7. Recognition of expenses

Introduction

7.1. The reporting tiers for Module 7 are as outlined in the table below.

Table 7.1A: Tiered reporting for Module 7

All tiers	The recognition and measurement requirements for expenses and liabilities in this module apply fully to all charities.

7.2. Expenses are the amount of a charity's resources that have been spent or consumed in carrying out its activities. Expenses arise from either a decrease in a charity's assets or an increase in its liabilities leading to a decrease in the funds of the charity.

7.3. Examples of an expense include the purchase of goods or services either for cash or on credit, or the depreciation charge on tangible fixed assets.

7.4. Expenses can result from exchange transactions, for example the purchase of goods or services or the employment of staff, or from non-exchange transactions such as making grants or other funding commitments to further a charity's purposes for which the charity receives no other benefit in return.

7.5. Charities should refer to Sections 21, 28 and 34 of FRS 102 for more information. This module applies to all charities and sets out:

- General principles for the recognition of liabilities and expenses
- Principles on measurement of liabilities
- Principles for recognising liabilities from constructive obligations
- Accounting for liabilities arising from grants with performance-related conditions
- Treatment of employee benefits

7.6. Charities should refer to the SORP module 10A '*Provisions, contingent liabilities and contingent assets*' for information on provisions, contingent liabilities and contingent assets and the necessary disclosure requirements for these items.

General principles for the recognition of liabilities and expenses

7.7. A liability is a present obligation of the charity to transfer an economic resource as a result of past events. For a liability to exist, three criteria must all be satisfied:

- the charity has an obligation
- the obligation is to transfer an economic resource

- the obligation is a present obligation that exists as a result of past events

Charities should refer to paragraphs 2.39 to 2.44 of FRS 102, for full details of these criteria.

7.8. When a charity enters into a contract for the supply of goods or services, the expense is recognised when the supplier of the goods or services has performed their part of the contract.

7.9. Guidance on the recognition and measurement of provisions (i.e. liabilities of uncertain timing or amount), funding commitments and onerous contracts is provided in the SORP module 10A '*Provisions, contingent liabilities and contingent assets*'.

Measurement of liabilities

7.10. A liability must be measured on recognition at its historical cost. The subsequent measurement of the liability must be based on information updated to reflect conditions at that measurement date. Other modules of the SORP consider other types of liabilities, for example:

- certain financial instruments, refer to the SORP module 11 '*Accounting for financial assets and financial liabilities*' for more information
- defined benefit pension liabilities, refer to the SORP module 17 '*Retirement benefits*' for more information
- provisions which are expected to be settled in more than 12 months after the reporting date, refer to the SORP module 10A '*Provisions, contingent liabilities and contingent assets*' for more information

Principles for recognising liabilities from constructive obligations

7.11. Charities frequently provide services or make grants to their beneficiaries on a non- contractual basis. Without a contract, there is unlikely to be a legal obligation. However, a constructive obligation, and therefore a liability can still arise if the charity has created a valid expectation to settle an obligation resulting from a commitment it has made. Not all commitments to provide future services or funding will result in a constructive obligation. Without an obligation, there is no liability to recognise.

7.12. A charity may make general statements about its future intentions, for example, the aim of relieving famine in a particular location or improving the quality of care provided to a particular group of people. Such statements can be communicated in a variety of ways, including within mission statements, setting out future plans within a trustees' annual report or simply making a general policy statement. Statements such as these do not normally create a constructive obligation as discretion is retained by the charity as to their implementation.

7.13. Evidence of a constructive obligation exists where:

- the commitment made by the charity is specific, for example, a promise is made to provide particular goods, services or grant funding
- this commitment is communicated to particular beneficiaries or grant recipients
- there is an established pattern of practice that indicates to the recipients of services or funding that the charity will discharge its responsibilities as a result of which the charity has created a valid expectation on the part of the recipient that the charity will meet its commitment

7.14. It follows that a charity's decision to provide funding does not create a constructive obligation that must be recognised as a liability unless that decision has been communicated to those affected before the reporting date. The commitment must be communicated in a sufficiently specific manner so as to create a valid expectation on the recipient's part that the charity will discharge its responsibilities.

7.15. The formal written offer of a grant gives the recipient a valid expectation that the grant will be given provided performance-related conditions are met where relevant. In such circumstances, the charity cannot realistically withdraw from its commitment and so it is unlikely to have a realistic alternative but to meet the obligation. However, the recognition of any resulting liability would be dependent on any conditions attaching to the commitment. Charities should refer to the SORP module 10A '*Provisions, contingent liabilities and contingent assets*' for more information.

Accounting for liabilities arising from grants with performance-related conditions

7.16. Certain grants may contain performance related conditions that closely specify a level of output or service to be performed by the recipient of the grant.

7.17. The key characteristic of a grant with performance-related conditions is that the amount of the grant payable to the recipient is determined by the extent of their performance in meeting the conditions set out in the grant agreement.

7.18. The payment of a grant with performance-related conditions is conditional on the grant recipient delivering a specified level of service or units of output. For example, the payment might be conditional on the number of meals provided or the usage or opening hours of a facility. In such cases the grant-maker will often have negotiated the nature of services to be provided. The liability and expense arising from grants with performance-related conditions must be recognised to the extent that the recipient of the grant has provided the specified service or goods.

7.19. A grant that is restricted to a particular purpose does not create a performance-related condition, as the payment of the grant is not conditional on the achievement of a specified level of service or outputs by the recipient. Similarly, a grant that funds a project over a number of years is not recognised as a grant with performance-related conditions simply because the funding obligation is to be met over an extended period of time.

Treatment of employee benefits

7.20. In addition to the guidance included in the Treatment of Employee Benefits section of this module, charities should refer to Section 28 of FRS 102 for information. In particular, charities should refer to:

- Paragraph 28.3 on the general recognition principle for all employee benefits
- Paragraphs 28.4 – 28.8 on short term employee benefits
- Paragraphs 28.29 – 28.30 and 28.42 on other long term employee benefits
- Paragraphs 28.31 – 28.37 and 28.43 – 28.44 on termination benefits

7.21. Employee benefits include all costs incurred by the charity in exchange for the services of its employees and any remunerated trustees. Expenses are recognised for all employee benefits resulting from their service to the charity during the reporting period unless the staff costs have been capitalised as part of the cost of an asset. Liabilities are recognised for the cost of all benefits to which employees are entitled, at the reporting date, that have yet to be paid.

7.22. Short-term employee benefits such as wages and salaries are measured at the amount expected to be paid in exchange for that service and not discounted for the time value of money.

7.23. Employee benefits may include compensated absences such as annual leave and sick leave. Some short-term compensated absences allow employees to accumulate an entitlement to a benefit that the employee can carry forward if the entitlement is not fully utilised in the current reporting period. Annual leave may be an example of such an accumulating benefit. Non-accumulating benefits cannot be carried forward to future reporting periods. Paid sick leave may be an example of a non-accumulating benefit.

7.24. An expense for accumulating compensated absence must be recognised as the employee earns entitlement to the compensated absence through the provision of services. A liability must be recognised for any entitlement to accumulating absences that the employee is entitled to, but which is unused, at the end of the reporting period. For example, a liability must be recognised for holiday pay where employees are entitled to paid holiday absence but have not used all of their entitlement by the end of the reporting period. The liability should be measured at the undiscounted additional amount that the charity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. Termination benefits are measured at the best estimate of the amount required to settle the obligation at the reporting date. If the expected settlement date of the termination payments is 12 months or more after making the provision, and the effect would be material, the present value of the obligation must be calculated using an appropriate discount rate. Post-employment benefits arising under defined benefit plans are measured at the present value of the obligation under the plan at the reporting date less the fair value of the plan assets at the reporting date (reference should be made to the SORP module 17 '*Retirement and post-employment benefits*').

7.25. Disclosure requirements for expenses incurred on staff costs are set out in the SORP module 9 '*Disclosure of trustee and staff remuneration, related party and other transactions*'.