5. Recognition of income, including legacies, grants and contract income

Introduction

5.1. The reporting tiers applied for module 5 are as specified in the table below.

Table 5.1A: Tiered reporting for module 5

All tiers	The requirements for income including legacies, grants and contract income in this module apply fully to all charities.

5.2. Income is an increase in assets, or a decrease in liabilities, that results in an increase in the funds of the charity from the activities that it undertakes and is an important element when considering the charity's performance.

5.3. This SORP uses the terms 'third party' as a generic term to include customers, clients and services users.

5.4. Charities should refer to Sections 23 'Revenue from Contracts with Customers', 24 'Government Grants' and 34 'Specialised Activities' of FRS 102 for more information. This module sets out:

- Disclosures and notes to the accounts

Understanding the nature of income

5.5. There are two broad categories of income: income from exchange transactions and income from non-exchange transactions. It is important for charities to distinguish between the two as they are recognised differently in a charity's accounts:

- income from exchange transactions is received by the charity for goods or services supplied under contract with third parties. The income the charity receives for the transfer of promised goods and services is an amount that reflects the consideration to which the charity expects to be entitled in exchange for those goods or services. Section one of this module provides further details on exchange transactions
- the essential feature of income from a non-exchange transaction is that the charity receives value from the donor, who may be an individual or an entity, without directly providing equal value in exchange. Section two of this module provides further details on non-exchange transactions

5.6. Transactions must be accounted for and presented in accordance with their substance and not simply their legal form. Charities must therefore consider the substance of any conditions attached to donations or grants and of any contractual terms when determining whether income should be recognised. Similarly, the substance of any restriction placed on the use of income must be considered when determining whether or not income is presented as restricted funds in a charity's accounts. A charity should consider whether:

- the receipt of income is subject to fulfilling performance-related conditions. A grant or a contract may contain performance-related conditions; an unconditional grant does not
- the terms of a donation or grant impose a restriction on use which is narrower than the general purposes of the charity. Donations or grants with terms that limit a charity's discretion over how income must be used are presented as restricted income in the accounts
- the terms of a contract limit a charity's income from the contract to amounts spent by the charity on specified purposes or restrict the charity's use of any surplus. Income that is restricted by contractual terms may be presented as restricted in the accounts if the restrictions are in substance the same as would apply to a restricted donation or grant
- the terms of a gift require it to be held as endowment that must be invested and not spent. Material endowment funds must be presented as a separate class of restricted funds. Further information on fund accounting is set out in SORP module 2 '*Fund Accounting*'

5.7. Income is recognised in the statement of financial activities (SoFA) when the criteria for income recognition that apply to that type of income are met. Different criteria apply to recognising income from exchange transactions to those that apply for non-exchange transactions. In respect of exchange transactions, there are five stages in income recognition, see paragraph 5.13 below.

5.8. All income must be reported gross when raised by the charity or its agents. Any fee charged for fundraising by a third party and deducted from the amount collected before it is remitted to the charity must not be offset against fundraising income recognised in the accounts but be reported as a fundraising expense. However, in the case of individuals not employed by, or contracted by, the charity who are acting on a purely voluntary basis and outside of the charity's control, the charity recognises the net amount remitted.

Section One – Exchange Transactions

5.9. Section 23 Revenue from Contracts with Customers of FRS 102 establishes a revenue recognition model for accounting for revenue from contracts with customers, which this SORP refers to as 'third parties'. The objective of the model is for a charity to recognise income (referred to as revenue in FRS 102) to depict the transfer of promised goods or services to third parties in an amount that reflects the payment (or consideration) to which the charity expects to be entitled in exchange for those goods or services. The model will only apply to contract income. Examples of transactions to which this model applies include the provision of educational services by a charity in return for course fees; the sale of educational goods by an art gallery or museum charity; or the provision of serviced residential accommodation by a residential care home in return for payment.

5.10. FRS 102 glossary defines revenue as the income arising in the course of an entity's ordinary activities. On the assumption that all income from contracts with third parties will be in the course of a charity's ordinary activities, this section will refer to 'income' instead of 'revenue'.

5.11. Section 1 of FRS 102 explains how charities should first apply the changes introduced by FRS 102. The specific transitional arrangements relating to revenue from contracts with customers are outlined in paragraphs 1.61 to 1.67 of FRS 102. Charities must refer to Section 1 of FRS 102 for more information.

5.12. Before applying the income recognition model, it is necessary to identify if the income is from an exchange transaction (involving the charity providing goods and/or services in exchange for money or other consideration) or if it is not.

For exchange transactions, there are five steps to the income recognition model:

- step one – identify the presence of a contract with a third party
- step two – identify the performance obligations in the contract
- step three – determine the transaction price
- step four – allocate the transaction price to the performance obligations in the contract
- step five – recognise income when or as the charity satisfies a performance obligation

The five steps of income recognition for exchange transactions

5.13. Step one is to identify the presence of a contract with a third party.

5.14. A contract is an exchange arrangement with enforceable rights and obligations on the part of the third party and the charity supplying the goods and/or services to the third party. A charity must apply the revenue recognition model to account for a contract with a third party only when all of the following criteria are met:

- the parties to the contract have approved the contract and are committed to perform their respective obligations
- the charity can identify each party's rights regarding the goods or services to be transferred
- the charity can identify the payment terms for the goods or services to be transferred
- the contract has commercial substance (i.e. the risk, timing or amount of the charity's future cash flows is expected to change as a result of the contract)
- it is probable that the third party will have the ability and intention to pay the consideration to which the charity will be entitled when it is due

If a contract does not meet the above criteria, refer to paragraphs 23.9 and 23.10 of FRS 102.

5.15. A contract is an agreement between two or more parties that creates enforceable rights and obligations. This can take many forms- a verbal undertaking, a sale of an item in a shop with agreed terms of sale or a formal documented contract.

5.16. Charities can combine two or more contracts with the same third party if these were agreed as a package, or where payment under one contract is related to the performance of the other, and taken together they comprise a single performance obligation.

5.17. During the life of a contract there may be a change in the scope or price (or both) of a contract that is approved by the parties to the contract in which case this is treated as a contract modification. Depending upon its nature it causes either a new contract to be recognised or adjustment to the income recognised under the existing contract. Refer to Section 23 of FRS 102 if this should apply.

5.18. For a modification to be a new contract it must both increase the scope of the existing contract because of additional goods or services promised that are distinct from those in the existing contract and increase the price by an amount of consideration that reflects the charity's stand-alone selling price of the additional goods or services and any appropriate adjustments to that price to reflect the circumstances of that contract.

5.19. For a modification to be an adjustment to an existing contract then either

- if remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification the charity must account for the contract modification as if it were a termination of the existing contract and the creation of a new contract and calculate the new transaction price, or

- if the remaining goods or services are not distinct from the goods or services transferred on or before the date of the contract modification, then the charity must account for the contract modification as if it had always been part of the existing contract.

The effect that the contract modification has on the transaction price, and on the charity's measure of progress towards complete satisfaction of the performance obligation, must be recognised as an adjustment to revenue at the date of the contract modification (i.e. on a cumulative catch-up basis).

FRS 102 Section 23 paragraphs 23.7 to 23.16

5.20. Step two is to identify the performance obligations in the contract.

5.21. At the outset, a charity must assess the goods and services promised to the third party in return for payment. For each transaction with a third party a form of contract exists, whether in a written or unwritten form, and the charity must identify as a performance obligation each promise to transfer to the customer either:

- a distinct good or service (or a distinct bundle of goods or services) or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the third party

5.22. A series of distinct goods or services has the same pattern of transfer to the third party if both of the following criteria are met:

- each distinct good or service in the series that the charity promises to transfer to the third party would meet the criteria of a performance obligation satisfied over time
- the same method would be used to measure the charity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the third party

5.23. A promise is a valid expectation of the third party that the charity will transfer a good or service to the third party. Promises may be implied by a charity's customary business practices, published policies or specific statements if these create a valid expectation of the third party that the charity will transfer a good or service to the third party.

5.24. To be distinct, the goods and/or services promised to a third party must be such that:

- the third party is able to benefit from the good or service on its own or together with other resources that are readily available to the third party
- the charity's promise to transfer the good or service is separate from other promises in the contract

If items are combined the items are included together as a bundle until the charity identifies a bundle of goods or services that is distinct, or this process results in all the goods or services in a contract being treated as a single performance obligation. The charity must therefore determine whether the nature of the charity's promise, within the context of the contract, is to transfer the good or service individually, rather than to transfer a combined item or items to which a particular good or service is an input.

Other considerations

5.25. Contracts can be quite complex and if offering warranties, including options to buy additional goods or services, or charging upfront fees a charity should refer to Section 23 of FRS 102 for the accounting treatment to follow.

5.26. In some contracts, another party is involved in proving goods or services to a third party. For example, an intermediary might arrange delivery of goods or services to third parties on behalf of the charity. For guidance on principal versus agent considerations, refer to Section 23 of FRS 102 and SORP module 19 '*Accounting for funds received as agent or as holding trustee*'.

FRS 102 section 23 paragraphs 23.17 to 23.40

5.27. Step three is to determine the transaction price.

5.28. A charity must consider the terms of the contract and its customary business and operating practices to determine the transaction price. The transaction price is the amount of consideration to which the charity expects to be entitled in exchange for transferring the goods or services promised to a third party, excluding amounts collected on behalf of other third parties (e.g. some sales taxes). The consideration promised in a contract may include a variable amount (e.g. because of some discounts, rebates, refunds, penalties or performance bonuses). In most cases the variable amount will be the amount judged by the charity as the most likely amount (i.e. the single most likely outcome of the contract) but if a charity has a large number of contracts with similar characteristics, then the expected value is calculated.

5.29. The expected value is the sum of the range of probability-weighted amounts of the possible outcomes. An amount of variable consideration is included only where it is highly probable (significantly more likely than probable) that the charity will be entitled to the income when the uncertainty associated with the variable consideration is resolved. A charity must apply one method consistently throughout the contract when estimating the amount of variable consideration.

5.30. A charity which has developed a pricing policy will find it easier to determine the transaction price and allocate the transaction price to the performance obligations in the contract (step four). This is because the pricing policy will identify the stand-alone prices for goods and/ or services being promised, together with any applicable prices for combinations or bundles of items, and third party options, warranties, deposit requirements and third party discounts. Where items stand alone, for example bought in items offered for sale in a charity shop, then allocating the price to an obligation is straightforward.

5.31. Should a charity offer payment terms to a third party that defers payment beyond normal business terms or is financed by the charity at a rate of interest that is not a market rate, the arrangement constitutes a financing transaction and so the charity must adjust the promised amount of consideration for the effects of the time value of money and recognise the interest revenue in accordance with Section 11 of FRS 102. The charity must present interest income separately from income from contracts with third parties under the relevant line items in the SoFA.

5.32. A charity need not adjust the promised amount of consideration for the effects of the time value of money if it expects, at contract inception, that the period between when the charity transfers the good or service promised to a third party and when the third party pays for that good or service will be 12 months or less.

FRS 102 Section 23 paragraphs 23.41 to 23.64

5.33. Step four involves allocating the transaction price to the performance obligations in the contract.

5.34. A charity must allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis unless the contract either contains only one performance obligation or all the performance obligations in a contract are satisfied at the same point in time.

5.35. The stand-alone selling price is the price applicable at the inception of the contract for each performance obligation in the contract. It is the price at which the charity would sell a good or service promised in a contract separately to a third party.

5.36. Where the contract price is not simply calculated by applying these stand-alone prices to the promised items then, the allocation made is in proportion to those stand-alone selling prices.

5.37. If there are no observable standalone prices then these must be estimated. Refer to paragraph 5.39 for suitable estimation techniques. When estimating a stand-alone selling price, a charity must consider all information that is reasonably available to it, including market conditions, charity-specific factors, and information about the third party or class of third party.

5.38. Discounts are applied proportionately across all the performance obligations unless a discount applies to a particular obligation only or an alternative method gives a fairer presentation of the amount that the charity expects to be entitled to in exchange for satisfying each performance obligation in the contract.

5.39. Suitable estimation methods include, but are not limited to, the adjusted market assessment approach, the expected cost plus a margin approach or the residual approach. The residual approach is rarely appropriate but if neither the adjusted market assessment approach nor the expected cost plus a margin approach are practicable, the residual basis approach can be considered. A charity must apply estimation methods consistently in similar circumstances.

5.40. The adjusted market assessment approach – a charity could evaluate the market in which it sells goods or services and estimate the price that a third party in that market would be willing to pay for those goods or services.

5.41. Expected cost plus a margin approach – a charity could forecast its expected costs of transferring the good or service promised to a third party and then add an appropriate margin for that good or service.

5.42. Residual approach – only if the stand-alone selling price of a good or service is highly variable or uncertain, then a charity may estimate the selling price by reference to the total transaction price less the sum of the observable or estimated stand-alone selling prices or services promised in the contract.

5.43. A charity must allocate any variable payment (consideration) to all the performance obligations in the contract on a relative stand-alone selling price basis unless this basis does not depict the amount of consideration to which the charity expects to be entitled in exchange for satisfying each performance obligation in the contract. In that case, the charity must allocate the variable consideration using a method that reflects such an amount (e.g. a variable payment may be allocated entirely to one performance obligation in the contract if the terms of that variable payment relate specifically to the charity's efforts to satisfy that performance obligation).

5.44. After contract inception, the charity's estimate of the amount of consideration to which it expects to be entitled in exchange for transferring goods or services may change. A change in estimate of the transaction price is allocated across the performance obligations in the contract on the same basis as at contract inception. Amounts allocated to a performance obligation that has been satisfied shall be recognised as income, or as a reduction of income, in the period in which the estimate of the transaction price changes.

FRS 102 Section 23 paragraphs 23.65 to 23.77

5.45. Step five is to recognise income when or as a charity satisfies a performance obligation.

5.46. A charity must recognise income when (or as) the charity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a third party. A good or service is transferred when (or as) the third party obtains control of that good or service. Control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining economic benefits that may flow from the asset. For each performance obligation identified, a charity must determine at contract inception whether the performance obligation is satisfied over time or satisfied at a point in time.

Performance obligations satisfied over time

5.47. A charity transfers control of a good or service over time, and therefore satisfies performance obligations over time, if one of the following criteria is met:

- the third party receives and consumes the benefits provided by the charity's performance as the charity performs (e.g. routine or recurring services). If this is not possible, a performance obligation is satisfied over time if the charity's work carried out to date would not need to be substantially reperformed if another entity were to fulfil the remainder of the performance obligation to the third party
- the charity's performance creates or enhances an asset that the third-

party controls as the asset is created or enhanced

- the charity's performance does not create an asset with alternative use and the charity has a right to be compensated for work carried out to date

If none of these criteria are met, the performance obligation is satisfied at a point in time, see paragraphs 5.49 to 5.50, below.

5.48. An example of income recognised over time would be a charity running an employment course where attendees pay for the course. The course involves attendance at 10 sessions, so the third party receives the benefits of the course as the charity provides the session (performs). In this case, the charity would allocate the fee for the course attendance as the course is delivered.

Performance obligations satisfied at a point in time

5.49. If a performance obligation is not satisfied over time, a charity satisfies the performance obligation at a point in time.

5.50. To determine the point in time at which a third party obtains control of a promised asset, the charity must consider if control transferred. Indicators of a transfer of control include but are not limited to the following:

- the charity has the right to payment for the asset
- the third party has legal title to the asset
- the third party has physical possession of the asset
- the third party has the significant risks and rewards of ownership of the asset
- the third party has accepted the asset. For charities selling items in a charity shop or selling discrete items of service, for example a counselling session establishing that a performance obligation has been met at a point in time may be straight forward

Measuring progress towards satisfaction of a performance obligation

5.51. For each performance obligation satisfied over time, a charity must recognise income over time by measuring its progress towards complete satisfaction of that performance obligation. A charity must select a method of measuring progress that represents its performance in transferring control of goods or services promised to a third party.

5.52. For fulfilment of performance obligations over time the charity must select a single method of measuring progress that depicts the charity's performance in transferring control of goods or services promised to a third party (i.e. the satisfaction of the performance obligation) for each obligation and apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, the charity must remeasure its progress towards complete satisfaction of a performance obligation satisfied over time and update its measure of progress. Any adjustment to the estimate of progress is accounted for as a change in accounting estimate. If the charity cannot reasonably measure its progress towards complete satisfaction of a performance obligation (e.g. in the early stages of a contract), but the charity expects to recover the costs incurred in satisfying that performance obligation, then it recognises income only to the extent of the costs incurred.

5.53. Those charities providing services over time or carrying out construction activities will need to identify performance against the agreed milestones, deliverables, stages, undertakings, or performance criteria set out in the contract. For example, in providing education or tuition services the third party simultaneously receives and consumes the benefits provided by the charity's performance as the charity performs or if undertaking a construction project for a third party to the extent that the charity creates or enhances an asset that the third party controls.

5.54. The charity should adopt the most appropriate method to measure progress in fulfilling performance obligations. Section 23 of FRS 102 notes the following methods:

- an output method based on surveys of work completed, when the surveys provide an objective measure of an entity's performance to date
- an output method based on units delivered, when each item transfers an equal amount of value to the third party on delivery and partly completed items are not significant
- an output method based on time elapsed, when control of the goods or services is transferred evenly over time
- an input method based on time elapsed, when an entity's efforts or inputs are expended evenly throughout the performance period
- an input method based on costs incurred, when the method includes costs that reflect an entity's performance to date and contribute to the entity's progress in transferring control of goods or services promised to a third party
- an input method based on labour hours expended, when there is a relationship between labour hours expended and the transfer of control of goods or services to a third party

5.55. If the charity has a right to consideration from a service user or third party in an amount that corresponds directly with the value to the third party of the charity's work to date (e.g. a service contract in which the charity bills a fixed amount for each hour of service provided), then it may recognise as income the amount to which the charity has a right to invoice.

5.56. If the charity cannot reasonably measure its progress towards complete satisfaction of a performance obligation (e.g. in the early stages of a contract), but the charity expects to recover the costs incurred in satisfying that performance obligation, then it can only recognise amount of income to the extent of the costs incurred.

5.57. Where income is received in advance, then a charity must not recognise income until the charity has fulfilled the related performance obligation. This occurs when control of the promised goods or services has transferred to the third party. For example, where a charity lays on a series of concert performances for the year ahead and takes advance ticket sales from paying members of the public, the income should be deferred until such time as the concert has taken place. Income received in advance should therefore be deferred until the ’significant risks and rewards’ of ownership are transferred to the service user.

FRS 102 Section 23 paragraphs 23.78 to 23.130

Exchange transactions – other considerations

5.58. Income earned from contracts with third parties is normally classified as unrestricted funds because it is not a gift and so cannot be restricted by trust law, and any surplus may normally be spent on any purpose of the charity. However, if a contract specifically requires all income received under it to be spent on a particular purpose of the charity and any unspent income to be returned to the funder or only applied for a particular purpose, then, in substance, the income may be regarded as restricted. If contract income is presented as restricted then all relevant disclosures required for a restricted fund must be made. For details of relevant disclosures, refer to SORP module 2 ‘*Fund Accounting*’.

Income from membership subscriptions

5.59. Membership subscriptions received by a charity may be in the nature of a donation (see 5.5, above, and section two, non-exchange transactions, below) or the member may buy a right to services or other benefits (an exchange transaction). When the substance of the subscription is that of a donation, the income and any associated Gift Aid or other tax refund should be recognised on the same basis as a donation. If the subscription purchases the right to services or benefits, the incoming resource should be recognised as income earned from the provision of goods and services as income from charitable activities.

5.60. Where the income from membership subscriptions arises from an exchange transaction, the charity must identify how it fulfils its performance obligations to the member and this will be linked to how member benefits are drawn down. For example, if an annual member pass to historic gardens allows a member to make as many or few visits as they desire, the charity is satisfying the performance obligations over time by keeping the gardens open. The charity does not know when or how frequently the member will visit so cannot recognise a known proportion of the income at each visit. It must therefore select a method of recognising income that best reflects the situation. Such a method could be recognising the income on a straight-line basis over a 12-month period.

Income from royalties

5.61. Income from royalties involving the licensing of intellectual property rights such as software, music or digital images are accrued in accordance with the substance of the performance obligations set out in the relevant agreement.

5.62. The terms of the agreement may permit the asset to be used for a period of time as set out in the licence and so performance obligations may be satisfied over time. However, some licenses may be usage based and involve variable income relating to the frequency of use of the asset by the third party in which case the charity must identify when performance obligations are fulfilled either over time or at one or more points in time.

5.63. If fulfilled over time the charity must apply a method to estimate the royalties receivable in the period, see step five, above.

5.64. If a sales-based or usage-based royalty is provided to a charity, the income is recognised when or as the later of the following events occur:

- the subsequent sale or usage takes place
- the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied, occurs

Long term contracts

5.65. Longer term contracts involve the supply of services over time with either a continuous performance, for example provision of help-line facility or a series of milestones, for example the construction of a building. Applying the five-step model, the charity must identify the performance obligations and whether these are distinct obligations or need to be combined together as a performance obligation. The charity must identify whether the performance obligations are fulfilled over time or at one or more points in time and establish its method for measuring progress in fulfilling the performance obligations set out in the contract. Any upfront fee payable in advance by the third party for future goods or services is normally deferred and only recognised as income when those future goods or services are provided.

Contract costs

5.66. If a charity incurs costs in its effort to obtain a contract with a third party, they may be recognised as an asset if the following criteria are met:

- the costs would not have been incurred by the charity if the contract had not been obtained
- the costs are expected to be recovered from the third party

If this policy is adopted by a charity, it must be applied consistently for all such costs that meet the criteria. Costs that do not meet these criteria are recognised as an expense. For further details on contract costs and contract balances, see paragraphs 23.113 to 23.30 of FRS 102.

Section two – non-exchange transactions

General principles for recognising income from non-exchange transactions

5.67. Non-exchange transactions include donations of money, goods, facilities or services which are given freely to the charity by a donor. Grants are a form of non-exchange transaction where the grant-maker awards a grant without receiving equal value in exchange. However, a grant may be presented as income from charitable activities where the payment is made to secure the provision of particular goods or services. Non exchange transactions are addressed in Section PBE34 of FRS 102. Government grants may also be received by a charity. These are addressed in Section 24 of FRS 102 but the use of the ‘accrual model’ option (in FRS 102) for the recognition of income from government grants is not permitted by this SORP.

5.68. A charity must recognise income from non-exchange transactions as follows:

- transactions that do not impose specified future performance-related conditions on the recipient are recognised in income when the resources are received or receivable
- transactions that do impose specified future performance-related conditions on the recipient are recognised in income only when the performance-related conditions are satisfied
- when resources are received or receivable before the performance-related conditions are satisfied, a liability is recognised

5.69. The existence of a restriction on the use of the resources does not prohibit a non-exchange transaction from being recognised as income when received or receivable.

5.70. Income from non-exchange transactions must only be recognised when the monetary value or amount of the income can be measured reliably.

5.71. This SORP requires that charities apply the ‘performance model’ for the recognition of income from all grants. The performance model is explained in paragraph 5.68, above.

5.72. In the case of a grant without any performance-related conditions, it is likely that when the formal offer of funding is communicated in writing to the charity there is a valid expectation that payment will be made, and the income is receivable. However, where a grant contains terms or performance-related conditions, the charity is not able to recognise the income until the terms and conditions are satisfied.

5.73. In the case of a donation, income will usually be recognised on receipt. However, some donations may include terms or conditions which must be met and in this case income is recognised when the terms and conditions are satisfied.

5.74. In the case of an arrangement that contains both a lease and non-exchange component, for example when lease payments are at significantly below market rates, see SORP module 10B ‘*Lease accounting*’.

Identification of terms and conditions

5.75. When recognising grants and donations, charities should identify those donations and grants that are subject to:

- performance-related conditions (paragraphs 5.76 and 5.80, below)

- other terms that may limit the recognition of income (paragraphs 5.81 and 5.84, below)

Performance-related conditions

5.76. Grant funding agreements may contain specific conditions that closely specify a level of output or service to be performed by a charity in receipt of a grant. These are performance- related conditions. See paragraphs 7.16 – 7.19 of this SORP for requirements for accounting for grants with performance-related conditions as a grant making charity.

5.77. A restriction on the use of a grant or donation to a particular purpose or activity of a charity does not create a performance-related condition. A restriction creates a requirement that limits or directs the purpose for which a resource may be used but it does not require a specific level of performance or output from the recipient charity.

5.78. A restriction may result from a specific appeal by the charity, or from the decision of the grant-maker or donor to support a specific purpose of the charity rather than making funds available for the charity's general use. A grant being restricted to a particular purpose of the recipient charity does not mean it should be recognised as a grant with performance-related conditions. Grants or donations that are subject to restrictions, but which are not subject to performance-related conditions are included within the SoFA heading 'income from donations and legacies.' Refer to SORP module 4 '*Statement of financial activities*', for further guidance on the classification of income.

5.79. A donation or grant that can be used for any purpose of the charity is unrestricted income. A restriction on the use of a grant or donation affects how they are presented in the accounts. For more information refer to SORP module 2 '*Fund accounting*'.

5.80. A grant with performance-related conditions is recognised in income only when the conditions are met. If grant funding is received in advance of meeting performance-related conditions, it is accounted for as a liability and shown on the balance sheet as deferred income. Deferred income is released to income on the SoFA when the performance-related conditions are met.

Other terms that may limit the recognition of income

5.81. Performance-related conditions are not the only terms that may apply to donations and grants. For example, a grant may be conditional on a charity obtaining matched funding or subject to successfully obtaining planning consent. Meeting these terms would not be wholly within the recipient charity's ability to satisfy and the outcome of the specified event is uncertain. Where a grant contains such terms, the income should not be recognised until there is reasonable assurance that it will be received.

5.82. Donor imposed terms may also specify the time period over which the expenditure of resources on a service can take place. For example, a term might specify the provision of a number of training weeks in a specific academic year or the completion of a number of work placements in a particular period. In this situation, the terms specify when the funds can be used, and it is not within the charity's discretion to make use of the funds at an earlier stage. The nature of the agreement limits the charity's ability to expend the resource until the time condition is met.

5.83. When a grant or donation contains terms, that are not performance related conditions, and these terms are not wholly within the recipient charity's ability to satisfy, it should be disclosed as a contingent asset if receipt of the grant or donation is probable once those terms are met. Once the inflow of economic benefits is virtually certain, then the related asset is no longer classed as a contingent asset and it is recognised once the conditions have been met.

5.84. If grant funding is received in advance of meeting terms not wholly within the charity's ability to satisfy, the income should be deferred as a liability until the terms are met.

Terms and conditions that do not prevent recognition

5.85. Terms or conditions such as the submission of accounts or certification of expenditure are administrative requirements and would not prevent the recognition of income. This is because these do not affect the charity's fulfillment of the performance obligations that relate to the activity or output delivered and so do not determine the amount of income receivable under the grant.

5.86. A donation or grant without performance-related conditions or any other terms should not be deferred even if the resources are received in advance of expenses being incurred on the activity for which the grant is given. The timing of the related expenditure is at the discretion of the charity and the income cannot be deferred simply because the related expenditure has not been incurred. For example, where a donation or grant is given specifically to provide a fixed asset or a fixed asset is donated (a gift in kind), the charity is normally entitled the income when it is receivable. At this point, all of the income must be recognised in the SoFA and not deferred over the life of the asset.

5.87. Similarly, a term or performance-related condition that allows for the recovery by the donor of any unexpended part of a grant does not prevent recognition. Instead, as a separate transaction, the charity should recognise a liability when the definition of a liability is met.

Grants received for capital expenditure

5.88. Where a grant is received for capital expenditure prior to an asset being purchased, a timing difference is created in the financial statements between the recognition of the grant income and the later accounting periods where depreciation is charged. If there is no restriction on the use of the asset, there will be a transfer of funds from restricted to unrestricted funds when the asset is purchased. (Refer to SORP module 2 '*Fund accounting*' for guidance on establishing whether capital grant receipts should be recorded in a restricted or an unrestricted fund). Where the grant income is in unrestricted funds, charities may create a designated fund for the tangible fixed asset purchased with the grant. The notes to the accounts showing fund movements, can show the charge to depreciation as an expense against the designated fund such that the balance on the designated fund is equal to the net book value of the relevant fixed asset.

Recognising income from legacies

5.89. Income from legacies must be recognised when it is probable that the legacy will be received and its value can be measured reliably. All accounting treatments and disclosures, including accounting for income from legacies, should be considered in the context of materiality. Refer to paragraphs 3.21 – 3.25 of this SORP for guidance on materiality.

5.90. Receipt of legacy income is normally probable when:

- there has been grant of probate or, in Scotland, grant of confirmation;
- the executors have established that there are sufficient assets in the estate, after settling any liabilities, to pay the legacy; and
- any conditions attached to the legacy are either within the control of the charity or have been met

5.91. Legacy income must only be recognised when it can be reliably measured. Charities should measure or estimate the fair value of the legacy income receivable based on the information available.

5.92. Whether receipt of a legacy is probable and whether its value can be measured reliably may be affected by events such as valuations and disputes. The charity must consider such events when forming a judgment as to recognising the income, or disclosing it as a contingent asset, or simply choosing whether or not to disclose the possibility of receipt.

5.93. A charity must refer to SORP module 13 and Section 32 of FRS 102 '*Events after the end of the reporting period*' to determine whether the receipt of evidence about a legacy after the reporting date is an adjusting event after the end of the reporting period.

5.94. Where a legacy is subject to the interest of a life tenant the legacy would not be recognised as income until the death of the life tenant.

5.95. Those charities with databases of current donors may well have information about an individual donor's intention or decision to leave a gift to them in their will and charities may also employ agents or carry out their own research to review publicly available information on recent deaths including granting of probate or, in Scotland, confirmation. Charities may also use a will notification service, for example Smee and Ford. Charities having such information should consider using this information when developing their accounting policy for recognising income from legacies.

5.96. In determining the probability of receipt and reliability of measurement, and in measuring the expected inflow of income from legacies, a charity may apply estimates and assumptions to a portfolio of legacies if the charity reasonably expects that the result of doing so would not differ materially from the result of applying this paragraph to each individual legacy.

5.97. Charities which receive a significant number of legacies in a reporting period and have detailed historical information on the settlement of legacies may apply an estimation technique in measuring the value of legacies that are recognised to allow for potential variation in settlement values and the risk of a will being contested. For example, where a charity has numerous immaterial legacies, by using a portfolio approach, the charity may estimate the monetary value of the income that may be received from legacies to which they are entitled by applying a formula or mathematical model.

5.98. A portfolio approach is unsuitable for material legacies or when a charity only receives legacies infrequently, as these should be considered individually.

5.99. Legacy income classified as receivable within one year is unlikely to be discounted to its present value unless the effect of discounting is material. If the distribution is to be deferred for more than 12 months and an estimate can be made of the likely date of distribution, the legacy, if material, may be discounted by the interest rate the charity anticipates it would earn on a comparable deposit over a similar time frame using the effective interest method set out in Section 11 of FRS 102. The unwinding of the discount should be reported as an adjustment to legacy income and not as interest receivable.

5.100. If the expected amount receivable from a legacy debtor is revised due to a change in the charity's estimate of the legacy debtor receivable, an adjustment is made to the amount of the legacy debtor and legacy income rather than charging the adjustment in the SoFA.

Income from donated goods, facilities and services

5.101. Goods, facilities, and services donated to a charity must be recognised as income when the criteria for their recognition are met. However, issues can arise in measuring the fair value of donated goods and services. Charities that have received donations of goods, facilities or services, including the services of volunteers, must refer to the separate SORP module 6 '*Donated goods, facilities and services, including volunteers*', which sets out the requirements for the recognition, measurement and disclosures of these income sources.

Income from interest and dividends

5.102. Interest is recognised using the effective interest method (see Section 11.20, of FRS 102 for more information). However, interest on concessionary loans and interest receivable on bank deposit accounts and from government gilts will not require adjustment, as the rate receivable normally reflects the effective interest rate applicable to the asset.

5.103. Dividends are accrued when the shareholder's right to receive payment is established, its receipt is probable, and the amount receivable can be measured reliably. Dividends are a distribution of distributable profit and entitlement is established when the declaration of the dividend has created a legal obligation to make the payment. In the case of a Gift Aid payment made within a charitable group, income is accrued when the Gift Aid payment is payable to the parent charity under a legal obligation. Measurement is at the fair value receivable, which will normally be the transaction value. A board decision to make a gift aid payment to a parent charity, that has not been taken prior to the reporting date, is not sufficient to create a legal obligation.

Settlement of insurance claims

5.104. An insurance claim must be recognised as income when the receipt of that reimbursement is virtually certain and its amount can be measured reliably.

5.105. Receipt is virtually certain when an offer of settlement is received from the insurer. The insurance settlement is recognised at the fair value receivable, which will normally be the settlement amount agreed with the insurer if this is available at the reporting date.

5.106. A charity must recognise the amount of the insurance reimbursement either as an item of other income or by offsetting it against the related expense heading in the SoFA. It must not be offset against the cost of a replacement asset. The amount reimbursed through an insurance claim is recognised as an addition to the fund that initially suffered the insured loss.

Disclosures and notes to the accounts

5.107. All charities must explain in the notes to the accounts the accounting policies adopted for the recognition of each material item of income.

5.108. This SORP requires that the headings used to analyse income in the SoFA must follow those required by the SORP module 4 '*Statement of financial activities*'. A charity in receipt of government grants must also disclose:

- the nature and extent of government grants recognised in the accounts
- unfulfilled conditions and other contingencies attaching to grants that have been recognised in income

5.109. A charity in receipt of government assistance must disclose an indication of the other forms of government assistance from which the charity has directly benefited.

5.110. A charity in receipt of income from non-exchange transactions must disclose the following:

- the nature and amounts of resources receivable from non-exchange transactions recognised in the financial statements
- any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised in income

- an indication of other forms of resources from non-exchange transactions from which the charity has benefited, for example unrecognised volunteer services, or donated goods that have been received but which the charity does not expect to recognise until the goods are sold or distributed.

5.111. This SORP requires that when a charity has deferred income, the notes to the accounts must explain the reasons why income is deferred and should analyse the movement on the deferred income account, identifying income deferred in the current year and the amounts released from previous reporting periods.

5.112. In circumstances where sufficient detail is not given in the statement of financial activities, a charity must disaggregate revenue recognised from contracts with third parties into categories that depict how its revenue and cash flows are affected by economic factors. Categories that might be appropriate include:

- type of good or service (e.g. major product lines)
- geographical market (e.g. country or region)
- market or type of customer (e.g. government and non-government)
- timing of transfer of goods or services (e.g. revenue from goods or services transferred to third parties at a point in time and revenue from goods or services transferred over time)
- revenue earned as an agent or as a principal

5.113. A charity must disclose the following amounts for the reporting period unless those amounts are presented separately in the statement of financial activities:

- revenue recognised from contracts with third parties, which the charity must disclose separately from its other sources of revenue
- any impairment losses recognised on any receivables or contract assets arising from the charity's contracts with third parties, which the charity must disclose, in aggregate, separately from impairment losses from other contracts

5.114. A charity must disclose:

- the opening and closing balances of trade debtors (receivables), contract assets and trade creditors (contract liabilities) from contracts with third parties, if not otherwise separately presented or disclosed
- revenue recognised in the reporting period that was included in the deferred income (contract liability) balance at the beginning of the period
- revenue recognised in the reporting period from performance obligations satisfied or partially satisfied in previous periods (e.g. changes in estimates of variable consideration)

5.115. A charity must disclose information about its performance obligations in contracts with third parties, including a description of:

- when the charity typically satisfies its performance obligations (e.g. upon shipment, upon delivery, as services are rendered or upon completion of service)
- the significant payment terms (e.g. when payment is typically due, whether the contract includes a financing transaction, and whether the

consideration amount is variable)

- the nature of the goods or services that the charity has promised to transfer, highlighting any promises to arrange for another party to transfer goods or services (i.e. if the charity is acting as an agent)
- obligations for returns, refunds and other similar obligations
- types of warranties and related obligations

5.116. For performance obligations that the charity satisfies over time, the charity must disclose the methods it used to recognise revenue – for example, a description of the output methods or input methods used and how those methods are applied.

5.117. The charity must provide a quantitative or qualitative explanation of the significance of unsatisfied performance obligations and when they are expected to be satisfied. However, a charity need not disclose such information for a performance obligation if either of the following conditions is met:

- the performance obligation is part of a contract that has an original expected duration of one year or less
- the charity recognises revenue from the satisfaction of the performance obligation where its right to consideration from a third party corresponds directly to the charity's work to date

5.118. The charity must disclose:

- the closing balances of assets recognised from the costs incurred to obtain a contract (see paragraph 5.66 and 23.113 of FRS 102) or fulfil a contract (see paragraph 23.117 of FRS 102) with a third party by main category of asset (e.g. costs to obtain contracts with third parties, pre-contract costs and set-up costs)
- the amount of amortisation and any impairment losses recognised in the reporting period

5.119. Where a charity chooses to exercise the option to make no adjustments for the time value of money, recognise the costs incurred to obtain a contract as an asset, and/ or recognise the costs to obtain a contract as expenses when incurred for contracts in which the amortisation period for the asset that the charity would otherwise have recognised is one year or less then this must be disclosed.