

## 2. Fund accounting

### Introduction

2.1. The reporting tiers applied for Module 2 are as specified in the table below.

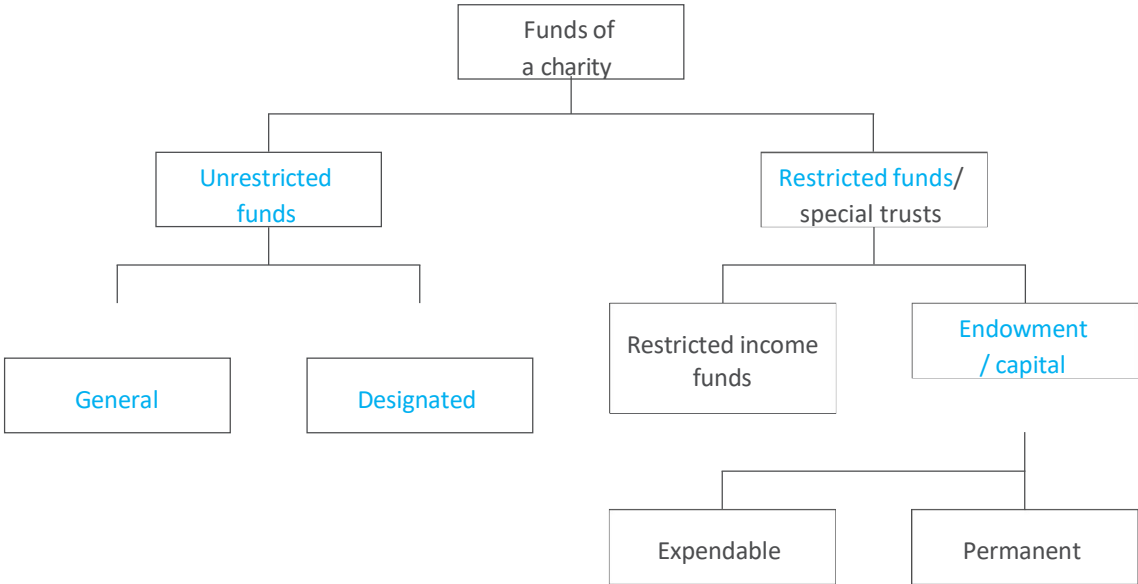
**Table X:** Tiered reporting for Module 2

All tiers	The requirements for income in this module apply fully to all charities.
-----------	--

- 2.2. Accounting for the particular charitable funds held by a charity is a key feature of charity accounting. Each class of fund has unique characteristics in trust law. Fund accounting distinguishes between two primary classes of fund: those that are unrestricted in their use, which can be spent for any charitable purposes of a charity, and those that are restricted in use, which can only be lawfully used for a specific charitable purpose.
- 2.3. The proper administration of individual charitable funds is essential if charity trustees are not to act in breach of trust.
- 2.4. **Restricted funds** (also known as special trusts in England and Wales) are further analysed between restricted income funds and **endowment** funds (also known as **capital funds**).

Figure 1 sets out these classes of fund diagrammatically. This differentiation of funds is an essential feature in the presentation of a charity’s statement of financial activities (SoFA) and balance sheet.

**Figure 1: The classes of charitable funds**



- 2.5. FRS 102 does not deal with fund accounting by charities and therefore this module reflects the requirements of charity law and current accounting practice which charities adopting this SORP must follow. This module sets out:
  - general principles of fund accounting;
  - tangible fixed assets funded through an appeal, grant or donation;
  - transfers between funds; and

- fund disclosures in the notes to the accounts.

## General principles of fund accounting

---

- 2.6. A prerequisite of fund accounting is an understanding of the different classes of funds a charity may hold on trust. A charity may hold both unrestricted and restricted funds. Income generated by the investment of a particular fund's assets accrues to that fund unless the terms of the initial gift provide otherwise, for example in the case of permanent endowment (see paragraph 2.27). Similarly, any Gift Aid amount recovered on a donation forms part of that gift and is an addition to the same fund as the initial donation unless the donor or the terms of the appeal have specified otherwise.

### Unrestricted funds

- 2.7. **Unrestricted funds** are spent or applied at the discretion of the trustees to further any of the charity's purposes. Unrestricted funds can be used to supplement expenses incurred from restricted funds. For example, a restricted grant may have provided part of the funding needed for a specific project. In this case unrestricted funds may be used to meet any funding shortfall for that project.
- 2.8. Trustees may choose to set aside a part of the unrestricted funds to be used for a particular future project or commitment. In this way, the trustees set up a **designated fund**. The designated fund remains part of the unrestricted funds of the charity. This is because the designation has an administrative purpose only and does not legally restrict the trustees' discretion in how to apply the designated fund. Identifying designated funds may be helpful when explaining the charity's reserve policy and the level of reserves it holds.

### Restricted funds

- 2.9. Funds held on special trusts under charity law are classed as restricted funds. The special trusts may be declared by the donor when making the gift or may result from the terms of an appeal for funds. The specific trusts establish the purpose for which a charity can lawfully use the restricted funds.
- 2.10. It is possible that a charity may have several individual restricted funds, each for a particular purpose of the charity.
- 2.11. In certain circumstances the donor may express a form of non-binding preference as to the use of the funds, which falls short of imposing a restriction in trust law. In which case the charity will include the funds as part of its unrestricted funds. To respect these non-binding donor wishes, trustees may decide to designate those funds to reflect the purposes which the donor had in mind (see paragraph 2.8).
- 2.12. Some trustees have the power to declare special trusts over unrestricted funds. Where such a power is available to the trustees and they use it, the assets affected will form part of the restricted funds as a special trust. The trustees' discretion to apply that fund will then be legally restricted.

- 2.13. Restricted funds fall into one of two sub-classes: restricted income funds or endowment funds. Restricted income funds are to be spent or applied within a reasonable period from their receipt to further a specific purpose of the charity, which is to further one or more but not all of the charity's charitable purposes. Alternatively the restricted fund may be an [endowment](#). Trust law requires a charity to invest the assets of an endowment, or retain them for the charity's use in furtherance of its charitable purposes, rather than apply or spend them as income (see 'Endowment funds' below).
- 2.14. In maintaining the accounting records, charities must separately identify each restricted fund and the income received and expenses incurred from each restricted fund.
- 2.15. Expenses charged to a restricted fund relate to the activities undertaken to further the specific charitable purposes the fund was established to support. These expenses include both direct expenses and support costs associated with the activities undertaken by the restricted fund(s). In addition to a reasonable allocation of support costs, other costs associated with raising, investing and managing the restricted funds should normally be charged to the fund to which the cost relates.
- 2.16. Expenses attributable to a restricted fund may still be charged to it even if there is an insufficient balance on that fund at the time. However, expenses should only be charged to a restricted fund in deficit when there is a realistic expectation that future income will be received to cover the shortfall, for example when a decision has been made to invite donations to that restricted fund.

### **Endowment funds**

- 2.17. An [endowment](#), where there is no power to convert the [capital](#) into income, is known as a permanent endowment fund. A permanent endowment fund must normally be held indefinitely.
- 2.18. Where trustees have the power to convert endowment funds into income, such funds are known as expendable endowments. A gift of expendable endowment provides the trustees with a power to convert all or part of it into income.

- 2.19. Expendable endowment is distinguishable from income funds in that there is no actual requirement to spend or apply the capital unless, or until, the trustees decide to spend it. If the trustees exercise the power to spend or apply the capital of the expendable endowment, the relevant funds become unrestricted funds or restricted income funds depending on the terms of the endowment.
- 2.20. The income generated from endowment funds held for investment must be spent on furthering its charitable purposes unless the charity exercises a power of accumulation or a charity in England and Wales has invested the endowment on a total return basis (see the SORP module '[Total return \(investments\)](#)') under the provisions of section 104A of the Charities Act 2011 as amended by the Trust (Capital and Income) Act 2013 or an Order of the Charity Commission made under section 105 of the Charities Act 2011. If there is no restriction as to the use of the income, the income is an addition to unrestricted funds. It is possible that a charity may have several endowment funds; the income from each endowment being restricted to a particular purpose.
- 2.21. The concept of permanence does not always mean that a charity must keep holding the assets in the endowment funds in the form that they were initially given. The investments or property held within an endowment fund can be changed. For example, a charity could sell a particular equity investment and reinvest the proceeds in a different financial asset, or it might use the proceeds from the sale of endowed freehold land and buildings to purchase a new freehold property which will then form part of the endowment.
- 2.22. In some cases, the permanent endowment's trusts will require the retention of a specific asset for the charity's own use, for example a building. It follows that an endowed asset may be capable of depreciation or impairment. Trustees that use income funds to build, erect, extend or improve a building on land which is an endowment asset should note that the default position is that the value of the enhancement to the asset will form part of the endowment in the absence of evidence to the contrary.

### Accounting for expenses related to endowment

- 2.23. A charity cannot use permanent endowment as if it were income, for example, to make payments or grants to third parties. Trust law only permits expenses to be charged to permanent endowment when incurred in the administration or protection of the investments or property of the endowment, for example:
- fees incurred in managing the investment of the endowment;
  - the costs of valuation fees and expenses incurred in connection with the sale of endowed land;
  - the cost of improvements to land held as an endowment investment; or
  - the loss of value due to depreciation or impairment of an endowed property.
- 2.24. If the endowment has insufficient funds to meet the expenses that can be charged to it, or the terms of the trust of the endowed gift prohibit the charging of expenses, then the expenses must be charged to income funds. Other expenses must normally be charged to

income funds.

### Accounting for the investment return on funds

2.25. The return on investment is made up of the income derived from the investment (interest, dividends, royalties or rents) and any gain or loss in the market value of the investment.

If a charity sells an investment, a gain or loss on the carrying amount of the asset is realised upon its disposal. Where a charity retains an investment, an unrealised gain or loss on the carrying amount of the investment may arise at the balance sheet date.

2.26. For unrestricted funds and restricted income funds, trust law requires both the income and any investment gain or loss to be allocated to the fund holding the investment. Where the charity has a number of individual restricted income funds, any investment income and gain or loss on investments must be allocated to the individual restricted funds holding the investment.

2.27. Trust law applies different rules to endowment funds. In the case of endowment, trustees cannot add the income from investments to the endowment capital except where they have a power to invest on a total return basis (see the SORP module '[Total return \(investments\)](#)') or exercise a power of accumulation. Instead, the income from the investment is allocated to either unrestricted funds or a restricted income fund depending on the terms of the gift. However, any gain or loss on investment is attributed to the endowment capital. If a charity has several invested endowments, any gain or loss on investments must be allocated correctly to each individual endowment.

### Tangible fixed assets funded through an appeal, grant or donation

---

2.28. When a tangible fixed asset is funded through an appeal or by way of a grant or donation, the accounting treatment of the asset acquired will depend on the circumstances of each case. In deciding whether the asset is categorised as restricted or unrestricted, trustees should consider whether the terms of the grant or donation:

- require the charity to hold the tangible fixed asset acquired on an on-going basis for a specific purpose; or
- are met once the specified asset is acquired, so allowing the charity to use the asset acquired on an unrestricted basis for any charitable purpose.

2.29. In some circumstances the trustees may be able to settle a tangible fixed asset on trust for a specific purpose implied by the appeal, provided this is consistent with the charity's governing instrument. Where this happens, the trustees' decision is legally binding and the asset is an addition to the restricted funds.

### Transfers between funds

---

2.30. The transfer line in the SoFA is used to record transfers between funds. The total transfers recorded between classes of fund in the reporting period must always net to nil. A transfer may be made for several reasons, including:

- to transfer assets from unrestricted funds to finance a deficit on a restricted fund;
- to transfer the value of tangible fixed assets from restricted to unrestricted funds when

the asset has been purchased from a restricted fund donation but is held for a general and not a restricted purpose;

- where restricted funds have been lawfully released and transferred to unrestricted funds;
- where the trustees have exercised a power to declare a special trust over a gift initially recognised as unrestricted; or
- where charity law permits the proceeds of restricted funds to be spent for an alternative purpose (such as the cy-près procedures in England and Wales), for example the alternative use of the proceeds of a failed appeal, or the alternative use of excess of funds raised from an appeal.



## Fund disclosures in the notes to the accounts

---

- 2.31. For the proper administration of charitable funds, the accounting records of a charity must identify the transactions for each of the funds held. This SORP requires that items recorded in the SoFA must be analysed between unrestricted funds, restricted income funds and endowment funds. The information for endowment funds provided in the SoFA should combine the presentation of permanent and expendable endowment.
- 2.32. This SORP requires that the notes to the accounts must provide information on material individual fund balances, movements in the reporting period and the purposes for which the funds are held. The notes must differentiate unrestricted funds (both general and designated), restricted income funds, permanently endowed funds and expendable endowments. Table 1, 'Outline summary of fund movements' gives an example of how the movements in material funds may be shown.
- 2.33. In particular, this SORP requires that notes to the accounts must disclose:
- a summary of the assets and liabilities of each category of fund of the charity, if not provided by presenting this information in a columnar balance sheet;
  - details of the purposes and trust law restrictions imposed on each material individual fund;
  - details of the movements on material individual funds in the reporting period, reconciling the opening and closing fund balance (small funds with similar purposes may be aggregated);
  - details of the reasons for any material transfers between different classes of funds;
  - where endowment has been converted to income, details of the amount(s) converted and the legal power for its conversion;
  - where the trustees have a power to invest permanent endowment on a total return basis, the details of the movements in the value of unapplied total return for the reporting period (refer to the SORP module '[Total return \(investments\)](#)'); and
  - details of the planned use of any material designated funds, explaining the purpose of the designation.
- 2.34. In deciding on the most suitable form of presentation, the charity should consider:
- the complexity of the fund structure; and
  - the need for any separate fund statement(s) or note(s) to agree with the charity's SoFA and balance sheet.

Table X: Outline summary of fund movements

Fund name	Fund balances brought forward	Income	Expenses	Transfers	Gains and losses	Fund balances carried forward
	£	£	£	£	£	£
<b>Restricted Funds</b>						
<b>Endowment Funds</b>						
Fund 1						
Fund 2						
Fund 3						
Other endowment funds						
<b>Restricted Income Funds</b>						
Fund 1						
Fund 2						
Fund 3						
Other restricted income funds						
<b>Total Restricted Funds</b>						
<b>Unrestricted Funds</b>						
<b>Designated Funds</b>						
Fund 1						
Fund 2						
Fund 3						
Other designated funds						
<b>Total Designated Funds</b>						
<b>General Funds</b>						
<b>Total Unrestricted Funds</b>						
<b>Total Funds</b>						

## 4. Statement of financial activities

### Introduction

4.1. The reporting tiers are applied for Module 4 as outlined in Table X below.

Table X Tiered Reporting for Module 4

Tier 1	Charities within tier 1 may choose to adopt either the activity basis of reporting or the <b>natural classification</b> basis of reporting. This SORP requires charities within tier 1: <ul style="list-style-type: none"> <li>that have adopted the <b>natural classification</b> basis of reporting to use the format of the statement of financial activities as presented in <b>Table 2a</b></li> <li>that have adopted the <b>activity basis</b> of reporting to use the format of the statement of financial activities as presented in <b>Table 2b</b></li> </ul>
Tier 2	This SORP requires charities within tier 2 to adopt the activity basis of reporting. Charities in tier 2 are therefore required to adopt the format of the statement of financial activities as presented in table 2b.
Tier 3	This SORP requires charities within tier 3 to adopt the activity basis of reporting. Charities in tier 3 are therefore required to adopt the format of the statement of financial activities as presented in table 2b.

**Commented [ED1]:** Proposal to include an explanation of natural classification in the Glossary (NB Activity Classification is already in the glossary). Proposed wording:

**Natural classification** of expenses shows the expenses incurred by the charity according to the nature of the expense/what the expenses are (e.g. staff costs, grant-making, premises costs) without reference to the charitable activities the expenses contribute towards.

- 4.2. All charities must prepare a statement of financial activities (SoFA) for each reporting period; termed statement of comprehensive income in FRS 102.
- 4.3. FRS 102 requires that comparative information must be provided for all amounts presented in the SoFA. This SORP requires that the comparative information provided for the total funds of a charity is presented on the face of the SoFA, and that comparative information for separate classes of funds may be provided either on the face of the SoFA or in the notes to the accounts.
- 4.4. The statement of financial activities (SoFA) is a single financial statement that includes all income, expenses, gains, and losses recognised for the reporting period. It provides the user with an analysis of the income and endowment funds received and the expenses incurred by the charity on its activities and presents a reconciliation of the movements in a charity's funds for the reporting period.
- 4.5. Charities in tier 1 may report their expenses using natural classification or on an activity basis. An illustrative SoFA setting out the structure, format and suggested headings of the SoFA when prepared using natural classification is set out in Table 2a. Where a charity in tier 1 adopts the natural classification basis of analysis, the charity may choose its own headings for the analysis of income, provided they are useful to the users of the accounts and noting the

### Accounting and Reporting by Charities

requirements of paragraphs 4.17 and 4.18 on the disclosure of material items of income.

- 4.6. This SORP requires charities in tiers 2 and 3 to report expenses on an activity basis to show how the charity has used its resources to further its charitable aims for the public benefit.
- 4.7. The structure, format and headings of the SoFA required by this SORP when prepared on an activity basis are set out in Table 2b.
- 4.8. For all charities, the SoFA should be prepared with the needs of the charity's stakeholders in mind (see the SORP module '[Accounting and reporting by charities – the statement of recommended practice \(SORP\) scope and application](#)'). Charities reporting on an activity basis should ensure that those activities reviewed in the trustees' annual report are also reported on the face of the SoFA or in the notes to the accounts.
- 4.9. FRS 102 does not address the presentation of charitable funds within the statement of comprehensive income provided by the SoFA. The columns in Tables 2a and 2b headed 'Further details' provide references to later sections of this module that set out those transaction(s) and, in the case of Table 2b, activities falling within each of the SoFA's headings.

CHARITIES SORP (FRS 102)

**Table 2a: Statement of financial activities – Expenses presented on a natural classification basis**

(note that this presentation is an option available to Tier 1 charities only)

	Unrestricted funds	Restricted funds	Endowment funds	Total funds	Prior period Total funds	Further details
	£	£	£	£	£	£
<b>Income and endowments from:</b>						
(e.g.) Charitable activities						
(e.g.) Other						
<b>Total</b>						
<b>Expenses incurred:</b>						
(e.g.) Salary-related costs						B1
(e.g.) Premises-related costs						B1
(e.g.) Grants made						B1
(e.g.) Interest expense						B1
(e.g.) Depreciation and impairment charges						B1
(e.g.) Other expenses						B1
<b>Total</b>						
Net gains/(losses) on investments						B5
<b>Net income/(expenditure)</b>						
<b>Transfers between funds</b>						C
<b>Other recognised gains/(losses):</b>						
Gains/(losses) on revaluation of fixed assets						D1
Actuarial gains/(losses) on defined benefit pension schemes						D2
Other gains/(losses)						D3
<b>Net movement in funds</b>						
<b>Reconciliation of funds:</b>						E
Total funds brought forward						
<b>Total funds carried forward</b>						

## Accounting and Reporting by Charities

**Table 2b: Statement of financial activities – expenses presented on an activity basis**

(this presentation is required for Tier 2 and Tier 3 charities and applicable to those charities in Tier 1 who opt to use the activity basis of reporting)

	Unrestricted funds	Restricted funds	Endowment funds	Total funds	Prior period Total funds	Further details
	£	£	£	£	£	£
<b>Income and endowments from:</b>						
Donations and legacies						A1
Charitable activities						A2
Other trading activities						A3
Investments						A4
Other						A5
<b>Total</b>						
<b>Expenses incurred on:</b>						
Raising funds						B2
Charitable activities						B3
Other						B4
<b>Total</b>						
Net gains/(losses) on investments						B5
<b>Net income/(expense)</b>						
<b>Transfers between funds</b>						C
<b>Other recognised gains/(losses):</b>						
Gains/(losses) on revaluation of fixed assets						D1
Actuarial gains/(losses) on defined benefit pension schemes						D2
Other gains/(losses)						D3
<b>Net movement in funds</b>						
<b>Reconciliation of funds:</b>						E
Total funds brought forward						
<b>Total funds carried forward</b>						

4.10. The module is divided into two parts as follows:

- **Presentation of information:**
  - structure of the SoFA – all charities;
  - accounting for material items – all charities;
  - accounting for extraordinary items – all charities;
  - accounting for discontinued operations – all charities;
  - structure of the SoFA – charities in tier 1; and
  - structure of the SoFA – all charities reporting on an activity basis.

**Line headings used in the statement of financial activities:**

- A1 Income from donations and legacies;
- A2 Income from charitable activities;
- A3 Income from other trading activities;
- A4 Investment income
- A5 Other income;
- Analysis of income in the notes to the accounts;
- **B1 Expenses incurred (natural classification analysis);**
- B2 Expenses incurred on raising funds;
- B3 Expenses incurred on charitable activities;
- B4 Other expenses;
- Analysis of expenses in the notes to the accounts (analysis on an activity basis);
- B5 Gains/(losses) on investments;
- C Transfers between funds;
- D1 Gains/(losses) on revaluations of fixed assets;
- D2 Actuarial gains/(losses) on defined benefit pension schemes;
- D3 Other gains/(losses); and
- E Reconciliation of funds.

## Presentation of information

---

### Structure of the SoFA – all charities

4.11. A charity's statement of financial activities (SoFA) must:

- adopt the same format in subsequent reporting periods unless there are special reasons for a change that are explained in the notes to the accounts. Note that a change in format from using the activity basis per Table 2b to presentation using natural classifications per Table 2a (or vice versa) is a change in accounting policy. Refer to SORP paragraphs 3.32 - 3.34 which set out the circumstances in which a change in accounting policy is justified;

### Accounting and Reporting by Charities

- provide comparative amounts for the total funds presented on the face of the SoFA; and
  - omit headings where there is nothing to report in both the current and preceding reporting period.
- 4.12. The columns of the SoFA must be used to distinguish **restricted income funds, unrestricted funds, and endowment funds**.
- 4.13. All of the charity's income and expenses, transfers and other recognised gains and losses must be analysed between the classes of funds, but a charity will not necessarily have funds of all three classes.
- 4.14. If a class of funds would not be considered material it may be combined with another class of funds and shown as a single combined funds column. If a single combined total funds column is used the heading must be changed to 'all unrestricted and restricted funds' or 'all unrestricted, restricted and endowed funds' as appropriate. Where a single column approach is followed the summary of fund movements must include an analysis for each class of fund for each row in the SoFA together with a total that corresponds to the total shown in the SoFA. For more information refer to the SORP module '**Fund accounting**'.
- 4.15. A charity may vary the order in which it presents headings within the income and expense sections of the SoFA to meet its own presentational needs. Some charities may also find it informative to their users to insert additional subtotals.
- 4.16. A charity may add additional columns to the SoFA to present material funds or activities on the face of the statement rather than in the notes. For example, the charity may wish to show two columns within unrestricted funds, being "**general funds**" and "**designated funds**". Any additional analysis of this type provided on the face of the SoFA must make clear the class of fund (unrestricted, restricted or endowment) in the column title. In providing additional information, a balance needs to be struck between the provision of additional information and the resulting complexity of the statement.

**Commented [ED2]:** Proposed definition for inclusion in the glossary:

**General funds** are unrestricted funds that have not been designated for a particular purpose by the trustees.

### Accounting for material items – all charities

- 4.17. All charities must disclose the nature and amount of any material item(s) of income or expense when this information is relevant to an understanding of the charity's financial performance.
- 4.18. The disclosure of material items must be made either in the notes or by the insertion of an additional line within the relevant heading on the face of the SoFA when necessary for the presentation of a true and fair view of a charity's financial activities. For example material items that should be disclosed separately are a material fraud or the loss of a material tangible fixed asset.

### Accounting for extraordinary items – all charities

- 4.19. Extraordinary items are material events or transactions that:
- fall outside of the charity's ordinary activities;
  - are highly abnormal in their nature; and
  - are not expected to recur.

4.20. Extraordinary items are by their nature extremely rare.



#### CHARITIES SORP (FRS 102)

- 4.21. In the unlikely event of their occurrence, extraordinary items must be disclosed on the face of the SoFA immediately after the total of net income/(expense). The nature of each extraordinary item should be explained in the notes to the accounts.

#### Accounting for discontinued operations – all charities

- 4.22. A discontinued operation is a component of a charity that has been disposed of and:
- represented a separate major line of business or geographical area of operations; or
  - was part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
  - was a subsidiary acquired exclusively with a view to resale.
- 4.23. Charities are established to pursue one or more charitable purposes for the public benefit. Decisions as to the use of resources and the relative priority given to the charity's aims may differ from year to year to reflect the demands placed on the charity by its beneficiaries and social and economic circumstances. Such changes in the way in which activities are provided, or goods or services are delivered, or the range or extent of the activities pursued, do not represent discontinued operations.
- 4.24. For example, a charity providing disaster relief and humanitarian assistance may operate on a global basis and carry out its activities in different countries in different years. Similarly, a charity providing services to the elderly may alter the way in which it delivers its services, for example by switching from residential care to supporting the elderly in their own homes. Neither charity is discontinuing its charitable purpose; they are fulfilling it in a different way.
- 4.25. Spending out a restricted fund does not constitute a discontinued operation.
- 4.26. In the event of a charity having a discontinued operation, an analysis of continuing and discontinued operations must be provided in the SoFA by way of additional column(s).

#### Structure of the SoFA – charities in tier 1

- 4.27. The analysis of expenses by activity is encouraged for all charities preparing accruals accounts. However, charities in tier 1 are not required to report their expenses on an activity basis and may adopt the natural classification basis for reporting the charity's expenses. See section B1 for further details.
- 4.28. Where the natural classification basis for reporting is adopted, this SORP requires that charities must disclose in their SoFA:
- total income of the charity;
  - a relevant analysis of the components of income (see paragraph 4.5);
  - total expenses incurred by the charity;
  - a relevant analysis of the components of expenses incurred;
  - gains/(losses) on investments (where applicable);
  - net income/(expense);
  - transfers between funds;
  - gains on the revaluation of fixed assets (where applicable);

### Accounting and Reporting by Charities

- actuarial gains/(losses) on any defined benefit pension scheme (where applicable);
  - net movement in funds;
  - total funds brought forward from the previous reporting period; and
  - total funds carried forward at the end of the reporting period.
- 4.29. If a material component of income or expense is not presented on the face of the SoFA, the nature and amount of the item must be disclosed in the notes to the accounts.
- 4.30. Charities preparing their accounts using the natural classification basis of reporting must also provide those disclosures required by other modules relevant to the charity. For example, a charity must disclose any remuneration, benefits or expenses paid to trustees and any related party transactions.

### Structure of the SoFA – all charities reporting on an activity basis

- 4.31. This SORP requires that those charities reporting on an activity basis must classify their expenses by activity.
- 4.32. Where relevant to the understanding of material activities, the expense analysis headings should enable the user of the accounts to understand the relationship with income derived from the activity. For example:
- a charity selling donated goods through a shop could use the description 'Shops' within row A3 ('Income from other trading activities') and row B2 ('Expenses incurred on raising funds');
  - a charity running a care home could use the description 'Residential care fees' within row A2 ('Income from charitable activities') and 'Residential care costs' in row B3 ('Expenses incurred on charitable activities');
  - an arts charity providing a mix of paid-for and free services could use the description 'Admission fees for galleries and exhibitions' within row A2 ('Income from charitable activities') and use the heading 'Operation of art gallery and touring exhibitions to schools and community' in row B3 ('Expenses incurred on charitable activities'); and
  - an endowed grant-making charity mainly making grants to advance education could use the description 'Investment income' within row A4 ('Investment income') and 'Grants to education and research institutions, student bursaries and other grants' in row B3 ('Expenses incurred on charitable activities').
- 4.33. In most cases, it will be clear which activity generated the income or expense. Expenses shared between two or more activities should be apportioned between them on a reasonable, justifiable and consistent basis (see the SORP module '[Allocating costs by activity in the statement of financial activities](#)').

## Line headings used in the statement of financial activities

---

### **A: Income and receipt of endowment**

4.34. Charities in tier 1 that adopt the natural classification basis of analysis may choose to use different headings for the analysis of income. See paragraph 4.5.

#### *A1: Income from donations and legacies*

4.35. Donations and legacies include all income received by the charity that is, in substance, a gift made to it on a voluntary basis. A donation or legacy may be for any purpose of the charity (unrestricted funds) or for a particular purpose of the charity (restricted income funds or endowment funds).

4.36. Donations and legacies do not provide any significant benefit to the donor in return for their payment other than the knowledge that the charity must use the gift to further its purposes. Income from donations and legacies includes:

- donations and gifts made by individuals and corporations, including any related tax refund or Gift Aid claimed on gifts made by individuals but excluding goods donated for resale;
- legacies receivable by the charity;
- grants of a general nature provided by government and charitable foundations which are not conditional on delivering certain levels or volumes of a service or supply of charitable goods;
- membership subscriptions and sponsorships where these are, in substance, donations rather than payment for goods or services; and
- donated goods for the charity's own use or distribution and donated services and facilities.

#### *A2: Income from charitable activities*

4.37. Income from charitable activities includes income earned both from the supply of goods or services under contractual arrangements and from performance-related grants which have conditions that specify the provision of particular goods or services to be provided by the charity. To fall within this analysis heading, the activities specified by the contractual terms or grant conditions must be undertaken for the charitable purposes of the charity.

4.38. Income from charitable activities therefore includes:

- a) the sale of goods and services as part of the charitable activities of the charity (also known as primary purpose trading), whether the sale is intended to make a profit or is at or below cost;
- b) contractual payments from government or public authorities and other parties which fund the provision of particular goods or services, for example the provision of care;
- c) the sale of goods or services made or provided by the beneficiaries of the charity;
- d) performance-related grants where the income is conditional on delivering certain

### Accounting and Reporting by Charities

levels or volumes of a service or supply of goods;

- e) ancillary trades connected to primary purpose trading; and
- f) the letting of non-investment property in furtherance of charitable purposes.

*A3: Income from other trading activities*

- 4.39. Income from other trading activities includes income earned from both trading activities to raise funds for the charity and income from fundraising events. To fall within this analysis heading, the income must be received in exchange for supplying goods and services in order to raise funds for the charity. While selling donated goods is legally considered to be the realisation of a donation in kind, in economic terms it is similar to a trading activity and should therefore be included in this analysis heading.
- 4.40. Income from other trading activities includes:
- income from non-charitable trading activities, including non-charitable trading activities of subsidiary entities consolidated into group accounts;
  - membership subscriptions and sponsorships where the recipient is not a beneficiary and where these are, in substance, a payment for goods or services;
  - income from fundraising events that are unconnected to primary purpose trading (see paragraph 4.38(a)) such as jumble sales, firework displays and concerts by the charity (or by volunteers working under the charity's management direction) or its agents;
  - shop income from selling donated and bought-in goods;
  - income from letting and licensing arrangements for property held primarily for functional use by the charity but temporarily surplus to operational requirements; and
  - income from sponsorships and social lotteries which cannot be considered pure donations.

*A4: Investment income*

- 4.41. Investment income is earned from holding assets for investment purposes and includes dividends, interest, and rents from investment property. Where income from investments is material, it must be presented as a separate heading on the face of the SoFA.
- 4.42. While income must be presented gross in the SoFA before the deduction of any costs incurred, it is often not practicable for charities to identify the investment management costs incurred within collective investment schemes, such as unit trusts or common investment funds, prior to the distribution of income. Where it is not practicable to identify the investment management costs incurred within the scheme with reasonable accuracy, the investment income should be reported net.

## Accounting and Reporting by Charities

### A5: Other income

- 4.43. Other income represents income that cannot be reported under the other analysis headings provided within the SoFA. Other income may also include the conversion of endowment funds into income with the equivalent offsetting reduction to endowment funds shown as a deduction under other income in the 'Endowment funds' column. This approach may be helpful in those jurisdictions that include such items in the calculation of gross income for audit threshold purposes. Alternatively, a conversion of endowment funds into income may be included under the heading 'Transfers between funds'.
- 4.44. The conversion of endowment into income includes:
- capital funds released to an income fund from expendable endowment; and
  - the release of funds to income from the 'unapplied total return fund' held within the permanent endowment fund where a charity has authority to adopt a total return approach to investment.
- 4.45. This heading should also include all other sources of income unless the amount is sufficiently material as to require its presentation as a separate SoFA heading. Other income may include:
- a gain on the disposal of a tangible fixed asset held for the charity's own use;
  - a gain on the disposal of a programme related investment;
  - any royalties from the exploitation of intellectual property rights; and
  - any other income not falling into the other income categories.

### Analysis of income in the notes to the accounts

- 4.46. Unless analysed on the face of the SoFA, this SORP requires that the notes to the accounts must provide an analysis of the material components of income included within each analysis heading of the SoFA.
- 4.47. For charities adopting the activity basis of analysis, amounts for similar activities should be aggregated so as to provide an analysis of:
- donations and legacies, distinguishing between the types of gift receivable, for example the amount of donations, grants of a general nature and legacies;
  - income from charitable activities, identifying the nature of the activities undertaken and the income produced;
  - income from other trading activities, identifying the nature of the trading or fundraising activity and income produced;
  - investment income analysed according to each class of investment shown on the balance sheet or in the investment note to the accounts; and
  - the nature and amount of other income receivable.
- 4.48. Where applicable, this SORP requires that the notes to the accounts must give the amount and reason for the conversion of all or part of any endowment fund converted into income in the reporting period.

**B: Expenses**

*B1: Expenses incurred (natural classification analysis)*

4.49. Charities in tier 1 that choose to adopt the natural classification basis of reporting will analyse expenses by their nature. For example, expenses could be analysed by salary-related costs, premises-related costs, interest expenses, transport costs and grants made. Alternatively, the headings used by the charity to record expenses in its own accounting records could be used, provided they are capable of being understood by the users of the accounts.

*B2: Expenses incurred on raising funds*

4.50. Expenses incurred on raising funds includes all expenses incurred by a charity to raise funds for its charitable purposes. It includes the costs of all fundraising activities, events, non-charitable trading activities, and the sale of donated goods. However, any costs incurred in providing goods or services as a charitable activity must not be included in this heading, even if a charge is made for their provision.

4.51. Expenses incurred on raising funds may include those costs incurred in:

- seeking donations, grants and legacies;
- operating membership schemes and social lotteries;
- staging events, including the performance fees, licence fees and other related costs;
- contracting with agents to raise funds on behalf of the charity;
- operating charity shops selling donated and/or bought-in goods;
- operating a trading company undertaking non-charitable trading activities;
- advertising, marketing and direct mail materials, including publicity costs not associated with educational material designed wholly or mainly to further the charity's purposes; and
- investment management costs.

4.52. Investment management costs include the costs of:

- portfolio management;
- obtaining investment advice;
- administration of the investments;
- costs of licensing intellectual property; and
- rent collection, property repairs and maintenance charges.

4.53. Where investment management costs are material, these costs should be presented as a separate heading on the face of the SoFA or in the notes to the accounts.

4.54. Costs associated with acquiring and disposing of investments would normally form part of the acquisition cost of the investment or reduce the return on disposals. These costs are therefore not part of investment management costs. Where investment managers deduct management fees from investment income, the charity should report the gross

investment income before fees and report the management fees charged in this cost category. However, charities are not expected to prorate investment management fees charged to a collective investment scheme to identify the notional cost attributable to its own holding in the scheme.

- 4.55. Investment management costs associated with endowment fund investments should generally be charged to the endowment fund in the SoFA. Further guidance on the charging of investment management costs to endowment funds is provided in the SORP module '[Fund accounting](#)'.
- 4.56. Fundraising costs may be incurred in starting up a new source of future income such as legacies, or in developing a supporter database. In most cases these start-up costs should not be carried forward as prepayments or deferred expenses. Instead, such costs are charged to the SoFA as incurred. Data capture costs of an internally developed database must not be capitalised. The costs of a database that has been purchased or donated to the charity can be capitalised where it is probable that it will generate economic benefits, for example in generating income, and the resulting database has a readily ascertainable cost or value.
- 4.57. Charities may choose to expand the analysis provided within this heading for example by identifying separately 'Expenses incurred raising donations and legacies' (A1), 'Expenses incurred on other trading activities' (A3) and 'Investment management costs' (A4) either in the SoFA or by way of an explanatory note.

#### *B3: Expenses incurred on charitable activities*

- 4.58. Expenses incurred on charitable activities includes all costs incurred by a charity in undertaking activities that further its charitable aims for the benefit of its beneficiaries, including those support costs apportioned to charitable activities. Costs involved in negotiating contracts or grants that require the charity to provide specific charitable services should also be regarded as part of the cost of carrying out that activity.
- 4.59. Additional sub-headings should be added to the analysis of charitable activities to identify the significant charitable activities undertaken which have been reviewed in the trustees' annual report. The sub-headings used should reflect the activity undertaken.
- 4.60. On occasions, a subsidiary entity may undertake activities specifically to further the purposes of a parent charity rather than as a fundraising activity. Expenses incurred by a subsidiary on activities that fall within the parent charity's purposes should be analysed as charitable activity when consolidated accounts are prepared.
- 4.61. Charities may carry out their activities through a combination of direct service provision and the grant funding of third parties to undertake work that contributes to the charity's aims or programme of work. The cost of charitable activities presented in the SoFA includes the costs of both direct service provision and the payment of grants. Charities making grants must refer to the SORP module '[Presentation and disclosure of grant-making activities](#)', which sets out the particular disclosures required for grant-making in the notes to the accounts.

#### *B4: Other expenses*

- 4.62. Other expenses include all expenses that are neither related to raising funds for the charity nor part of its expenses incurred on charitable activities. Where an amount is material or its



## CHARITIES SORP (FRS 102)

presentation on the face of the SoFA is necessary for an understanding of a charity's financial performance, an additional sub-heading should be used.

### *Analysis of expenses in the notes to the accounts – activity basis*

- 4.63. This SORP requires that for charities analysing expenses on the activity basis, the notes to the accounts must provide a relevant analysis of the activities included within each expense heading provided on the face of the SoFA. The analysis provided should aggregate the cost of similar activities and provide the user of the accounts with an understanding of the charity's main activities.
- 4.64. This SORP also requires that the analysis must give details of the support costs charged to an activity and the cost of grant funding to third parties that have been included within the cost of charitable activities. The total provided within the analysis must reconcile with the amounts presented within the relevant expense headings of the SoFA. This information may, for example, be presented in a tabular format. An illustrative example of a tabular format that charities may wish to use is presented below in Table 3.
- 4.65. Paragraph 8.13 of the SORP module '[Allocating costs by activity in the statement of financial activities](#)' requires the disclosure of the accounting policy adopted by the charity for the apportionment of costs between activities and any estimation technique(s) used to calculate their apportionment. Charities may opt to include this disclosure alongside analysis of expenses incurred on charitable activities as illustrated in the column headed 'Basis of Apportionment' in Table 3.

**Table 3: Analysis of expenses incurred on charitable activities**

	Activity 1	Activity 2	Activity 3	Total	Basis of Apportionment
	£	£	£	£	
Activities undertaken directly					
Grant funding of activities					
(e.g.) Salaries and wages (indirect)					Text describing method
(e.g.) Fundraising costs					Text describing method
(e.g.) IT costs					Text describing method
<b>Total</b>					

### *B4: Gains/(losses) on investment assets*

- 4.66. This heading is used to record any realised and unrealised gains or losses on investment assets and investment properties, including those gains or losses arising from their revaluation in the reporting period.

## **C: Transfers between funds**

- 4.67. All transfers between the different classes of funds must be shown in the transfer row of the SoFA. The transfer line must always net to nil. Refer to the SORP module '[Fund accounting](#)' for more information.
- 4.68. The transfer row may also be used to record the conversion of endowment funds (including the release of any unapplied total return where a total return approach to investment is adopted) into income. Alternatively, charities may choose to present the conversion of endowment funds in row A5 ('Other income').

#### **D: Other recognised gains/(losses)**

##### *D1: Gains/(losses) on the revaluation of fixed assets*

- 4.69. This heading includes gains or losses on the revaluation of property, plant and equipment used by a charity, and heritage assets and intangible assets. This heading should not be used when adjusting for a reversal in a previous charge for impairment.

##### *D2: Actuarial gains/(losses) on defined benefit pension schemes*

- 4.70. This heading is used to record actuarial gains or losses on defined benefit pension schemes and post-employment benefit plans.
- 4.71. Charities which operate defined benefit pension schemes must refer to the SORP module '[Retirement and post-employment benefits](#)', which provides recommendations on the recognition of pension costs, assets and liabilities and their disclosure in the accounts.

##### *D3: Other recognised gains/(losses)*

- 4.72. A charity must insert additional headings to report any other gains and losses required by accounting standards or which company law (when the charity is a company) requires to be recognised outside of a charity's income and expenditure account.
- 4.73. Items presented within this category include:
- where hedge accounting is adopted for that portion of the change in fair value of the hedging instrument that cannot be recognised as income or expense; and
  - foreign exchange gains or losses arising on conversion of non-monetary assets at the end of the reporting period where the valuation, gains or losses on those assets are not accounted for in headings B4, D1 and D2.

#### **E: Reconciliation of funds**

- 4.74. This SORP requires that the opening and closing balances for each class of fund must be shown with the difference reconciled by the movement in funds in the reporting period. The closing fund balances presented in the SoFA must agree with the equivalent totals shown in the 'Funds of the charity' section on the balance sheet.