSO which reflect its goals and objectives.

Functional Classification of Expenses

Expenses are classified in relation to the major classification – programs/projects, administrative, fund-raising. This practice classifies all costs according to different functions of the CSO. It is recommended that for CSOs, expenses must be presented by functional classification in the Statement of Activities. Functional reporting, as its name implies, describes the activity for which the CSO incurs an expense. The functional classification of expenses is as follows:

a. Program/Project expenses,

b. Administrative expenses, which are further classified as: General expenses, human resource development (includes Training Expenses),

c. Fund-raising expenses.

Definitions of Functional Classification:

a. Program/Project Expenses – relate to those program service activities that result in services (or goods) being distributed to beneficiaries or members that fulfill the basic mission of the

CSO. An organization can have more than one category of program services.

Program services expenses are those amounts specifically expended in support of activities that directly advance the organization's nonprofit mission. In other words, if an organization exists to promote the development of a cure for AIDS, amounts spent in grants to AIDS researchers is a program services expense.

b. Administrative Expenses:

General Expenses – relate to activities such as oversight management, general record keeping, office maintenance, and similar expenses.

Human Resource Development – pertains to expenses incurred for the purpose of developing and consolidating the CSO's board of trustee, management and staff.

c. Fund-Raising Expenses – are those expenses incurred in encouraging donors to contribute to the CSO. Fundraising expenses are those amounts used to bring in additional revenue, typically (but not only) through public donations. An example of fundraising expenses are the costs of printing and mailing to the general public flyers that encourage them to support the organization's mission by sending a donation.

d. Personnel and other costs traceable to a specific program should be part of program costs. Administrative personnel and overhead costs are part of Administrative expenses.

Practical Examples:

a. Conducted training to co-operators and the following expenses were incurred:

a. Conducted training to co-operators and the following expenses were incurred:

Training Venue	Nu. 10,000
Travel and Transportation of co-operators	5,000
Accommodations and meals	45,000
Lecturers Honoraria	15,000
Total	Nu. 75,000

	Debit	Credit
Project Expenses – Co-operators Training	75,000	
Cash/Bank		75,000
b. Professional fees paid for Writers –	20,000	
Project Expenses – Professional Fees		20,000
Cash/Bank		20,000

c. Supplies and materials were procured for 10,000

Administration Expenses – Supplies & materials 10,000

Cash/Bank 10,000

d. The Project pays the monthly rental - 40,000

Administration Expenses – Office rent 40,000

Cash/Bank 80,000

e. Paid salaries of Project management staff 200,000

Administration Expenses – Personnel cost 200,000

Cash/Bank 200,000

f. Conducted staff development training – total expenses = 50,000

Human Resource Dev't – Staff Development training 50,000

Cash/Bank 50,000

g. Incurred fund-raising expenses, raffle tickets - 20,000

Fund Raising Costs – Materials 20,000

Cash/Bank 20,000

18.3 Allocation of Joint Costs

This addresses a situation where a cost incurred by a CSO relates to two or more different activities. The cost is allocated and reflected in the financial statements, with a particular impact on the functional reporting in the statement of activities. Joint costs and indirect costs are allocated to programs and support services. There are three criteria permitting cost allocation:

a. Purpose criterion

   Purpose criterion is met if the purpose of the joint activity includes two or more programs or support services.

b. Audience criterion

   Audience criterion is met if the target audience or beneficiaries includes two or more programs or support services.

c. Content criterion

Content criterion is met if the joint activity supports program or support services

There are ways of allocation. However, the adopted allocation method should form part the accounting policies of the CSO and should be applied consistently for the same type of transaction until the policy is revised. The following are some of the methods:

a. Physical units method. This method allocates costs based on the physical materials that make up the joint costs.

b. Relative direct method. This method allocates joint costs in relation to the direct costs of each of the activities.

c. Stand-alone cost method. This method allocates joint costs to each component of the joint activity on a ratio that estimates the costs that would have been incurred had the joint activity been performed separately

Many CSOs practice allocating joint costs using any or combination of the following:

a. Equal allocation. Each project shares equally.

b. Budget-based allocation. Costs are allocated on overflow basis, starting with the project that has the lowest budget.

c. Size-based allocation. Size may be measured by:

Allocation Base	**Unit**
Staff	Persons
Office Area	Square Meter/monthly rental
Vehicle Usage	Mileage/Kilometers Used
Phone Extension	Numbers
Phone Calls	Call Units
Grant Size	Local Currency/Equivalent
Beneficiaries	Persons
Field Area	Villages/coverage

19. GAINS AND LOSSES

Revenues of CSOs increase their Net Assets, expenses decrease Net Assets. All other transactions that increase or decrease the net assets of a CSO are referred to as gains or losses, respectively. Gains and losses are auxiliary to the CSO's revenues and expenses. In presenting gains and losses, the Net Basis should be used, i.e., only the net gain or loss arising from a single set of transactions is presented.

PART IV

OTHER RELEVANT ASPECTS OF CSO ACCOUNTING

20. MATRIX REPORTING/FUND ACCOUNTING

20.1 Definition

Fund Accounting is generally prepared to meet the donor requirements. If there are any donor specific reporting requirements, CSOs should adhere to the requirements. If there are no specific reporting requirements to donors, follow this as generic guide to prepare Fund Accounting.

The Matrix Reporting/Fund Accounting is peculiar to CSOs and government institutions. Matrix Reporting/Fund Accounting is defined as a system of recording resources whose use may be limited by donors, granting agencies, governing boards, management, or by law. To keep the books and records in a way that gave recognition to the restrictions set by the donors, some CSOs kept a series of separate funds for a variety of specific purposes. Each fund consisted of a self-balancing set of assets, liabilities and net asset accounts.

20.2 As a Method of Accounting for CSOs

Matrix Reporting/Fund Accounting reports may be considered as special-purpose financial reports and therefore not included as basic requirements in financial reporting. However, Matrix Reporting/Fund Accounting as part of the accounting system of CSOs may contribute to better CSO accounting based on the following justifications:

- Matrix Reporting/Fund Accounting is a concept peculiar to CSOs. CSOs receive funds under various terms and conditions and may be grouped in various ways based on their intent and purpose and restrictions set by donors and management. Funding sources and funding arrangements may also vary - single fund, co-funding, or multi-funding for either individual activities, individual programs, several programs or the entire organization.
- Accountability, transparency, and monitoring were on the top of the list of reasons why CSOs applied the concept of matrix reporting/fund accounting.
- Matrix Reporting/Fund Accounting is also the expression of “matching of sources against intentions” (a fundamental concept in accounting) in CSOs. In business, there should be a proper matching of costs against revenues. In the same manner, CSOs should have proper matching of funds/sources against its intentions. Fund is defined as an amount set aside for a specific purpose.
- Matrix Reporting/Fund Accounting also enable CSOs for Segment Reporting. Reporting financial information by segments will:
    - help users of the financial statements to better understand the entity’s past performance and to identify the resources allocated to support the major activities

of the entity; and

- enhance the transparency of financial reporting and enable the entity to better discharge its accountability obligations.

A segment is a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources.

20.3 Dimensions of Fund Accounting

Based on the agreements with the intended user of the CSO financial statements, like funding agencies (FA), a supporting statement to the Statement of Activities showing, in a matrix form the relationship of the revenues, expenses, and Net Assets with respect to each funding source, programs, area of operation, etc., may be prepared.

It can be a relationship between Funding Agency and Programs:

	FA 1	FA 2	FA 3	Total
Research	X	X		
Education	X		X	
Training		X		
Livelihood	X			
Total				

Or between Programs and Area of Operation:

	Area1	Area2	Area3	Total
Research	X	X		
Education	X		X	
Training		X		
Livelihood	X			
Total				

Or could be Area of Operation vis-à-vis Funwding Agency:

Property & Equipt Fund	Area1	Area2	Area3	Total
FA 1	X	X		
FA 2	X		X	
FA 3		X		
FA 4	X			
Total				

Other form of relationships may be derived based on the needs of management, donors and other stakeholders. It can also be a multi-dimensional thing.

	FA 1	FA 2	FA 3	Total
Research - Area1 - Area2 - Area3				
Education - Area1 - Area2 - Area3				
Training - Area1 - Area2 - Area3				
Livelihood - Area1 - Area2 - Area3				

20.4 Specific Transactions in Fund Accounting

1. **Inter-fund Transactions**

Interfund Transaction

a. Interfund Borrowings

The practices of interfund borrowing among the CSOs in Bhutan are found to be quite common[24]. For instance, a donor funded project is agreed and secured, but when the funds are yet to be released, the CSOs uses funds from the other projects. This process of fund transfer by the CSOs form other project is a situation of interfund borrowing which needs to be recorded correctly by making entries for both the disbursing and the receiving funds at the same time.

This is one of the most overlooked transactions. Sometimes, records are reflected in one fund only or records are not done at the same time. This type of transaction results in an Interfund Receivable in the disbursing fund and an Interfund Payable in the receiving fund. The Interfund Receivable/Payable accounts are accounts of the individual funds but these should always have a zero balance at the total column; therefore these are offset accounts in the final accounts preparation.

[24] CSOs Consultative Interview Report

Example:

ABC Project Fund temporarily borrowed Nu. 10,000.00 from XYZ Project Fund.

In ABC Project Fund's record:	Dr	Cr	
Cash	10,000.00		
Interfund Payable – XYZ Project Fund		10,000.00	
To record amount borrowed from XYZ Project Fund			
In XYZ Project Fund's record:			
Interfund Receivable – ICCO Fund	10,000.00		
Cash		10,000.00	
To record amount borrowed by ABC Project Fund			
Presentation in the balance sheet:			
	ABC Project Fund	XYZ Project Fund	TOTAL
Interfund Receivable (Payable)	(10,000)	10,000	-

Interfund borrowings result in Interfund receivable in the paying fund and Interfund payable in the receiving fund. These accounts only exist in individual Net Assets while these are non-account in the consolidated financial statements.

b. Expense paid by one Fund for another

Another transaction is the payment of expenses, which are chargeable to another fund. As in the case of interfund borrowings, this type of transaction results in Interfund Receivable/Payable in two or more funds.

Example: For a valid reason and again from a sound management decision, a situation may arise wherein an expense, e.g. training, pertaining to XYZ Project Fund was paid from ABC Project Fund's cash account.

	Dr	Cr
In ABC Project Fund's record:		
Interfund Receivable – XYZ Project Fund	800.00	
Cash		800.00
To record payment of XYZ Project Fund's training expenses		
In XYZ Project Fund's record:		
Training Expense	800.00	
Interfund Payable – ABC Project Fund		800.00
To record training expenses paid by ABC Project Fund		
Presentation in the balance sheet:		
Similar to the above (item a).		

c. Correcting Entries affecting Fund/s different from the original Entry/ies

This occurs when previous erroneous entries were charged against or credited to a specific fund but later on it was corrected that the said entries should have been charged against or credited to another fund. Assuming there was an error in the original entries wherein a certain expense (transportation for example) was erroneously charged against and paid from ABC Project Fund, but later on determined that the activity was actually for XYZ Project Fund.

Original Entries (erroneous)		
In ABC Project Fund		
	Dr	Cr
Transportation Expense	100.00	
Cash		100.00
To record payment for transportation from _____ to _______		
Correcting Entries		
In ABC Project Fund		
Interfund Receivable	100.00	
Transportation Expense		100.00
To correct entry per Voucher Number ___; transaction should be charged against XYZ Project Fund.		
In XYZ Project Fund		
Transportation Expense	100.00	
Interfund Payable		100.00
To recognize transportation expense paid from Voucher Number ___ (ABC Project Fund).		

d. Transfer of Fund Balance from one category to another

This type of interfund transfers is a mechanism in which one classification of Net Asset increases and another classification of Net Asset decreases, with no change in the total Net Assets of the CSO. These are reflected in the Statement of Activities to reflect the satisfaction of donor restrictions. When this happens, the related assets, representing the Net Asset transferred, are also transferred. The nature, circumstances, and related information of the transfer should be adequately disclosed as a note to financial statements. Most importantly, this type of transfer should be in accordance to the agreement with the donor.

Example: When a project is closed but there is still a fund balance for the project (e.g. ABC

Project Fund), the CSO and the Donor Agency may agree that the project fund balance can be transferred to the General Fund. Some Donors may require that any balance should be returned or forwarded to a new project being funded by the same donor. It is very important that the CSO and the Donor agree on the treatment of the balance.

	Dr	Cr
In ABC Project Fund		
Operational Fund (Net Asset)	1,200.00	
Cash		1,200.00
to close SPF project and to record transfer of fund to General Fund.		
In General Fund		
Cash	1,200.00	
Operational Fund (Net Asset)		1,200.00
To record SPF fund balance transferred to General Fund.		

Presentation in the Financial Statement

	ABC Project Fund	General Fund
Operational Fund *	1,200.00	10,500.00
Fund Transfer **	(1,200.00)	1,200.00
Operational Fund after Fund Transfer	-	11,700.00

** If the transfer was agreed and effected after the period then the Fund Transfer is reflected in the following period's financial statement; the Fund Transfer should then be reflected as an adjustment to the Operational Fund – Beginning. If the transfer was agreed and effected within the current period then the Fund Transfer is reflected in the current period's financial statement; the Fund Transfer should then be reflected at the bottom of the financial statement to arrive at the Operational Fund – End for the current period.*

*** The circumstances of the fund transfer as well as the related agreement and authority should be disclosed in the Notes to Financial Statements.*

ANNEXURE

Pro-forma Vouchers

<u>RECIPT VOUCHER</u>

ABC Foundation

(Address)

Voucher No…………………

Date:…………………………

	Amount	
Account to be Credited: ………………………………..	Nu.	Ch
Being the amount received		
TOTAL		
(Ngultrums: ……………………………………………………………………………… …………………………………………)only		

Accountant /Prepared by

Approved by

PAYMENT VOUCHER
ABC Foundation
(Address)

Voucher No…………………………
Date:……………………………………

	Amount	
Account to be Debited…………………………….	Nu.	Ch
Being the amount paid		
Total		
(Ngultrums: ……………………………………………………………………………… ………………………………………………………..)only		

Accountant /Prepared by | Payments Received by | Approved by

<u>JOURNAL VOUCHER</u>
ABC Foundation
(Address)

Voucher No…………

Date: …………

Particulars	Debit		Credit	
	Nu.	Ch	Nu.	Ch
(Ngultrum……………………….……………..............................) Only				

Accountant/prepared by: Approved by: