Accounting by charities

(Issued by the Accounting Standards Committee in May 1988)

This Statement of Recommended Practice sets out recommendations, on the way in which a charity should report annually on the resources entrusted to it and the activities it undertakes.

Althouth the recommendations are not mandatory, charities are encouraged to follow them and to state in their accounts that they have done so. They are also encouraged to disclose any departure from the recommendations and the reason for it. The recommendations *need not be applied to immaterial items.*

The recommendations contained in this statement of recommended practice go beyond the requirements of the Charities Act 1960 and the Charities Act 1985 and have been welcomed by the Charity Commission. Accounts prepared in accordance with these recommendations will therefore be acceptable for filing with the Charity Commission and, if necessary, with the appropriate local authority.

Part 1 Explanatory note

Introduction

1 The purpose of a charity's annual report is to provide timely and regular information on the charity, enabling the user of the report to gain an understanding of the charity's operations and achievements and a full and proper appreciation of the charity's transactions during the period and of its position at the period end. This statement of recommended practice sets out recommendations on the form and content of the annual report and on the way in which the accounts contained in the report should be prepared.

2 The Accounting Standards Committee's purpose in setting out these recommendations is to help improve the quality of financial reporting by charities. It also wishes to provide assistance to those who are responsible for the preparation of charities' annual reports and accounts. The Accounting Standards Committee hopes that the recommendations will assist in reducing the current diversity in accounting practice and presentation although the intention is not to try to standardise them.

3 Universities are not included within the scope of the recommendations. That apart, the statement is intended to be applicable to all charities in the United Kingdom and the Republic of Ireland, regardless of their constitution, size or complexity. However, it is recognised that some of the recommendations may not be applicable to all charities because of the nature of the particular charity or because of the limited classes or size of the transactions or assets involved. Nevertheless, the full recommendations have been given in this statement, leaving discretion to the trustees of each charity to apply the recommendations according to the character of their charity and the significance of the figures involved.

4 The Accounting Standards Committee has issued 'Accounting by charities: A guide for the smaller charity' in order to assist the trustees of small charities in exercising this discretion.

Interpretation of financial information on charities

5 Charities are highly disparate in character, so any comparison of the financial information they produce must be undertaken with care, even if the charities involved seem to be homogeneous. Also it is important to note that, when interpreting the income and expenditure account of a charity, the amount by which income exceeds expenditure, or expenditure exceeds income, in any one year is not usually a measure of performance or efficiency and does not usually provide an indication of the charity's future needs. Similarly, the balance sheet is not necessarily a measure of the wealth of the charity.

6 This statement recommends that a review and explanation of the accounts be provided in the annual report. It is important that reference be made to this review and explanation by those seeking to interpret the accounts correctly.

Simplified reporting

7 It has been assumed in preparing this statement that a full annual report is to be prepared and that it will include a full set of accounts. However, some charities include simplified accounts in their annual report or include extracts from their annual report in other publications. As the form of such documents will vary considerably depending on the purpose for which they have been prepared, it is not practicable to include detailed recommendations on their preparation in this statement. However, some general principles which ought to be followed are set out below.

(a) Regardless of the intended circulation of any simplified report, a full annual report should always be produced. Details of how this full report can be obtained should be given in the simplified report.

(b) Simplified accounts should carry a statement explaining that they are not the full accounts and that they are not audited.

(c) Simplified accounts should be a fair summary of the full accounts. This means that they should contain information on both the income and expenditure account and the balance sheet and that they should be based on the principles set out in this statement.

Part 2 – Definition of terms

8 A **charity** is any institution established for charitable purposes only. Where the institution is involved in more than one activity, operates more than one fund, or is not centralised into one unit of operation, the term is used in this statement to incorporate all those activities and funds which fall within the scope of a single governing instrument (or instruments supplemental to the main instrument) and any further endowments held within the terms of the original instrument.

9 A **fund** is a pool of unexpended resources, held and maintained separately from other pools because of the circumstances in which the resources were originally received or the way in which they have subsequently been treated. A fund will be one

of two kinds: a restricted fund or an unrestricted fund. (The terms 'fund' and 'funds' are used in the statement in this specialised way except when used in the phrases 'fund-raising' and 'statement of source and application of funds'.)

10 **Restricted funds** are funds subject to specific conditions, imposed by the donor* and binding on the trustees. They represent unspent restricted income and/or assets to which restrictions as to their use apply.

11 A **permanent endowment** is a particular form of restricted fund in that the fund must be held permanently, although its constituent assets may change from time to time.

12 A **designated fund** is a particular form of unrestricted fund, consisting of amounts of unrestricted funds which have been allocated or designated for specific purposes by the charity itself. The use of designated funds for their designated purpose will remain at the discretion of the trustees.

13 **Administration expenses** comprise the costs which are not incurred directly on any of the charitable activities or projects of the charity and which are not incurred on fund-raising activities or publicity. Administration expenses will include a proper allocation of items of expenditure involving more than one cost category (e.g. administration expenses, fund-raising expenses etc), but should not include any apportionment of costs which belong to other cost categories.

14 **Fund-raising expenses** comprise the costs incurred by a charity in inducing others to make voluntary contributions to it. They will also include a proper allocation of items of expenditure involving more than one cost category (e.g. administration expenses, fund-raising expenses etc), but should not include any apportionment of costs which belong to other cost categories.

Part 3 – Recommended practice

The scope of the recommendations

15 These recommendations are intended to be applicable to all charities other than universities. Any departure from the recommendations should be disclosed and explained in the annual report.

The annual report

Activities and funds to be reported on

16 The annual report of a charity should contain information on all the activities and funds of the charity and its non-autonomous branches. If a charity has some branches which are autonomous and which are therefore not dealt with in the report, this fact should be explained.

17 In order for the user to gain a full appreciation of the scope of a charity's activities, the annual report should also provide information on charities which are connected with the reporting charity and on its subsidiary and associated companies. Recommendations on the provision of this information are set out in paragraphs 70 to 73.

* The conditions may alternatively be imposed not by the donor but by the trusts relating to the donation. For example, if a donation is made in response to a special appeal, its use will be restricted to the purpose of the appeal, notwithstanding the fact that the donor did not impose any restriction on its use.

18 Funds held by a charity as custodian trustee will not usually fall within the scope of the annual report. Nevertheless, an indication of the extent to which the charity acts as a custodian trustee will need to be provided when explaining the charity's unquantifiable charitable work and the level of its administration expenses incurred.

The content of the annual report

19 The annual report should contain:

(a) legal and administrative details. These details will provide background information on the constitution of the charity. Paragraph 21 sets out the information which should usually be disclosed;

(b) a trustees' report or equivalent statement. This report should, as explained in paragraph 22, include a description of the charity and how it operates and a commentary on the figures shown in the accounts; and

(c) the accounts and notes thereto and, if the accounts have been audited, the auditors' report on them. The accounts are a report, expressed in financial terms, on the activities and resources of the charity. Paragraph 24 describes the accounts in detail, and the remainder of this statement sets out recommendations on their preparation.

Although it has been assumed in this statement that the legal and administrative details, the trustees' report, and the accounts will form three separate parts of the annual report, it is recognised that some or all of the legal and administrative details could just as easily be provided in the trustees' report or in the notes to the accounts.

Responsibility for preparing the annual report

20 The trustes are responsible for the preparation of the annual report and therefore for the form and content of the accounts. They should discharge this responsibility by formally approving and adopting the report. The trustees' report and balance sheet should be signed by at least two trustees on behalf of all of them in order to show this approval. The date of approval should also be disclosed.

Legal and administrative details

21 The legal and administrative details provided in the annual report should include the following information:

(a) an indication of the nature of the governing instrument or legal status of the charity. If applicable, the charity registration number and the company registration number should also be provided;

(b) the names of the trustees and their nominating body (or other method of appointment or election), the names of the members of any management committee and the names of the principal officers of the charity;

(c) the principal or registered address of the charity;

(d) the names and addresses of any other relevant organisations or persons. This may include the names and addresses of those acting as bankers, solicitors, auditors, and investment or other advisers;

(c) details of any restrictions in the way in which the charity can operate. This should include details of any limitations in the trustees' powers of investment including, for example, any restrictions imposed by the Trustee Investments Act 1961.

The trustees' report

22 The trustees' report is the main narrative section of the annual report. It should contain:

(a) an explanation of the objectives of the charity and a description of the way in which the charity is organised. The policies that have been adopted in order to try to achieve these objectives should also be explained. If there have been any significant changes in the objectives, organisation or policies since the last report, this should also be made clear. The purpose of this part of the report is to explain what the charity is trying to achieve and how it is going about it;

(b) a review of the development, activities and achievements of the charity during the year. This review should bring the reader up-to-date on the charity's progress and achievements. It should also explain the important events which have occurred during the year and how the charity has responded to them. It will be in this part of the report that information enabling the reader to judge the effectiveness of the charity will usually be provided;

(c) a review of the transactions and financial position of the charity, and an explanation of the salient features of the accounts. This review should enable the reader to appreciate the significance of any surpluses or deficits disclosed in the accounts and the purposes for which the charity's assets are being held. It will also put the charity's current financial position in the context of its future plans and commitments, particularly with regard to on-going items of expenditure, projects not yet completed and obligations not yet met. The purpose of this part of the report is to help ensure that the accounts are properly interpreted.

23 Other information which, if not included in the accounts, could usefully be provided in the trustees' report includes details of voluntary help, donations-in-kind and other intangible income received during the accounting period (see paragraph 36), an indication of the extent to which the charity is dependent upon certain donors and, if the charity was set up to undertake a specific project, cumulative figures on progress of the project.

The accounts

24 The accounts are a report in financial terms on the activities and resources of the charity. They should comprise:

(a) an income and expenditure account that shows the resources made available to the charity and the expenditure incurred by the charity during the period;

(b) a balance sheet that shows the assets, liabilities and funds of the charity. The balance sheet (or its notes, see (f) below) should also provide some indication of how the funds may or, because of restrictions imposed by donors, must be utilised;

(c) a statement of source and application of funds that shows the flow of cash through the charity. However, as explained more fully in paragraph 64, there may be circumstances in which such a statement is neither necessary nor helpful. If this is the case, the statement should not be prepared;

(d) an explanation of the accounting policies used to prepare the accounts;

(e) details of the movement on, and position of, the various funds of the charity; and

(f) other notes which explain or expand upon the information contained in the accounting statements referred to above or which provide other useful information. This will include notes which show an analysis of the figures in the accounts and notes which explain the relationship between the figures.

The corresponding amounts for the previous accounting period should be given for figures disclosed in the accounts or in the notes to the accounts. The duration of the current and corresponding accounting periods should also be shown.

Accounting for separate funds

25 Most charities will hold unrestricted funds. Some may also hold one or more restricted funds, some of which may be permanent endowment funds. Appendix 1 explains in detail the legal position as regards transactions involving these various funds. To summarise, the position is as follows.

(a) The assets and liabilities representing the various funds of the charity need to be distinguished in the accounting records so that it is known which assets and liabilities are held in which funds.

(b) Realised and unrealised profits and losses on assets held in a particular fund form part of that fund. Similarly, provisions for depreciation or for a permanent fall in value of an asset form part of the fund in which the asset is held.

(c) Income generated from assets held in a particular fund may be subject to donor-imposed restrictions as to its use or the fund to which it belongs. However, where this is not the case the income will be unrestricted income.

Accounting for permanent endowment funds

26 Permanent endowment funds represent the capital of a charity. A consequence of this is that increases and decreases in the amount of the permanent endowment funds should not be dealt with in the income and expenditure account, but should instead be taken directly to the relevant permanent endowment fund in the balance sheet. A note to the accounts should disclose all movements on permanent endowment funds.

27 Income derived from assets held within a permanent endowment fund may be subject to donor-imposed restrictions as to its use or the fund to which it belongs. However, where this is not the case the income will be unrestricted income: it will not form part of the permanent endowment fund. It should therefore be included in the income and expenditure account in the normal way.

Accounting for other funds

28 The treatment of movements on all other funds should not be affected by the type of fund involved. This means, for example, that restricted income and unrestricted income received at the same time should be included in the income and expenditure account at the same time. Similarly, expenditure out of restricted funds should be included no sooner or later than expenditure made at the same time out of unrestricted funds.

29 The accounts and notes should provide information on the charity's fund structure and on the significance of each of the major fund balances. There are a number of different ways in which this information could be presented. For example, the accounts could consist of a single set of accounting statements with columnar or note analysis. On the other hand, separate sets of statements could be produced for each major fund. The trustees should decide on the presentation to be adopted. In doing so, they should take into account the complexity of the fund structure and the need to avoid confusion between the movements on the various funds.*

30 Whatever the presentation adopted, the accounts or notes should contain a reconciliation of the total opening funds of the charity to the total closing funds, showing the income less expenditure figure from the income and expenditure account and details of all other movements on the funds during the period. This reconciliation should be analysed between the major funds of the charity. The amount of each major fund should be analysed between the amount that is realised and the amount that is unrealised. The nature and purpose of each major fund should also be disclosed.

31 When disclosing details of movements on the major funds, transfers should be shown separately from allocations to designated funds. Furthermore:

(a) material transfers and allocations of income received to designated funds should be separately disclosed, without aggregation or netting off, and should be accompanied by a narrative explanation of the nature and objective of the transfer or allocation;

(b) transfers and allocations should, if they are to be included in the income and expenditure account, be shown separately from, and beneath a subtotal of, the income and expenditure for the period.

Accounting policies

32 In order to understand the accounts it is essential that they are accompanied by an explanation of the basis on which they have been prepared. The accounting policies adopted for dealing with material items should therefore be explained in the notes to the accounts. These explanations should be clear, fair, and as brief as possible.

33 Examples of the accounting policies which should be explained include the policies adopted in the following areas:

(a) the capitalisation and depreciation of fixed assets;

(b) commitments not yet met and the use of designated funds;

* References in the remainder of the statement to 'the income and expenditure account', 'the balance sheet' and 'the statement of source and application of funds' should be taken to be references to all income and expenditure accounts, balance sheets and statements of source and application of funds prepared by the charity.

(c) determining the amounts at which assets are included in the balance sheet;

(d) donations, legacies and other forms of voluntary income;

(e) grants payable and receivable;

(f) identifying the items to be included within administration expenses, fund-raising expenses, and publicity expenses;

(g) investment income;

(h) netting off of expenses and related income;

(i) realised and unrealised gains and losses on investments and fixed assets;

(j) stock;

(k) subscriptions for life membership.

Where a charity is involved in specialised activities, such as research, it is particularly important that the accounting policies adopted to account for these activities are explained.

34 The accounting policies should be consistently applied throughout the period and from one period to the next. A change in accounting policy should not be made unless the new policy will give a fairer presentation of the transactions or financial position of the charity than the one it replaces. Any change in accounting policy should be disclosed. If the effect of such a change is material, it should be accounted for by restating the opening balance of the fund or funds involved. The corresponding amounts for the previous period should also be adjusted. Any such restatements should be disclosed and explained.

Voluntary income

35 Voluntary income consists of all incoming resources (whether in the form of cash or other assets or in kind) other than incoming resources received for permanent endowment, government and similar grants, investment income and gains, and payments received for services or goods.

36 A charity may receive assistance in the form of donated facilities, voluntary help or beneficial loan arrangements. Such assistance is generally referred to as 'intangible income' or 'donations-in-kind'. Although some intangible income could be included in the income and expenditure account, it will usually be more appropriate to deal with it in the notes to the accounts or in the trustees' report – particularly as its value will often be impossible to quantify. The information disclosed in respect of such income should be sufficient to give a reasonable appreciation of the benefit derived from it.

37 The value of all other voluntary income should be included in the income and expenditure account as soon as it is prudent and practicable to do so. This will usually be when the income is received. Paragraphs 38 to 44 expand upon this general principle. This means, for example, that all legacies (other than those received for permanent endowment) should be included in full in the income and expenditure account as soon as they are received.

Restricted income

38 As explained in paragraph 28, the fact that income is restricted should not affect the manner in which it is accounted for in the income and expenditure account or the timing of its recognition as income. The one exception to this rule is when the restrictions imposed are so onerous that it is impossible to use the income in the way intended. In such circumstances the income should be carried forward in the balance sheet under the heading 'deferred restricted income' and the restrictions involved explained.

Donated assets

39 Incoming resources in the form of donated assets should usually be included in the income and expenditure account as soon as they are received. The amount at which they should be included should be a reasonable estimate of their value to the charity. The basis of valuation should be disclosed. This treatment is appropriate regardless of whether the assets were donated for use, sale or distribution.

40 On occasion it may not be practicable to ascertain the value of assets received, in which case their receipt should instead be disclosed in a note to the accounts. If it later becomes practicable to ascertain a value for them, this value should be included in the income and expenditure account as income at the date of valuation. For example, if an asset cannot be valued at the date of receipt but is later sold, the sale proceeds should be included as income at the date of sale. If the amount of assets included in income in a period other than the period of receipt is significant, this fact should be reported and the amounts involved disclosed.

Cash collections

41 When income has been collected for a charity but has not been received by it by the end of the accounting period, an estimate of the amount not received should in theory be included in the income and expenditure account. Similarly, when some of the charity's income is in collection containers at public premises at the period end, an estimate of the amount in the containers should in theory be included as income. However, because of the practical difficulties which will often be involved, it is not necessary to include such estimates in the income and expenditure account. Whatever treatment is adopted to account for such income should be applied consistently and disclosed.

Life subscriptions

42 Life subscriptions purchase for the subscriber facilities or benefits extending over a number of years. In theory a proportion of each subscription received should be allocated to each of the periods for which it is anticipated the subscription will apply. However, rather than undertake lengthy calculations to estimate the appropriate period to use, it is acceptable to use an approximation, perhaps based on the relationship between the amount of the annual subscription and the amount of the life subscription. The period used should be disclosed.

Grants receivable

43 Government and similar grants should be dealt with in accordance with the terms of the grant. Grants made towards the cost of acquiring a fixed asset should be taken to income and expenditure account over the useful life of the asset concerned

(see paragraphs 51 to 55, which deal with accounting for fixed assets). The amount of the grant still to be taken to income and expenditure account should be shown on the balance sheet as a deferred credit or, where appropriate, included in the relevant fund balance.

44 If a grant is to be received after the expenditure to which it relates, a best estimate of the amount to be received should be included in the income and expenditure account.

Gains and losses on investments and fixed assets

45 A realised or unrealised gain or loss arising on an asset will form part of the fund in which the asset involved is (or, in the case of an asset disposed of, was) held.

Realised gains and losses

46 Realised gains and losses on the disposal of investments should either be:

(a) included in the income and expenditure account, in which case they should be disclosed separately from other income; or

(b) disclosed in the statement of investment gains (an example of which is shown in Appendix 2) and then added to or deducted from the appropriate fund in the balance sheet. Statements of investment gains should be disclosed on the face of the accounts, not in the notes.

47 Realised gains and losses on the disposal of fixed assets should be included in the income and expenditure account and, if material, disclosed separately from other income.

Unrealised gains and losses

48 As explained in paragraph 68, investments may be carried in the balance sheet at cost or at market value. Where they are carried at cost, there will be no unrealised gains or losses to account for, except in the case of a permanent diminution in value (see paragraph 69).

Where they are carried at market value, unrealised gains and losses will arise. Such gains and losses should be accounted for in a manner which is consistent with realised gains and losses on investments; in other words, if realised gains and losses on investments are included in the income and expenditure account, unrealised gains and losses on investments should be as well.

49 Similarly, unrealised gains or losses will arise if fixed assets are included in the balance sheet at revalued amounts (see paragraph 68). Such gains and losses should not be included in the income and expenditure account: they should be added to or deducted from the appropriate fund in the balance sheet.

Other income

50 If a charity carries out trading activities, the income should be accounted for in accordance with the normal accounting rules for profit-oriented entities. If a charity charges for services which it provides, the charges should be recognised as income in the income and expenditure account as they are earned. For example, if a service is provided over a period of time, the income involved should be recognised over the period of service and not over the period in which the payment is received.

Accounting for fixed assets

Capitalisation of fixed assets

51 All expenditure on the acquisition, production or installation of fixed assets and all receipts of fixed assets by way of gift should be capitalised and included in the balance sheet. This general principle is not affected by the source of finance used to pay for the fixed asset, or the source of finance likely to be used to pay for any future replacement of the asset.

(a) Expenditure on the acquisition, production or installation of fixed assets should be capitalised at the amount expended.

(b) Fixed assets received by way of gift should be capitalised at the value at which the gift was included in income (see paragraph 39).

(c) Fixed assets being capitalised some time after being acquired, for example as a result of a change in accounting policy, should similarly be capitalised at original cost or at the value at which the gift was included in income. However, if neither of these amounts are ascertainable, a reasonable estimate of the asset's current value to the charity should be used.

For the remainder of this statement all of these valuation bases will be referred to as 'cost'.

52 The only exception to this general principle is that a charity need not capitalise a fixed asset which is either:

(a) inalienable (in other words a fixed asset which the charity is prohibited from disposing of) historic (such as a monument or statue); or

(b) for which neither a cost nor a market value is available. This should be an extremely rare occurrence: it will be usually be possible to determine a reasonable estimate of its cost or value without incurring significant expenditure.

A summary of the fixed assets not included in the balance sheet but still in use should be given in the notes to the accounts. These summary details should be sufficient to enable the reader to appreciate the age and scale of fixed assets not included on the balance sheet.

Revaluation of fixed assets

53 If a charity revalues some or all of its fixed assets, this fact, together with the date and bases of valuation, should be stated in the notes to the accounts. In the year of valuation, the names and qualifications of the persons responsible for making the valuation should also be disclosed.

Depreciation of fixed assets

54 Most fixed assets depreciate, that is wear out, get consumed or otherwise suffer a reduction in their useful life through use, the passing of time or obsolescence. Fixed assets which have a finite useful life should be depreciated. Fixed assets which have an indefinite useful life, such as freehold land, should not be depreciated. This means that:

(a) fixed assets with finite useful lives should be included in the balance sheet at cost (or, if revalued, at a revalued amount) less an appropriate provision for depreciation, and

(b) fixed assets with an indefinite useful life should be included at cost (or, if revalued, at a revalued amount).

55 If a fixed asset is revalued its depreciation should be based on the revalued amount, the residual value and remaining useful life of the asset at the date of the revaluation.

Other expenditure and costs

56 All expenditure should be included in the income and expenditure account as soon as it is incurred. The only exception to this is expenditure incurred to acquire assets, that is, expenditure on the acquisition, production or installation of fixed assets, expenditure on stock items, expenditure on the acquistion of investments, advance expenditure or prepayments. Expenditure incurred to acquire assets should be carried forward in the balance sheet.

57 Expenditure is not incurred until consideration for the expenditure has passed, in other words until something is received in exchange for the expenditure. However, in the case of expenditure and grants relating directly to charitable activities an exchange is usually not involved. Where there is no exchange, the expenditure or grant should be recognised in the income and expenditure account when its payment becomes due. An implication of this is that commitments which extend beyond the end of the accounting period and grants which fall to be paid in future accounting periods should be charged in future income and expenditure accounts. (See also paragraph 74 and 75.)

The income and expenditure account

Presentation

58 The income and expenditure should be analysed in a manner appropriate to the charity. This analysis should enable the user of the accounts to gain a proper appreciation of the principal elements of the income and expenditure of the charity, but should not be excessively detailed. The following items should be shown separately in the analysis:

(a) realised and unrealised gains and losses on investments (if included in the income and expenditure account) and, if material, realised gains and losses on the disposal of fixed assets;

(b) fund-raising expenses;

(c) publicity expenses;

(d) administration expenses; and

(e) expenditure and grants relating directly to charitable activities.:

Administration expenses, fund-raising expenses and publicity expenses

59 It is not practicable to produce precise definitions of 'administration expenses', 'fund-raising expenses' and 'publicity expenses' or to set out detailed guidance, applicable to all charities, on what expenditure should be included within each heading. The following principles should however be applied.

(a) Items of expenditure which involve more than one category, for example some administration expenses and some expenditure relating directly to charitable activities, should be allocated on a rational basis to the cost categories involved.

(b) Expenditure incurred on activities falling directly within one cost category should not be apportioned to any other cost category.

60 The absence of precise definitions or detailed guidance means that each charity should develop principles for cost allocation suitable to its own circumstances. These principles should be applied consistently. A full description of the items included within each category and of the principles adopted should be disclosed.

Netting-off

61 A minimum of 'netting off' of income and expenditure and of assets and liabilities should take place. However, if a charity has received income from, and incurred expenses on, special fund-raising events or activities, it may occasionally be more informative to include only the net figure in the income and expenditure account. Where netting off takes place, the reason for it and, whenever practicable, the 'gross' figures should be disclosed in the notes.

Tax credits on income

62 Income received after deduction of tax at source and income received by deed of covenant should be grossed up for the tax recoverable and this gross figure included in the income and expenditure account. The tax recoverable should be shown as a debtor until the charity recovers the amount involved.

The statement of source and application of funds

63 The purpose of the statement of source and application of funds is to show the movement of cash through the charity. Some charities believe information on their cash transactions to be more meaningful than information on their income and expenditure because, for example, they are funded on the basis of their cash needs or because their investment activity is directed primarily towards making the proceeds of sales available for charitable purposes. Where this is the case the statement of source and application of funds may be given greater prominence than the income and expenditure account.

64 On the other hand, there may be circumstances in which the preparation of a statement of source and application of funds is neither necessary to give full disclosure of information nor helpful in enabling the user to understand the charity's activities. For example, charities that operate on a cash basis and consequently have no significant assets or liabilities will find that the statement will be similar to their income and expenditure account. In such circumstances, the statement need not be included in the accounts.

65 Where a statement of source and application of funds is prepared:

(a) the analysis of the cash movements and the use of figures which have been netted-off should follow the same principles as those adopted for the income and expenditure account (see paragraphs 35 to 41, and 61); and

(b) the statement should be reconcilable to the income and expenditure account and the balance sheet.

The balance sheet

Presentation

66 The assets of a charity should be analysed in the balance sheet between fixed assets, investments (including investment properties), and current assets; and the liabilities should be analysed between current and long-term liabilities. In addition, the assets and liabilities should be analysed in a way that enables the reader to gain a proper appreciation of their spread and character. The example set of accounts in Appendix 2 illustrates what this might entail.

67 The total amount of the assets less liabilities of a charity should be analysed between its major funds.

(a) Wherever possible it should be made clear which assets and liabilities form part of restricted funds, particularly permanent endowment funds. Where this is not practicable, the notes should provide an indication as to whether or not sufficient resources are held in an appropriate form to enable the funds concerned to be applied in accordance with the restrictions imposed. For example, if a charity has a fund which is to be spent in the near future, it should be made clear in the notes whether or not the assets held in the fund are short-term assets.

(b) Where funds have been divided into wider and narrower ranges under the powers given to trustees by the Trustee Investments Act 1961, the accounts or notes should indicate the investments allowed to each range.

The amounts at which assets and liabilities are included in the balance sheet

68 Except as explained in paragraph 69, the assets and liabilities of a charity should be included in the balance sheet at the following amounts:

(a) fixed assets at cost (or valuation) less an appropriate provision for depreciation;

(b) investments at cost or market value. If the investments are included in the balance sheet at cost, the market value should be disclosed in the notes to the accounts;

(c) current assets at the lower cost and net realisable value; and

(d) liabilities at their settlement value.

69 If an asset suffers a permanent loss (or diminution) in value, the amount at which the asset is carried in the balance sheet should be reduced to the asset's current value by a provision. Where this provision should be charged will depend on the circumstances involved.

(a) If the asset involved is an investment, the provision should be charged to the same place as realised and unrealised losses on the investments (see paragraphs 45 to 48).

(b) If the asset is a fixed asset, the provision should be charged to the income and expenditure account to the extent that it is not covered by a previous gain on revaluation of that asset. To the extent that it is covered by a previous gain, the provision should be used to reduce the gain by deducting it from the appropriate fund in the balance sheet.

In determining whether any asset has suffered a permanent loss, gains in the value of other assets should not be taken into account.

Connected charities

70 A charity may be connected with other charities. It will usually be possible to identify whether charities are connected by considering whether they have common trustees, unity of administration, and common, parallel or related objects and activities.

71 If the reporting charity is connected to other charities, information about the other charities' activities and resources should be included in its annual report. This information should include:

(a) particulars of the connected charities, including principal contact addresses and the nature of the relationship between the charities; and

(b) particulars of any material transactions between the charities.

One way in which the relevant information could be given is by aggregating the accounts of the charity with those of its connected charities. If aggregated accounts are prepared, the basis on which they have been prepared should be disclosed. Separate accounts for the reporting charity should still be prepared.

Subsidiary and associated companies

72 A charity may have one or more subsidiary companies.

(a) The activities of a subsidiary may not be fundamentally different from those of the charity. For example, the subsidiary may be an investment-holding company; it might be concerned solely or largely with fund-raising; or it might be the vehicle used to undertake the charitable activities of the charity. If a charity has such a subsidiary or subsidiaries, it should prepare consolidated accounts for itself and its subsidiary or subsidiaries. Separate accounts for the charity itself should still be prepared.

(b) If a subsidiary undertakes activities which are fundamentally different from those of the charity, for example if it is a trading company, it will not be appropriate to consolidate its accounts with those of the charity. Instead, the investment in the subsidiary should be treated in the same way as other investments are treated. A summary of the transactions, assets and liabilities of the subsidiary, together with an explanation of its activities and their relevance to the charity, should be disclosed in the notes to the accounts. As an alternative to providing a summary of its subsidiary's transactions, assets and liabilities, the charity may if it wishes include the accounts of the subsidiary within its annual report.

73 A charity may have one or more associated companies. Investments in associated companies should be treated in the same way as investments in subsidiaries undertaking activities which are fundamentally different from those of the charity (see paragraph 72).

Other disclosure items

Commitments and designated funds

74 Particulars of all material commitments in respect of specific charitable projects, whether they are legally binding or not, should be disclosed in the accounts. These particulars should include the amounts involved, when the commitments are likely to be met, and the movements on commitments previously reported. Particulars of all other material legally binding commitments should also be disclosed.

75 Commitments can be dealt with either by disclosing them in a note to the accounts or by using designated funds to represent committed unrestricted funds. If designated funds are used, they should be disclosed separately from restricted funds and appropriately described.

76 Guarantees given by the charity, and the conditions under which liabilities might arise as a result of guarantees, should be disclosed in a note to the accounts.

Loans and other liabilities

77 If loans or other liabilites are secured on the assets of a charity then this fact, along with details of the security, should be disclosed in the notes to the accounts. The existence of charges against assets should be disclosed in a similar manner.

78 The amount and interest and repayment terms of all inter-fund loans should be disclosed in the notes to the accounts.

Information relating to transactions with trustees and to employees of the charity

79 Particulars, including the amounts involved, of any transaction, contract or other arrangement between a charity and any of its employees or trustees, or persons connected with them, should be disclosed in the notes to the accounts if the transaction, contract or other arrangement is likely to be significant to the user of the accounts. Employees' contracts of employment are an example of contracts which will not usually be significant to the user.

80 Particulars of any relevant connection of the trustees or officers of a charity (for example, as trustees or officers of charities with which the reporting charity works) should also be disclosed.

81 If some or all of the trustees have received remuneration from the charity or have been reimbursed by the charity for expenses which they have incurred, this fact and the amounts involved should be disclosed in the notes to the accounts. An indication of the type of expenses reimbursed should also be provided. If no remuneration was paid or no expenses reimbursed, this should be reported.

82 The total emoluments (i.e. remuneration and benefits-in-kind) paid to employees during the accounting period and the average number of employees during the period should be disclosed in the notes to the accounts.

Part 4 – Notes on legal requirements in the United Kingdom and the Republic of Ireland

83 A charity constituted in the United Kingdom or the Republic of Ireland may, by virtue of its constitution or activities, be subject to a range of statutory reporting requirements. Some of the more commonly encountered requirements are referred to below. Although the recommendations contained in this statement are intended to represent best practice there may be circumstances in which they conflict with some of the statutory requirements imposed on a charity. This statement cannot overrule such requirements.

84 The recommendations do not incorporate every statutory reporting requirement that may be imposed on a particular charity. For example, an incorporated charity would be required to provide certain additional disclosures and analyses in the notes to the accounts and would also be required to prepare a directors' report containing specified information. Compliance with the recommendations contained in this statement will therefore not necessarily mean that all the statutory reporting requirements that may be imposed on a charity have been met.

England and Wales

Charities Act 1960

85 All charities in England and Wales must comply with the financial reporting requirements of the Charities Act 1960 and the Charities (Statement of Account) Regulations, 1960 ('the 1960 legislation'). This legislation requires charities to keep proper accounting records to enable them to prepare consecutive statements of account. These statements of account should consist of an income and expenditure relating to a period of not more than fifteen months and a balance sheet relating to the end of that period. Each statement of account should contain:

(a) particulars of the charity's assets at the balance sheet date, distinguishing between assets forming part of the permanent endowment and other assets. These particulars should include the names of the persons in whom the assets are vested;

(b) the approximate amount of the charity's liabilities at that date;

(c) the amount of the receipts during the period, classified according to the nature of the receipt and distinguishing between receipts forming part of the permanent endowment and other receipts; and

(d) the amount of the payments made during the period, classified according to the nature of the payment and distinguishing between payments made out of the permanent endowment and other payments.

86 All charities having permanent endowments, other than 'excepted charities', must automatically send to the Commissioners each year a statement of account. All charities, other than 'exempt charities', must send statements of account to the Commissioners on request.

87 The format in which the income and expenditure account and balance sheet should be prepared, and the accounting policies which should be adopted in preparing them, are not specified in the legislation. Although the Charity Commission provide charities with standard forms for the prepartion of statements of account, alternative formats can be used as long as the information provided meets the requirements of the legislation.

Charities Act 1985

88 All local charities whose sole or primary object is the relief of poverty, other than exempt charities (as defined in the 1960 legislation) and ecclesiastical charities, must send statements of account prepared in accordance with the 1960 legislation to the 'appropriate local authority'.

Companies Act 1985

89 Many charities are incorporated as limited companies and, as a consequence, are required to follow the reporting requirements set out in the Companies Act 1985 ('the 1985 Act'). In essence, this Act requires all incorporated charities to prepare, in respect of each accounting period, and file an income and expenditure account, a balance sheet, various notes, a directors' report and an auditors' report. If, at the end of the accounting period, the charity has one or more subsidiaries, then group accounts should also be prepared and filed. The accounts of the charity and its group are required to show a true and fair view and, except where it is not consistent with the showing of a true and fair view, should comply with the detailed requirements set out in Schedule 4 to the 1985 Act.

90 Schedule 4 sets out the formats in which the income and expenditure account and balance sheet should usually be prepared. These formats, and the income and expenditure account formats in particular, are not wholly appropriate for the income and expenditure accounts of charities. It is therefore normally necessary to take advantage of paragraph 3(3) of Schedule 4, which allows the formats to be adapted in respect of items to which an Arabic number has been assigned to reflect the special nature of a charity's operations.

91 Although Schedule 4 requires the disclosure of certain information not referred to in this statement, the statement's recommendations, with the following exceptions, are consistent with the Schedule's requirements:

(a) In paragraph 61 it is recognised that, although the netting off of income and expenditure will usually be inappropriate, it may occasionally be acceptable. Schedule 4, paragraph 5 states that no material netting off of separate items should take place.

(b) In paragraph 66 it is recommended that the assets of a charity be analysed between fixed assets, investments, and current assets. Schedule 4 requires assets to be analysed between fixed assets and current assets. Fixed assets and current assets are designated by capital letters in the balance sheet formats. They cannot, therefore, be adapted under paragraph 3(3). However, provided that all the investments are fixed assets it should be possible to satisfy both the Companies Act formats and the recommendations of the SORP.

Scotland

92 Although the Companies Act 1985 extends to incorporated charities constituted in Scotland, there is no equivalent legislation to the Charities Act 1960 or the Charities Act 1985 in Scotland. This means that, whilst incorporated charities have to prepare and file an income and expenditure account, balance sheet and various notes in respect of each accounting period, unincorporated charities constituted in Scotland are not required by law to prepare accounts.

Northern Ireland
Charities Act 1964

93 In Northern Ireland charities are governed by the Charities Act (Northern Ireland) 1964. However, this Act requires neither registration nor the preparation or filing of accounts.

Companies (Northern Ireland) Order 1986

94 The Companies (Northern Ireland) Order 1986 is the Northern Ireland legislation equivalent to the Companies Act 1985. The references to the Companies Act 1985 in paragraphs 89 to 91 should therefore also be taken to be references to the 1986 Order.

Republic of Ireland
Charities Acts 1961 and 1973

95 In the Republic of Ireland charities are governed by the Charities Act 1961 and 1973. Neither of these Acts requires charities to register or to prepare and submit accounts.

Companies (Amendment) Act 1986

96 The Companies (Amendment) Act 1986 ('the 1986 Act') is the Republic of Ireland legislation equivalent to the Companies Act 1985. The 1986 Act references that are equivalent to those given in paragraphs 89 to 91 are as follows:

The 1985 Act	*The 1986 Act*
Schedule 4	The Schedule
Paragraph 3(3) of Sch 4	Section 4 (13)

Appendix 1 – The funds of a charity

The purpose of this appendix is to explain the legal position as regards the various funds of a charity and the implications this has for the way in which the funds are accounted for.

The types of funds a charity might have

97 A charity's funds can be categorised into restricted funds and unrestricted funds. Restricted funds are funds subject to specific conditions, imposed by the donor, or the trusts under which the donation was made, and binding on the trustees. All other funds are unrestricted funds, which means that as long as they are used in pursuance of the charity's objectives and in a way which is consistent with the charity's charitable status, their use is at the complete discretion of the trustees.

The need to distinguish between the assets and liabilities held in different funds

98 If a profit is made on the disposal of an asset, the profit will form part of the fund in which the asset was held. An unrealised profit on an asset will also form part of the fund in which the asset is held. Similarly, realised and unrealised losses and provisions for depreciation and for the permanent diminution in value of an asset reduce the fund in which the asset is (or, in the case of a realised loss, was) held. In order to ensure that profits, losses and provisions are added to or deducted from the correct fund, it is therefore essential to know which assets and liabilities are held in which fund.

99 The trustees of a charity will be in breach of trust if they use restricted income in a way which is not consistent with the restrictions imposed. To this end it is essential that items of income and expenditure are added to, or deducted from, the appropriate fund. It is also important for the trustees to ensure that the assets and liabilities held in a fund are consistent with the fund type: if a fund which, because of donor restrictions, must be used in the short-term is represented by assets which can only be utilised in the long-term, there is a real possibility that the charity will not be able to meet the restrictions.

Income derived from assets held by the charity

100 Although profits arising on the disposal of an asset will form part of the fund in which the asset was held, this will not necessarily be the case with income derived from the asset. Unless the terms on which the asset was donated make it clear than an alternative treatment should be adopted, income derived from an asset already held by the charity will be unrestricted income, even if the asset is held in a permanent endowment fund.

Permanent endowment funds

101 One particular type of restricted fund is known as a permanent endowment fund. Permanent endowment funds must be held indefinitely. This does not however necessarily mean that the assets held in the permanent endowment fund cannot be disposed of – although the terms of the endowment might prohibit this. What it does mean is that the permanent endowment fund cannot be used to make payments to others, and the assets making up the permanent endowment fund cannot be given away. Furthermore, if an asset that is held as part of a permanent endowment fund is disposed of, its place in the fund must be taken by the assets received in exchange.

102 As explained above, if a profit is made on the disposal of an asset held in a permanent endowment fund, the profit will become part of the permanent endowment and the amount of the fund will increase. The other means by which permanent endowment funds will be increased will be by receiving incoming resources received for permanent endowment (whether in the form of new permanent endowment funds or additions to existing ones) and by recognising unrealised gains on assets held in permanent endowments. On the other hand, income derived from assets held within a permanent endowment fund does not affect the amount of permanent endowment unless either the terms of the original endowment require it to do so or the Charity Commission so order.

103 Similarly, a loss made on the disposal of an asset held in a permanent endowment fund will result in the amount of the fund being decreased. Such losses are in fact the only transactions which can reduce the amount of the permanent endowment. Provisions for the depreciation of assets held in permanent endowment funds or for the permanent diminution in value of assets held in permanent endowment funds, and unrealised losses recognised in the accounts in respect of assets held in permanent endowment funds are the only other means by which a permanent endowment fund can be reduced.

104 Permanent endowment funds, because of their permanence, are tantamount to being the capital of the charity. The statement of recommended practice recognises this by recommending that increases and decreases in the amount of permanent endowment funds are not dealt with in the income and expenditure account.

Appendix 2 – Example set of accounts

105 Income and Expenditure Account
Year Ended 31 December 1987

	1987		*15 months ended 31.12.86*	
Income	£	£	£	£
Donations and gifts		7,920		8,942
Legacies		3,416		19,761
Covenanted income		15,600		15,500
Voluntary income		26,936		44,203
Grants received		2,793		2,749
Investment income		414		481
		30,143		47,433
Indirect expenditure				
Fund-raising expenses	782		656	
Publicity expenses	534		412	
Administration expenses	1,236		1,471	
		2,552		2,539
Income less indirect expenditure		27,591		44,894
Direct charitable expenditure		30,479		41,684
Income less expenditure		(2,888)		3,210

Statement of Investment Gains
Year Ended 31 December 1987

	1987	*15 months ended 31.12.86*
Realised gains on disposal of	£	£
investments	1,463	912
Change in unrealised gains/(losses)		
on investments	(1,212)	361
Net investment gains	251	1,273

The income and expenditure account and statement of investment gains should be read in conjunction with the reconciliation and analysis of movements on the funds shown on page . . .

Balance Sheet as 31 December 1987

	1987		*1986*	
	£	£	£	£
Fixed assets		5,461		5,698
Investments		3,913		4,561
Current assets				
Stock	671		631	
Debtors	483		886	
Cash at bank and in hand	816		361	
	1,970		1,878	
Current liabilities	421		216	
Net current assets		1,549		1,662
		10,923		11,921
Long-term liabilities		(248)		(225)
		10,675		11,696
Funds				
Permanent endowment funds		1,850		234
Other restricted funds		8,357		5,911
Unrestricted funds		468		5,551
		10,675		11,696

The balance sheet should be read in conjunction with the reconciliation and analysis of movements on the funds shown on page . . .

Reconciliation and Analysis of Movements on the Funds for the Year Ended 31 December 1987

	Unrestricted funds			*Restricted funds* (excluding permanent endowment funds)				*Total*	*Permanent endowment funds*
	General £	*Designated* £	*Total* £	*Core* £	*India* £	*Africa* £	*Total* £	£	£
Income	22,038	—	22,038	—	7,112	993	8,105	30,143	—
Indirect expenditure	(1,636)	—	(1,636)	—	(822)	(94)	(916)	(2,552)	—
	20,402	—	20,402	—	6,290	899	7.189	27,591	—
Opening value of funds	938	4,100	5,038	1,513	3,631	1,280	6,424	11,462	234
Funds available for use	21,340	4,100	25,440	1,513	9,921	2,179	13,613	39,053	—
New permanent endowment fund	—	—	—	—	—	—	—	—	1,020
Net investment gains	—	—	—	201	50	—	251	251	596
Charitable expenditure	(15,674)	(7,911)	(23,585)	—	(4,753)	(2,141)	(6,894)	(30,479)	—
	5,666	(3,811)	1,855	1,714	5,218	38	6,970	8,825	1,850
Transfers	(1,387)	—	(1,387)	1,387	—	—	1,387	—	—
Designations	(4,235)	4,235	—	—	—	—	—	—	—
	44	424	468	3,101	5,218	38	8,357	8,825	1,850

Analysis of Fund Balances Between the Net Assets

	Unrestricted funds	*Restricted funds* (excluding permanent endowment funds)				*Permanent endowment funds*	*Total Funds*
		Core	*India*	*Africa*	*Total*		
	£	£	£	£	£	£	£
Fixed assets	—	—	4,106	—	4,106	1,355	5,461
Investments	—	3,101	279	38	3,418	495	3,913
Net current assets	716	—	833	—	833	—	1,549
Long term liabilities	(136)	—	—	—	—	—	(136)
Provisions	(112)	—	—	—	—	—	(112)
	468	3,101	5,218	38	8,357	1,850	10,675
Represented by:							
Realised amounts	468	2,435	5,188	38	7,661	1,619	9,748
Unrealised amounts	—	666	30	—	696	231	927
	468	3,101	5,218	38	8,357	1,850	10,675

Extracts from notes

(NB Although the accounts would normally be accompanied by a full set of notes, only extracts from the notes are included here. The extracts shown illustrate some of the more important or more complex of the recommended disclosures. The notes should be cross referenced to the accounts.)

Fixed assets

	Motor vehicles	*Fixtures and fittings*	*Total*
Cost	£	£	£
Opening balance at 1 January 1987	7,531	1,100	8,631
Additions	2,980	—	2,980
Disposals	(2,329)	—	(2,329)
Closing balance at 31 December 1987	8,182	1,100	9,282
Accumulated depreciation			
Opening balance at 1 January 1987	2,383	550	2,933
Charge for the year	2,359	275	2,634
Depreciation on disposals	(1,746)	—	(1,746)
Closing balance at 31 December 1987	2,996	825	3,821
Net book value			
At 31 December 1987	5,186	275	5,461
At 1 January 1987	5,148	550	5,698

Commitments

(a) *Charitable commitments*

As explained in accounting policy note . . . , commitments for specific charitable projects are dealt with by making allocations to designated funds. Therefore, as the reconciliation and analysis of movements on the funds shows, the commitments of the charity in respect of such projects are as follows:

	1987	*1986*
	£	£
Commitments at the beginning of the period	4,100	796
Additional commitments entered into	4,235	8,213
Commitments met	(7,911)	(4,909)
Commitments at the end of the period	424	4,100

It is expected that the commitments outstanding at the period-end will all be met in 1988.

(b) *Other commitments*

In addition to the commitments referred to above, the charity has entered into the following legally-binding commitments:

	1987	1986
	£	£
For the purchase of motor vehicles	5,921	2,980

Subsidiary companies

The charity has a subsidiary, ShopCo Ltd, which undertakes trading activities. As these activities are fundamentally different from the activities of the charity, consolidated accounts have not been prepared. ShopCo Ltd operates three shops, located in various parts of the country. It purchases ornaments and artefacts from manufacturers and sells them to the public. The profits earned are passed to the charity by means of a deed of covenant; a fact which is referred to in the company's publicity material. Two trustees of the charity sit on the board of ShopCo Ltd but receive no remuneration for doing so. A summary of ShopCo Ltd's transactions and financial position is set out below.

(a) *Profit and loss account*	*1987*	*1986*
	£	£
Turnover	72,149	68,163
Cost of sales	43,637	40,611
Gross profit	28,512	27,552
Selling costs	9,361	8,800
Administration costs	3,461	3,013
Profit before deed of covenant	15,690	15,739
Deed of covenant	15,600	15,500
Profit before taxation	90	239
Taxation	—	—
Retained profit for the financial year	90	239

(b) *Balance sheet*		
Current assets		
Stock	9,239	12,576
Cash in hand and at bank	1,610	(311)
	10,849	12,265
Creditors: amounts due within one year		
Trade creditors	840	2,346
	10,009	9,919

	1987	1986
	£	£
Represented by:		
Share Capital	10,000	10,000
Profit and loss account	9	(81)
	10,009	9,919

Connected charities

The trustees of the charity are also the trustees of the Pollington Charity, a charity with which the charity shares administration facilities. Whilst the charity provides assistance and comfort to those being treated for cancer, the Pollington Charity makes grants to persons researching into cures for cancer. From time to time, loans on commercial terms may be made by one of the charities to the other, although there were no such loans outstanding at the year-end. There are no other transactions between the charities. A summarised set of accounts, in which the accounts of the charity and the Pollington Charity have been aggregated, are set out below:

(a) *Income and expenditure account*

	1987	1986
	£	£
Voluntary income	34,631	57,351
Grants received	33,961	31,621
Investment income	1,321	1,012
	69,913	89,984
Indirect expenditure	7,264	6,982
	62,649	83,002
Direct charitable expenditure	60,192	73,139
Income less expenditure	2,457	9,863

(b) *Statement of investment gains*

Realised gains	2,651	1,101
Change in unrealised gains	381	1,312
Net investment gains	3,032	2,413

	1987 £	1986 £
(c) *Balance sheet*		
Fixed assets	5,461	5,698
Investments	28,140	24,163
Current assets	4,136	2,011
Current liabilities	(4,596)	(6,035)
Long-term liabilities	(248)	(225)
	32,893	25,612
Permanent endowment funds	6,211	4,419
Other restricted funds	10,487	9,321
Unrestricted funds	16,195	11,872
	32,893	25,612

The Pollington Charity can be contacted at the following address: . . . (Not shown)