CHARITIES SORP (FRS 102)

Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland

INFORMATION SHEET 2: Accounting for gift aid payments made by a subsidiary to its parent charity where no legal obligation to make the payment exists

Publication date: January 2019

CIPFA The Chartered Institute of Public Finance & Accountancy

CHARITY COMMISSION FOR ENGLAND AND WALES

The Charity Commission for Northern Ireland

OSCR Scottish Charity Regulator

Background

The Charity Commission for England and Wales (CCEW), the Charity Commission for Northern Ireland (CCNI), and the Office of the Scottish Charity Regulator (OSCR) comprise the joint SORP-making body for charities and as such are required by the Financial Reporting Council (FRC), in accordance with its Policy on Developing Statements of Recommended Practice (SORPs), to keep the Statement of Recommended Practice (SORP) under review.

As part of this work, the joint SORP-making body may issue information sheets which seek to clarify the application of the SORP or of particular recommendations contained within the SORP. Information sheets may also cover matters not addressed in either FRC standards or the SORP, but are relevant to charity reporting and on which the joint SORP-making body considers additional guidance to be necessary. Information sheets do not amend the SORP, are advisory in nature and are released to assist preparers, auditors and examiners of accounts.

It should be noted that information sheets do not form part of the SORP, nor are they reviewed by the FRC and therefore they do not carry the authority of the SORP. They do not introduce new standards for the preparation of financial statements or impose particular interpretations of statutory prescriptions or recommendations of the SORP.

Context

This information sheet was developed by the joint SORP-making body with the assistance of a working group formed of members of the advisory SORP Committee. Information sheets represent the views of the SORP-making body and its advisory SORP Committee.

All reasonable care has been exercised in preparing this information sheet. However, it is important for preparers of accounts to make reference both to the relevant SORP modules and to FRS 102 when preparing accounts and in making the required disclosures. As part of this process, preparers should also refer to the primary sources of guidance cited within the information sheet.

Charities and their subsidiaries may wish to take independent advice from appropriately qualified professional persons specific to their own circumstances, in particular if there is any reason to suppose that the facts differ from those considered for illustrative purposes within this information sheet. This is recommended due to the complexity of the law in this particular area, and the potential for misstatement.

References to legislation and reporting standards are correct at the date of publication. Where this information sheet predates changes in legislation or accounting standards and a conflict is thereby created, or other developments lead to a conflict, the affected provisions of the SORP and clarifications offered in this information sheet cease to have effect.

1. Introduction

Purpose of Information Sheet

1.1 This information sheet assists practitioners in implementing the clarification and corresponding changes to the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) and the Charities SORP (FRS 102) in respect of the accounting for gift aid payments made by a subsidiary to its parent charity where no legal obligation exists. It aims to provide guidance on the requirements of FRS 102 and the recommendations of the SORP related to this issue and suggest possible solutions for the implementation and disclosures of these changes. However, this information sheet should not be relied upon as a definitive statement on the application of accounting standards or recommendations of the SORP.

Scope

1.2 This information sheet covers the accounting changes and disclosures required where there is no legal obligation for the subsidiary entity to make a gift aid payment to the parent charity. The implementation guidance and the illustrative examples focus solely on this scenario. The accounting changes and disclosures required where there is a legal obligation for the subsidiary entity to make a gift aid payment to the parent charity are **not** covered in this information sheet.

1.3 This information sheet primarily focuses on the accounting changes and the impact on the subsidiary entity. However, the changes in accounting for the gift aid payment may also have an impact on the parent charity's financial statements.

1.4 The information sheet has been developed primarily to assist practitioners' first-time application of these changes. However, it will remain relevant after this time, for example where a subsidiary changes its practice for making gift aid payments to its parent charity or a charity establishes a subsidiary undertaking.

Application for entities using Section 1A of FRS 102 or applying FRS 105

1.5 This information sheet is written primarily for subsidiary entities of a charitable parent that apply FRS 102. Subsidiary entities that use Section 1A *Small Entities* of FRS 102 may still find the information sheet useful because the recognition and measurement requirements of FRS 102 also apply to these entities. As the information sheet provides guidance relating to the presentation and disclosure requirements of FRS 102, small subsidiary entities should refer to the applicable requirements of Section 1A, since some of the FRS 102 requirements may not apply to them.

1.6 Similarly, for subsidiary entities that apply FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, some of the content of the information sheet may be useful, but there are a number of significant differences between the recognition, measurement, presentation and disclosure requirements of FRS 102 and FRS 105. This affects the extent to which the information sheet can be used by a subsidiary entity applying FRS 105. If a subsidiary entity applying FRS 105 wishes to use this information sheet it needs to do so by reference to FRS 105.

2. Index of Topics (Hyperlinked index)

3. Recognising a gift aid payment made by a subsidiary to its parent charity

3.1 The FRC issued Amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications ('Triennial Review 2017 Amendments') in December 2017. FRS 102 was updated for these amendments and a revised edition of the standard was published in March 2018.

3.2 The Basis for Conclusions which accompanies FRS 102 (March 2018) summarise the main issues considered by the FRC in amending FRS 102 for the accounting for gift aid payments made by a subsidiary to its parent charity. Paragraph B29.12 states that '*… although such payments are donations for tax purposes, they are a distribution from the entity to its owners for company law purposes*'[1].

3.3 Paragraph B29.13 clarifies that '*FRS 102 requires the gift aid payment to be accounted for as a distribution to owners*'. The paragraph then goes on to specify that paragraph 32.8 of FRS 102 '*… should be applied to gift aid payments, and an expected gift aid payment shall not be accrued unless a legal obligation to make the payment exists at the reporting date. A board decision to make a gift aid payment to a parent charity, that has been taken prior to the reporting date, is not sufficient to create a legal obligation.*'.

3.4 In effect, a gift aid payment should be treated akin to a dividend.

3.5 Where a gift aid payment is unpaid at the reporting date, it can only be recognised if a legal obligation for the subsidiary to make a payment to the parent charity exists at the reporting date.

3.6 Notwithstanding the accounting treatment, under gift aid rules, it is not necessary for there to be a legal obligation to make the payment in order for it to be eligible for corporation tax relief. However, the payment must be made to the parent charity during the 9 months following the relevant reporting date in order to be eligible.

[1] Confirmed through legal advice received by the ICAEW (see ICAEW Technical Release TECH 16/14BL REVISED *Guidance on donations by a company to its parent charity*, paragraph 2)

4. Accounting for tax associated with expected gift aid payments

4.1 Where the subsidiary does not have a legal obligation to distribute its profits to its owners at the reporting date by way of gift aid payment, it would have taxable profits and need to recognise a tax expense in profit or loss. However, paragraph 29.14A of FRS 102 requires the tax effects of the expected gift aid payment to be taken into account when it is probable that the gift aid payment will be made within 9 months of the reporting date. Therefore FRS 102 requires the gift aid relief to be recognised at the reporting date before the gift aid payment is reflected in its financial statements in circumstances where there is no legal obligation at the reporting date. The tax charge and corresponding tax relief effectively net off, resulting in an overall nil tax charge. The relief must be presented in profit or loss, in accordance with paragraph 29.22A of FRS 102.

4.2 As a consequence of this exception, a current or deferred tax liability is not recognised by the subsidiary in relation to such a gift aid payment.

4.3 However, any other tax effects (i.e. both current and deferred taxation) are required be recognised by the subsidiary, when relevant, and in accordance with Section 29 of FRS 102. For example if an entity:

- does not expect to distribute all of its taxable profits (*in such cases there will be a current tax effect to account for*); or
- has an anticipated capital gain as a result of the revaluation of items of property, plant and equipment (*in such cases there will be a deferred tax effect to account for*).

5. Presentation of change in accounting

Background

5.1 The amendments to FRS 102 for this accounting issue aim to improve the consistency of reporting by public benefit entity groups and the entities within those groups. The amendments reflect the legal status of expected gift aid payments as distributions from the subsidiary to its owner(s).[2]

5.2 As previously noted in Section 3, the amendments were issued in December 2017 as part of the FRC's Triennial Review 2017 Amendments. As part of this review, the FRC clarified that a gift aid payment can only be accrued where a legal obligation to make the payment exists at the reporting date and introduced an exception for accounting for the tax effects of an expected gift aid payment.

Effective date

5.3 The Triennial Review 2017 Amendments are effective for accounting periods beginning on or after 1 January 2019. Paragraph 1.18(b) of FRS 102 permits early application of those amendments which relate to the taxation impact of this accounting issue without early application of the rest of the Triennial Review 2017 Amendments. Section 4 of this information sheet provides details of these amendments which relate to the tax effects of expected gift aid payments.

5.4 Any other changes that are necessary to comply with clarification around the accounting for gift aid payments detailed in this information sheet must be adopted immediately given they reflect existing requirements of FRS 102 which are already applicable for subsidiary entities preparing accounts in accordance with that standard.

Presentation of changes

5.5 The Triennial Review 2017 Amendments provided clarification around the accounting for gift aid payments and the related tax relief.

5.6 Where the application of the Triennial Review 2017 Amendments:

- changes an entity's existing accounting policy for expected gift aid payments and/or the related tax relief; and
- these transactions are material,

then these changes in accounting policies will require full retrospective application in accordance with paragraphs 10.11 and 10.12 of FRS 102.

5.7 Both the potential change of accounting for the gift aid payment and the change of accounting for the related tax relief can be separate prior period adjustments. Section 7 of this information sheet includes illustrative examples of the possible impact of these changes in accounting policies for the subsidiary entity making the gift aid payment.

[2] See ICAEW Technical release TECH 16/14BL REVISED *Guidance on donations by a company to its parent charity*

6. Accounting for gift aid income in the parent charity

6.1 SORP Update Bulletin 2 updates the Charities SORP (FRS 102) for the Triennial Review 2017 Amendments to FRS 102. The Update Bulletin was published on 5 October 2018 and amends Module 5 of the SORP to cover the recognition of gift aid payments made by a subsidiary to its parent charity. Paragraph 5.52 of the SORP clarifies that gift aid income is accrued when the gift aid payment is payable to the parent charity under a legal obligation.

6.2 A prior period restatement may be required where material gift aid income had previously been recognised by the parent charity in the absence of a legal obligation at the reporting date. Where material, the change in accounting policy will require full retrospective application in accordance with paragraphs 10.11 and 10.12 of FRS 102.

6.3 Such prior period restatements will impact the parent charity's Statement of Financial Activities (SoFA) and Balance Sheet only and not the consolidated charity financial statements given that the gift aid income is fully eliminated on consolidation.

7. Examples - accounting for gift aid payments and the associated tax relief

7.1 These examples relate to situations where there is no legal obligation for the subsidiary entity to make a gift payment to the parent charity at the reporting date. They illustrate the key principles for the accounting of gift aid payments and the related tax effects from the perspective of the subsidiary entity making the payment. They do not cover all possible scenarios.

7.2 The following summarises the key characteristics of each example:

- Example 1: *Previously accounted for the gift aid payment as an expense in the income statement when profits arose* - no legal obligation at the reporting date
- Example 2: *Previously accounted for the gift aid payment in equity when profits arose* - no legal obligation at the reporting date
- Example 3: *Previously accounted for the gift aid payment in equity when paid* - no legal obligation at the reporting date
- Example 4: *Previously accounted for the gift aid payments as an expense in the income statement when profits arose: an interim gift aid payment made during the reporting period* - no legal obligation at the reporting date for the final gift aid payment

Financial statement presentation

7.3 FRS 102 requires the gift aid payment to be accounted for as a distribution to owners. The subsidiary entity has applied paragraph 22.17 of FRS 102 which requires distributions to owners to be recognised in equity. Therefore the transaction is shown as a movement in reserves, which may either be reported within a 'Statement of Income and Retained Earnings' or be shown within a separate 'Statement of Changes in Equity'.

7.4 In each example, the subsidiary entity has presented a single 'Statement of Income and Retained Earnings' in place of the 'Statement of Comprehensive Income' and 'Statement of Changes in Equity', as permitted under paragraph 3.18 of FRS 102. This assessment is based on the gift aid payment, as a distribution to owners, being akin to a dividend and therefore included in the changes to equity listed in this paragraph.

7.5 The examples do not consider the impact on all primary statements.

Presentation of tax

7.6 In each example, the tax relief in respect of gift aid has been shown separately on the face of the income statement to illustrate how the tax charge and corresponding tax relief net off. Paragraph 5.5B of FRS 102 requires the presentation of a single taxation line. However the subsidiary entity may show the additional disclosure on the face of the income statement in accordance with paragraph 5.9 of FRS 102.

7.7 Where a single taxation line is presented, the tax charge and corresponding tax relief would be shown within a tax reconciliation as required by paragraph 29.27(b) of FRS 102. The examples do not include a tax reconciliation.

Changes in accounting policies

7.8 The changes in accounting policies as a result of the Triennial Review 2017 Amendments require full retrospective application in accordance with paragraphs 10.11 and 10.12 of FRS 102. In each example, the subsidiary entity has applied those changes to its accounting policies as a result of the triennial review amendments in its financial statements for the year ended 31 December 2018, with 1 January 2017 as the effective date of transition when the amendments are applicable. Therefore the (new) accounting policies have also been applied to comparative information for the year ended 31 December 2017, as the prior reporting period, as if the (new) accounting policies have always been applied. As a result, the entity has retrospectively restated its retained earnings at 1 January 2017 to reflect the new accounting policies.

Presentation of accounting policies

7.9 Extracts of example accounting policies for each scenario have been provided. These extracts cover the change in accounting policies for gift aid payments, the related tax effects and any prior year adjustments.

7.10 In cases where the changes in accounting policies result in significant retained earnings being reported by the subsidiary entity at the reporting date, the subsidiary entity may wish to provide additional disclosures in the financial statements to aid users understanding of the impact of the changes. This information sheet does not cover such additional disclosures.

Assumptions

7.11 In providing these examples, the following assumptions have been made:

- There is no legal obligation to make the gift aid payment at the reporting date.
- The reporting entity is wholly-owned by its parent charity. The examples do not consider the accounting for gift aid payments made to other charitable group members or related parties, nor where different ownership structures are in place.
- The subsidiary entity is a private company limited by shares which prepares financial statements in accordance with FRS 102.
- Taxable profits are equal to accounting profits and accounting reserves are equal to distributable profits.
- The tax rate has been assumed as 20% for years ending 31 December 2017 and 31 December 2018.
- All taxable profits will be paid by the subsidiary entity to its parent charity via a gift aid payment made within 9 months of the reporting date. The payment is made after the financial statements have been approved.
- The subsidiary entity has elected to apply paragraphs 29.14A and 29.22A of FRS 102 in its financial statements for the year ended 31 December 2018. This early adoption is permitted in paragraph 1.18(b) of FRS 102 and must be disclosed as part of the information about the basis of preparation in the notes to the financial statements.

Example 1: ***Previously accounted for the gift aid payment as an expense in the income statement when profits arose* - no legal obligation at the reporting date**

In this example the entity is required to:

- *recognise the gift aid payment when paid (i.e. in the following year's accounts); and*
- *change the presentation of the gift aid payment in the statutory accounts (i.e. recognise the payment in reserves rather than in the income statement).*

Background

The subsidiary did not have a legal obligation to make a payment to its parent charity at the reporting date. However, the board has indicated its intention to pay all the taxable profits for the reporting period to the parent charity. The taxable profits are finalised and paid once the financial statements of the subsidiary have been approved. The subsidiary has previously accrued the gift aid payments as an expense in the income statement at each reporting date based on the taxable profits for the reporting period.

Under FRS 102, a gift aid payment is a distribution to the subsidiary's owners and should not be accrued unless a legal obligation to make the payment exists at the reporting date. As the subsidiary does not have any legal obligation in place in respect of the gift aid payments at the reporting dates, the gift aid payment in respect of the reporting period is recognised in the subsequent reporting period (i.e. when paid). Also, in accordance with paragraph 22.17 of FRS 102, the gift aid payment should now be recognised as a distribution to owners in equity and not as an expense in the income statement. The subsidiary reflects these changes in accounting as prior year adjustments. They are considered changes in accounting policy and accounted for in accordance with Section 10 of FRS 102.

The subsidiary previously recognised the tax relief on gift aid payments in the income statement, therefore no prior year adjustment is required in respect of the tax relief. The application of paragraph 29.14A of FRS 102 following the triennial review amendments effectively results in an overall nil tax charge in the income statement. This exception is only applicable as long as it is probable that the gift aid payment will be made to the parent charity within 9 months of the reporting date.

A: *Extract of subsidiary's statement of income and retained earnings for Example 1*

Statement of Income and Retained Earnings
for the year ended 31 December 2018

	Note	2018 £	Restated 2017 £	Original 2017 * £
Turnover		50,000	40,000	40,000
Cost of sales		(35,000)	(30,000)	(30,000)
Operating profit		15,000	10,000	10,000
Interest payable		(500)	(500)	(500)
Profit before taxation		**14,500**	**9,500**	**9,500**
Gift aid payment to parent charity		-	-	(9,500)
Tax (charge) on profit at 20%		(2,900)	(1,900)	-
Tax relief in respect of gift aid	**1**	2,900	1,900	-
Profit after tax and for the year		**14,500**	**9,500**	-
Opening retained earnings as previously reported			-	
Prior year adjustment	**2**		4,500	
Opening retained earnings		9,500	4,500	-
Payment to parent charity made under the gift aid scheme	**3**	(9,500)	(4,500)	-
Closing retained earnings		**14,500**	**9,500**	-

***** Original column for the year ended 31 December 2017 has been included for information purposes only

Notes

1 Paragraph 29.14A of FRS 102 has been applied, allowing the tax relief on gift aid payments to be recognised in the period to which it relates. This exception is only applicable as long as it is probable that the gift aid payment will be made to the parent charity within 9 months of the reporting date. As the entity has elected to apply this paragraph early, it will be disclosed as part of the information about the basis of preparation in the notes to the financial statements.

The tax relief in respect of gift aid has been shown separately on the face of the statement to illustrate how the tax charge and corresponding tax relief net off. Paragraph 5.5B of FRS 102 requires the presentation of a single taxation line. However, the subsidiary may show the additional disclosure on the face of the income statement in accordance with paragraph 5.9 of FRS 102.

2 For the year ended 31 December 2016 the profit before taxation for the year was £4,500. Therefore, a prior year adjustment of £4,500 is required in the year ended 31 December 2017, to reflect the change of accounting for gift aid previously expensed in the income statement.

3 In the year ended 31 December 2017 £4,500 is recognised as a distribution relating to the gift aid payment made in respect of the year ended 31 December 2016.

In the year ended 31 December 2018, a gift aid payment of £9,500 has been recognised as a distribution, in respect of the year ended 31 December 2017.

B: *Example of an accounting policy for gift aid for Example 1*

Gift aid payment to parent charity

The company pays all its taxable profits for the reporting period to its parent charity under the gift aid scheme. These gift aid payments are recognised as distributions to owners in equity within retained earnings.

At the reporting date there was no legal obligation in place for the company to make this gift aid payment, although prior to the reporting date the board had indicated its intention to pay the taxable profits to the parent charity in respect of the reporting period. The payment is expected to be made within 9 months of the end of the reporting date.

The company previously recognised gift aid payments in the income statement in the year that the profits arose. The company has changed its accounting policy as a result of The Financial Reporting Council clarifying the accounting treatment for such payments in its triennial review of FRS 102. Therefore the prior year comparative figures have been restated to reflect this change.

There is a prior year adjustment of £4,500 reflecting the change in accounting for the gift aid payment for the year ended 31 December 2016. This increases the opening retained earnings for the year ended 31 December 2017 by this amount.

The change in accounting policy for gift aid payments results in the company recognising a taxation charge on its profits for the year. However, the application of the exception under paragraph 29.14A of FRS 102 provides relief in respect of the accounting for the tax charge. This results in an overall nil charge for tax in the income statement. This exception is only applicable as it is probable that the gift aid payment will be made by the company to the parent charity within 9 months of the reporting date.

Example 2: ***Previously accounted for the gift aid payment in equity when profits arose*** **- no legal obligation at the reporting date**

In this example the entity is required to:

- *recognise the gift aid payment when paid (i.e. in the following year's accounts); and*
- *change the presentation of the tax relief on the gift aid payment in the statutory accounts (i.e. recognise the relief in the income statement rather than in reserves).*

Background

The subsidiary did not have a legal obligation to make a payment to its parent charity at the reporting date. However, the board has indicated its intention to pay all the taxable profits for the reporting period to the parent charity. The taxable profits are finalised and paid once the financial statements of the subsidiary have been approved. The subsidiary has previously accrued the gift aid payments as distributions to owners in equity at each reporting date based on the taxable profits for the reporting period.

Under FRS 102, a gift aid payment is a distribution to the subsidiary's owners and should not be accrued unless a legal obligation to make the payment exists at the reporting date. As the subsidiary does not have any legal obligation in place in respect of the gift aid payments at the reporting dates, the gift aid payment in respect of the reporting period is recognised in the subsequent reporting period (i.e. when paid). The subsidiary reflects this change in accounting as a prior year adjustment. The change in the timing and recognition of gift aid payments is considered a change in accounting policy and accounted for in accordance with Section 10 of FRS 102.

As the subsidiary has previously recognised gift aid payments in equity, no change is required in respect of the presentation of the gift aid payments in the statutory accounts.

The subsidiary has also previously recognised the tax relief on gift aid payments in equity. As a result of the application of paragraph 29.22A of FRS 102, this tax relief is recognised in the income statement. This amendment was made as part of the triennial review amendments and represents a change in accounting policy. Therefore, the change is applied by the subsidiary retrospectively in accordance with Section 10 of FRS 102 and results in the prior year financial statements being restated. The change effectively results in an overall nil tax charge in income statement.

A: *Extract of subsidiary's statement of income and retained earnings for Example 2*

Statement of Income and Retained Earnings
for the year ended 31 December 2018

	Note	2018 £	Restated 2017 £	Original 2017 * £
Turnover		50,000	40,000	40,000
Cost of sales		(35,000)	(30,000)	(30,000)
Operating profit		15,000	10,000	10,000
Interest payable		(500)	(500)	(500)
Profit before taxation		**14,500**	**9,500**	**9,500**
Tax (charge) on profit at 20%		(2,900)	(1,900)	(1,900)
Tax relief in respect of gift aid	1	2,900	1,900	-
Profit after tax and for the year		**14,500**	**9,500**	**7,600**
Opening retained earnings as previously reported			-	
Prior year adjustment	2		4,500	
Opening retained earnings		9,500	4,500	-
Payment to parent charity made under the gift aid scheme	3	(9,500)	(4,500)	(9,500)
Tax relief on gift aid payment made		-	-	1,900
Closing retained earnings		**14,500**	**9,500**	-

***** Original column for the year ended 31 December 2017 has been included for information purposes only

Notes

1 Paragraph 29.14A of FRS 102 has been applied, allowing the tax relief on gift aid payments to be recognised in the period to which it relates. This exception is only applicable as long as it is probable that the gift aid payment will be made to the parent charity within 9 months of the reporting date. As the entity has elected to apply this paragraph early, it will be disclosed as part of the information about the basis of preparation in the notes to the financial statements.

The tax relief in respect of gift aid has been shown separately on the face of the statement to illustrate how the charge and corresponding tax relief net off. Paragraph 5.5B of FRS 102 requires the presentation of a single taxation line. However, the subsidiary may show the additional disclosure on the face of the income statement in accordance with paragraph 5.9 of FRS 102.

2 For the year ended 31 December 2016 the profit before taxation for the year was £4,500. Therefore, a prior year adjustment of £4,500 is required in the year ended 31 December 2017, to reflect the change of accounting for gift aid previously recognised in equity when the related profits arose.

3 In the year ended 31 December 2017 £4,500 is recognised as a distribution relating to the gift aid payment made in respect of the year ended 31 December 2016.

In the year ended 31 December 2018, a gift aid payment of £9,500 has been recognised as a distribution, in respect of the year ended 31 December 2017.

B: *Example of an accounting policy for gift aid for Example 2*

Gift aid payment to parent charity

The company pays all its taxable profits for the reporting period to its parent charity under the gift aid scheme. These gift aid payments are recognised as distributions to owners in equity within retained earnings.

At the reporting date there was no legal obligation in place for the company to make this gift aid payment, although prior to the reporting date the board had indicated its intention to pay the taxable profits to the parent charity in respect of the reporting period. The payment is planned to be made within 9 months of the end of the reporting date.

The company previously recognised gift aid payments in equity in the year that the profits arose. The company has changed its accounting policy as a result of The Financial Reporting Council clarifying the accounting treatment for such payments in its triennial review of FRS 102. Therefore the prior year comparative figures have been restated to reflect this change.

There is a prior year adjustment relating to the gift aid payment of £4,500 in respect of the year ended 31 December 2016 which increases the opening retained earnings for the year ended 31 December 2017 by this amount.

In addition, the company previously recognised tax relief gift aid payments in equity. On application of the FRS 102 triennial review amendments, the company has applied paragraphs 29.14A and 29.22A of FRS 102. Tax relief continues to be recognised in the reporting period in which the profits arise, but is now recognised in the income statement and not in equity. Therefore the prior year comparative figures have also been restated to reflect this change. The income statement is restated to recognise the tax relief of £1,900 in respect of the gift payment for the year ended 31 December 2017. This results in an overall nil charge for tax in the income statement.

Example 3: ***Previously accounted for the gift aid payment in equity when paid -*** no legal obligation at the reporting date

In this example the entity is required to:

- *recognise the tax relief on the gift aid payment before the payment is reflected in the statutory accounts (i.e. in advance of the gift payment being recognised); and*
- *change the presentation of the tax relief on the gift aid payments in the statutory accounts (i.e. recognise the tax relief in the income statement rather than in reserves).*

Background

The subsidiary did not have a legal obligation to make a payment to its parent charity at the reporting date. However, the board has indicated its intention to pay all the taxable profits for the reporting period to the parent charity. The taxable profits are finalised and paid once the financial statements of the subsidiary have been approved. The subsidiary has previously recognised this payment as a distribution to owners in accordance with the requirements of FRS 102 and has recognised all gift aid payments in equity in the year that they were paid to the parent charity. Therefore in this example, no change is required in respect of the accounting for the gift aid payments.

However, the subsidiary previously recognised the tax relief on gift aid payments in equity in the year that the gift aid payment was paid to the parent charity. Paragraph 29.14A of FRS 102 requires the tax effects of the expected gift aid payment to be taken into account when it is probable that the gift aid payment will be made within 9 months of the reporting date. Paragraph 29.22A of FRS 102 requires the tax relief to be recognised in the income statement. Therefore the gift aid relief is recognised at the reporting date before the gift aid payment for the period is reflected in the financial statements, resulting in an overall nil tax charge in the income statement. These changes are made as part of the triennial review amendments and represent a change in accounting policy. Therefore, the change is applied by the subsidiary retrospectively in accordance with Section 10 of FRS 102 and results in the prior year financial statements being restated.

A: *Extract of subsidiary's statement of income and retained earnings for Example 3*

Statement of Income and Retained Earnings
for the year ended 31 December 2018

	Note	2018 £	Restated 2017 £	Original 2017 * £
Turnover		50,000	40,000	40,000
Cost of sales		(35,000)	(30,000)	(30,000)
Operating profit		15,000	10,000	10,000
Interest payable		(500)	(500)	(500)
Profit before taxation		**14,500**	**9,500**	**9,500**
Tax (charge) on profit at 20%		(2,900)	(1,900)	(1,900)
Tax relief in respect of gift aid	**1**	2,900	1,900	-
Profit after tax and for the year		**14,500**	**9,500**	**7,600**
Opening retained earnings as previously reported			3,600	
Prior year adjustment	**2**		900	
Opening retained earnings		9,500	4,500	3,600
Payment to parent charity made under the gift aid scheme	**3**	(9,500)	(4,500)	(4,500)
Tax relief on gift aid payment made		-	-	900
Closing retained earnings		**14,500**	**9,500**	**7,600**

***** Original column for the year ended 31 December 2017 has been included for information purposes only

Notes

1 Paragraph 29.14A of FRS 102 has been applied, allowing the tax relief on gift aid payments to be recognised in the period to which it relates. This exception is only applicable as long as it is probable that the gift aid payment will be made to the parent charity within 9 months of the reporting date. As the entity has elected to apply this paragraph early, it will be disclosed as part of the information about the basis of preparation in the notes to the financial statements.

The tax relief in respect of gift aid has been shown separately on the face of the statement to illustrate how the charge and corresponding tax relief net off. Paragraph 5.5B of FRS 102 requires the presentation of a single taxation line. However, the subsidiary may show the additional disclosure on the face of the income statement in accordance with paragraph 5.9 of FRS 102.

2 The subsidiary reported profit before taxation of £4,500 for the year ended 31 December 2016. As the company pays all its taxable profits for the reporting period to its parent charity under the gift aid scheme, the associated tax relief of this gift aid payment is £900 (£4,500 × 20%).

Prior year restatement is now required due to a change in accounting policy as tax relief on gift aid payments is recognised in the income statement as opposed to equity. This reflects the application of the triennial review amendments as the subsidiary is required to apply paragraph 29.14A and 29.22A of FRS 102. Therefore tax relief of £900 is reversed from equity and recognised in income statement instead. This adjustment is made as an accounting entry through the 2017 retained earnings.

3 The subsidiary had reported taxable profits of £4,500 for the year ended 31 December 2016. These taxable profits were paid as gift aid to the parent charity in the year ended 31 December 2017 and recognised in equity. The subsidiary did not account for this gift aid payment in the year ended 31 December 2016 as there was no legal obligation to make the payment at the reporting date.

A gift aid payment of £9,500 has been recognised in equity in the year ended 31 December 2018. This is in respect of the profits made in the year ended 31 December 2017. As there is no legal obligation at the reporting date to make payments under gift aid, this amount is the amount of gift aid paid in the reporting period.

B*: Example of an accounting policy for gift aid for Example 3*

Gift aid payment to parent charity

The company pays all its taxable profits for the reporting period to its parent charity under the gift aid scheme. These gift aid payments are recognised as distributions to owners in equity within retained earnings.

The company does not have a legal obligation in place at the reporting date to make the payment of its taxable profits to the parent charity under the gift aid scheme. Therefore, gift aid payments are only recognised in the reporting period that the payments are made. The gift aid payment for the current reporting period is expected to be made within 9 months of the reporting date.

The company previously recognised the related tax relief in equity within retained earnings in the year that the gift aid payment was made to the parent charity. On application of the triennial review amendments, the subsidiary has applied paragraph 29.14A and 29.22A of FRS 102. This has resulted in a change in accounting policy. Tax relief is now recognised in the reporting period in which the profits arise and is also recognised in the income statement and not in equity.

There is a prior year adjustment relating to tax relief of £900 in respect of the gift aid payment of £4,500 for the year ended 31 December 2016. This increases the opening retained earnings brought forward at 1 December 2017. The income statement for the year to 31 December 2017 is also restated to recognise the tax relief of £1,900 in respect of the gift payment for the period. This results in an overall nil charge for tax in the income statement.

Example 4: ***Previously accounted for the gift aid payments as an expense in the income statement when profits arose: an interim gift aid payment made during the reporting period*** **- no legal obligation at the reporting date for the final gift aid payment**

In this example the entity is required to:

- *recognise the final gift aid payment when paid (i.e. in the following year's accounts); and*
- *change the presentation of the gift aid payment in the statutory accounts (i.e. recognise the payment in reserves rather than in the income statement).*

Background

All taxable profits are paid by the subsidiary to its parent charity via an interim gift aid payment made during the reporting period and a final gift aid payment made after the reporting date. The final gift aid payment is equal to the taxable profits for reporting period less the interim gift aid payment made in the period. The taxable profits are finalised and the final gift aid payment paid once the financial statements of the subsidiary have been approved. The subsidiary has previously accrued the final gift aid payment as an expense in the income statement at each reporting date. The subsidiary does not have any legal obligation in place in respect of the final gift aid payment at the reporting date.

For the year ended 31 December 2017, the subsidiary reported profit before taxation of £9,500. The subsidiary made an interim gift aid payment of £5,000 during the year ended 31 December 2017 to its parent charity and a final gift aid payment of £4,500 during the year ended 31 December 2018. Similarly, for the year ended 31 December 2018, the subsidiary reported profits before taxation of £14,500. The subsidiary made an interim gift aid payment of £7,500 during the year ended 31 December 2018 to its parent charity. The final gift aid payment for the reporting period of £7,000 is expected to be made within 9 months of 31 December 2018.

Under FRS 102, a gift aid payment is a distribution to the subsidiary's owners and should not be accrued unless a legal obligation to make the payment exists at the reporting date. As the subsidiary does not have any legal obligation in place in respect of the final gift aid payments at the reporting dates, the final gift aid payment in respect of the reporting period is recognised in the subsequent reporting period (i.e. when paid). Also, in accordance with paragraph 22.17 of FRS 102, the gift aid payments should now be recognised as a distribution to owners in equity and not as an expense in the income statement. The subsidiary reflects these changes in accounting as prior year adjustments. They are considered changes in accounting policy and accounted for in accordance with Section 10 of FRS 102.

The subsidiary previously recognised the tax relief on gift aid payments in the income statement, therefore no prior year adjustment is required in respect of the tax relief. The application of paragraph 29.14A of FRS 102 following the triennial review amendments effectively results in an overall nil tax charge in the income statement as shown in the statement of income and retained earnings. This exception is only applicable as long as it is probable that the final gift aid payment will be made to the parent charity within 9 months of the reporting date.

A: *Extract of subsidiary's statement of income and retained earnings for Example 4*

Statement of Income and Retained Earnings
for the year ended 31 December 2018

	Note	2018 £	Restated 2017 £	Original 2017 £ *
Turnover		50,000	40,000	40,000
Cost of sales		(35,000)	(30,000)	(30,000)
Operating profit		15,000	10,000	10,000
Interest payable		(500)	(500)	(500)
Profit before taxation		**14,500**	**9,500**	**9,500**
Gift aid payment to parent charity		-	-	(9,500)
Tax (charge) on profit at 20%		(2,900)	(1,900)	-
Tax relief in respect of gift aid	**1**	2,900	1,900	-
Profit after tax and for the year		**14,500**	**9,500**	-
Opening retained earnings as previously reported			-	
Prior year adjustment	**2**		4,000	
Opening retained earnings		4,500	4,000	-
Payment to parent charity made under the gift aid scheme				
Interim gift aid payment	**3**	(7,500)	(5,000)	-
Final gift aid payment in respect of the prior year	**4**	(4,500)	(4,000)	-
Closing retained earnings		**7,000**	**4,500**	-

***** Original column for the year ended 31 December 2017 has been included for information purposes only

Notes

1 Paragraph 29.14A of FRS 102 has been applied, allowing the tax relief on gift aid payments to be recognised in the period to which it relates. This exception is only applicable as long as it is probable that the gift aid payment will be made to the parent charity within 9 months of the reporting date. As the entity has elected to apply this paragraph early, it will be disclosed as part of the information about the basis of preparation in the notes to the financial statements.

The tax relief in respect of gift aid has been shown separately on the face of the statement to illustrate how the tax charge and corresponding tax relief net off. Paragraph 5.5B of FRS 102 requires the presentation of a single taxation line in the income statement. However, the subsidiary may show the additional disclosure on the face of the income statement in accordance with paragraph 5.9 of FRS 102.

2 For the year ended 31 December 2016, the subsidiary reported profit before taxation of £6,000. The subsidiary made an interim gift aid payment of £2,000 during the year ended 31 December 2016 to its parent charity and a final gift aid payment of £4,000 during the year ended to 31 December 2017.

The interim gift aid payment of £2,000 was recognised in the year as it was paid. Therefore no change is required in respect of the accounting for this gift aid payment.

The final gift aid payment of £4,000 was accrued at 31 December 2016 as an expense in the income statement. However, at this date there was no legal obligation in place for the company to make this gift aid payment. Therefore, a prior year adjustment of £4,000 is required in the year ended 31 December 2017, to reflect the change of accounting for gift aid previously expensed in the income statement. The final gift aid payment of £4,000 is recognised in equity in the year ended 31 December 2017 (i.e. when it was paid).

3 The interim gift aid payment of £5,000 made in the year ended 31 December 2017 is recognised in equity.

The interim gift aid payment of £7,500 made in the year ended 31 December 2018 is recognised in equity.

4 A final gift aid payment of £4,000 has been recognised in equity in the year ended 31 December 2017, which relates to the year ended 31 December 2016.

A final gift aid payment of £4,500 has been recognised in equity in the year ended 31 December 2018, which relates to the year ended 31 December 2017.

B*: Example of an accounting policy for gift aid for Example 4*

Gift aid payment to parent charity

The company pays all its taxable profits for the reporting period to its parent charity under the gift aid scheme. These gift aid payments are recognised as distributions to owners in equity within retained earnings.

The company does not have any legal obligation in place at the reporting date to make the final gift aid payment in respect of the reporting period to the parent charity. Therefore, gift aid payments are only recognised in the reporting period that the payment is made. The final gift aid payment is planned to be made within 9 months of the end of the reporting date.

The company previously recognised gift aid payments in the income statement in the year that the profits arose. The company has changed its accounting policy as a result of The Financial Reporting Council clarifying the accounting treatment for such payments in its triennial review of FRS 102. Therefore the prior year comparative figures have been restated to reflect this change.

There is a prior year adjustment of £4,000 reflecting the change in accounting for the final gift aid payment for the year ended 31 December 2016. This increases the opening retained earnings for the year ended 31 December 2017 by this amount.

The change in accounting policy for gift aid payments results in the company recognising a taxation charge on all of its profits for the year. However, the application of the exception under paragraph 29.14A of FRS 102 effectively provides relief in respect of the accounting for the tax charge. This results in an overall nil charge for tax in the income statement. This exception is only applicable as it is probable that the final gift aid payment will be made by the company to the parent charity within 9 months of the reporting date.