

Annex to the second submission: Proposed changes to FRS 102

Introduction

The proposal takes a different approach to the argument of practicality, which has been the welcome and pragmatic option allowed under section 34, paragraph PBE34.70 to allow flexibility in recognition based on the circumstances of the reporting charity. The suggested approach would allow a consistency in treatment on a whole charity sector basis. The changes proposed are in respect of the recognition of high volume goods for onward distribution at nil cost to the recipient, and to the treatment of services gifted for the sole use by the recipient charity. A final change to simplify the application of PBE34.70 is also suggested.

Each proposal is outlined here with the change sought, followed by the rationale and evidence base for change and concludes with a view on the impact of the proposed change. The research evidence presented is solely charity related. All additions to the existing text of FRS102 are shown as underlined text and deletions are shown with strikethrough.

1.1 Change with respect to the accounting treatment for the recognition and measurement of donated goods for onward distribution

Proposal: Section 34 of FRS 102 paragraph 1A.6 be amended as shown with an additional paragraph inserted

- PBE34.73 (c) Entities that solicit donations of goods for onward distribution at nil cost to the recipient which are PBEs and that prepare their accounts in accordance with the Charities SORP, shall not attribute a measurement of fair value to those goods and shall provide such additional disclosures as may be required by that SORP in respect of this class of donated item.

Rationale: The underlying rationale of paragraph PBE34.73 is to apply a charity context to the for-profit principle of recognising an economic benefit to the reporting entity. In a for-profit context, gifted items would represent a reduction in cost to bear or an asset to sell; in either case the gift increases the profit for distribution to owners.

The suggestion is that in a specific context of charitable activities where goods are sought for onward distribution, that these charities would not normally buy these goods in to pass on but instead seek these goods from the public or firms for onward relief to the beneficiary. The goods are not stock to sell but are the object of the charitable endeavour, for example food banks. Attributing a value to these goods to include in the accounts as a gain and stock and subsequently expenditure and a reduction in stock does not provide meaningful information to donors, rather it is the number of people helped or the volume of deliveries that is informative in showing the benefit provided.

Evidence: Statement of feedback and minutes of the SORP Committee meeting of 28 September 2021 (publication awaited).

Impact: The feedback from all the stakeholder engagement strands and of the advisory SORP Committee is that the onus on recognition and measurement does not reflect the character of the charity's operations. Neither does it reflect the intention of the donor or the difference the charity actually makes and is potentially misleading in uplifting income and expenditure with the valuation of stock appearing to enhance unrestricted funds when in fact that stock is intended by the donor or recipient charity to be directly used in the provision of charitable activity with the charity acting as a conduit or facilitator to their giving to those in need. The focus would be on explaining how the donations are used to make a difference rather than attributing an economic value to them.

1.2 Change with respect to the accounting treatment for gifted services for sole use by the recipient charity

Proposal: Section 34 of FRS 102 paragraph PBE34.73 be amended as shown and an additional paragraph PBE34.72A be inserted. Consequential amendments are proposed to Appendix B.

- Paragraph PBE34.73 (a) be amended: Donated services and facilities which are not conditional on their sole use by the reporting entity that would otherwise have been purchased, shall be measured at the value to the entity.
- A new paragraph PBE34.72A inserted: Donated services and facilities conditional on their sole use by the reporting entity shall not be measured and the entity shall provide such additional disclosures as may be required by the Charities SORP.
- Paragraph PBE34B.10 Donated services which can be resold or are used to trade that can be reasonably quantified include donated facilities, such as office accommodation, services that would otherwise have been purchased and services usually provided by an individual or an entity as part of their trade or profession for a fee.

Rationale: The underlying rationale of paragraph PBE34.73 is to apply a charity context to the for-profit principle of recognising an economic benefit to the reporting entity. In a for-profit context, gifted items would represent a reduction in cost to bear or an asset to sell; in either case the gift increases the profit for distribution to owners.

The suggestion is that in a specific context of charities, gifted services for their own use, that the recognition of some services that have a traded market from others such as general volunteers (paragraph PBE34B.11 is potentially anomalous since in many cases neither would be purchased by the charity. The motive for both is that of a donor wishing to contribute non-financially to the endeavour of the charity. Valuing some services is potentially misleading in terms of inflating apparent income and expenditure. It also has the perception that some services have value and others do not when both have inherent value to the charity's work. However, if the gift is sold for value or used to trade then the charity is seeking, as a for-profit entity would, a cash-flow advantage and recognition is appropriate.

Evidence: Statement of feedback and minutes of the SORP Committee meeting of 28 September 2021 (publication awaited) and post Committee review of this submission.

Impact: The current approach in requiring some services gifted for the charity's own sole use to be valued creates an anomaly in two ways, firstly valuation approaches differ on whether the market value that the donor would have sold commercially used or whether a lower value attributed by the charity based on affordability is used. Secondly both valuation approaches are potentially misleading as in many instances the charity would not have bought those services had they not been freely given. Uplifting income and expenditure with the valuation of such services is therefore misleading as the gift is not intended by donor or recipient charity to be converted into cash-flows through sale or added value to a trade. The focus would be on explaining how the donations are used to make a difference rather than attributing an economic value to them.

1.3 Change with respect to the accounting treatment for the recognition and measurement of donated goods for resale where the items are of unknown character at the point of receipt

Proposal: Appendix B to Section 34 of FRS 102 paragraph PBE34B.4 be amended as shown:

- When it is impractical to recognise resources from non-exchange transactions, the income is recognised in the period in which the resources are sold ~~or distributed~~. The most common example is that of items that are of unknown character at the time of receipt and high volume, low value second-hand goods donated for resale.

Rationale: The appendix provides a helpful approach to situations where the entity has no capability to recognise and value stock on receipt. This is not the case for for-profit companies that can value acquired stock by reference to purchase orders or contract or invoice documentation.

The common application of this pragmatic approach is that of charity shops selling donated goods. In practice goods are often left in plastic bags and are of unknown character upon receipt. The amendment removes the potential onus to distinguish from the bagged items the occasional item that might not be otherwise seen as low value. The safeguard is that if the character of the item is known e.g. a gifted item of valuable jewellery then the option not to recognise until sold is not exercisable.

The deletion of the reference to distribution is contingent on the proposal being accepted not to recognise goods for distribution (see above).

Evidence: Statement of feedback and minutes of the SORP Committee meeting of 28 September 2021 (publication awaited).

Impact: The proposed change provides a consistent approach to charity shops and similar entities and removes the administrative burden of undertaking an exercise to satisfy accounts preparation requirements that is hard to implement in a volunteer environment. The effect is to reduce in some instances the potential amount of initial gains and stock recognised and defer recognition to the point of sale.