EXPOSURE DRAFT SORP 2026

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

(FRS 102)

CHARITY COMMISSION
FOR ENGLAND AND WALES

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Accounting and reporting by charities: the statement of recommended practice (SORP) – scope and application

Introduction

1. This Statement of Recommended Practice, applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and the Republic of Ireland (the SORP), is issued by the Charity Commission for England and Wales, the Charity Commission for Northern Ireland and the Office of the Scottish Charity Regulator in their role as the joint SORP-making body, recognised by the Financial Reporting Council.
2. This SORP provides guidance for charities on how to apply FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland ('FRS 102'). It is important for preparers of accounts to make reference to this standard when preparing accounts and in making the required disclosures.
3. The introduction to each module identifies the section(s) in FRS 102 relevant to the issues addressed by that module. This SORP provides guidance on how to apply FRS 102 to charity accounts and it should be noted that in the hierarchy established in accounting standards, FRS 102 requirements and legal requirements take precedence over the SORP. Therefore, should an update to FRS 102 or a change in relevant legislation be made after the publication of this SORP, any of the provisions of this SORP that conflict with the updated FRS 102 or relevant legislation cease to have effect.
4. Where FRS 102 allows an accounting policy choice, the SORP will identify whether a particular treatment is required or whether charities can exercise a choice. The preparer should refer to the relevant SORP module to determine whether a particular policy is specified by the SORP as being more appropriate in the circumstances of a charity.
5. This SORP sets out how charities are expected to apply FRS 102 to their particular activities and transactions and explains how charities should present and disclose their activities and funds within their accounts. Preparers should also refer to FRS 102 as the disclosures listed in this SORP are not exhaustive. Note, this SORP does not permit the use of Section 1A Small Entities of FRS 102. The SORP sets out the content of the trustees' annual report which accompanies the accounts (financial statements). The trustees' annual report provides the context for, and a narrative explanation of, the financial information contained in the accounts and there must be consistency between the trustees' annual report and accounts.

6. This SORP includes charity-specific requirements that are additional to those of FRS 102. In particular, requirements relating to the trustees' annual report, fund accounting, the format of the statement of financial activities and additional disclosures aimed at providing a high level of accountability and transparency to donors, funders, financial supporters and other stakeholders. This is considered particularly important due to the public interest in the charitable sector. The phrase 'this SORP requires' is used to distinguish the additional disclosures required by the SORP which are not specifically required by FRS 102.

7. Before applying this SORP, the following sections should be read which explain the scope and application of this SORP:

- The intended user of the SORP
- Objectives of the SORP
- The intended user of the trustees' annual report and accounts
- Scope of the SORP
- The effective date of commencement
- Transitional arrangements
- Choice of accounts preparation methods
- How to use the modular SORP
- Use of the terms 'must', 'should' and 'may'

The intended user of the SORP

8. The SORP is developed primarily to assist those involved in the preparation of the accounts and trustees' annual report of a charity. The SORP is also relevant to charity auditors, independent examiners and accountancy practitioners who are involved in the scrutiny of charity accounts or in advising on the application of accounting standards in the context of charities.

9. It is anticipated that users of this SORP will be familiar with accounting concepts, principles and terminology and possess a reasonable knowledge of accounting practice.

10. The SORP is only relevant to charities who prepare their accounts on an accruals basis. Charities must prepare their accounts on an accruals basis if any of the following apply:
    - the charity is registered in England and Wales or Northern Ireland and gross income exceeds £250,000 for the year
    - the charity is registered in Scotland and gross income for the year is £250,000 or more
    - the charity is a company registered with Companies House
    - the charity's governing document requires accounts to be prepared on the accruals basis.

11. If none of the situations listed in a) to d) above apply, charities may be eligible to opt to prepare receipts and payments accounts. In such circumstances, the

trustees should assess, in accordance with their own circumstances, whether the receipts and payments basis or the accruals basis is more useful to the users of their accounts. Where charities elect to prepare receipts and payments accounts, this SORP does not apply.

Objectives of the SORP

12. The recommendations of the SORP are intended to achieve the following objectives:
    - improve the quality of financial and non-financial reporting by charities
    - enhance the relevance, comparability and understandability of the information presented in charity accounts
    - provide clarification, explanation and interpretation of accounting standards and their application to charities and to sector specific transactions
    - assist those who are responsible for the preparation of the trustees' annual report and accounts

The intended user of the trustees' annual report and accounts

13. The objective of the trustees' annual report (the report) and accounts is to provide information about a charity's financial performance and financial position that will be useful for decision-making by a wide range of stakeholders. Such information includes information about:
    - the economic resources of the charity, claims against the charity and changes in those resources and claims
    - the trustees' stewardship and management of charitable funds
    - the mission, objectives and service performance of the charity
14. Although past, current and potential funders, donors and financial supporters of a charity may be the primary audience for the information contained in a charity's report and accounts, the preparer should also be aware that interest in this information may also extend to a charity's service users and other beneficiaries.
15. The report and accounts should not be viewed simply as a statutory requirement or a technical exercise. The report and accounts, when read together, should help users of the information to understand:
    - what the charity is set up to do
    - the resources available to it
    - how these resources have been used
    - what has been achieved as a result of its activities
16. However, general purpose financial statements do not and cannot provide all the information that users need. Users also need to consider information from other

sources, for example, general economic conditions and expectations, political events and the political climate.

Scope of the SORP

17. Except where an alternative reporting framework is set out in legislation or regulation, or if another SORP applies, the accounting recommendations of this SORP apply to all charities in the UK that prepare accounts on the accruals basis to give a true and fair view of a charity's financial position and financial activities regardless of their size, constitution or complexity. In the Republic of Ireland this SORP sets out recommended good practice.
18. Where a separate SORP exists for a particular class of charities (for example, SORPs applicable to Registered Social Housing Providers or to Further and Higher Education Institutions, or to Common Investment Funds), those charities should adhere to that SORP.
19. Charities applying this SORP may also be subject to specific regulations or legal requirements based on how they are constituted or their jurisdiction(s) of formation, operation or registration. For example, charities constituted as companies will need to meet the reporting requirements of company law. Whilst this SORP has been prepared to be consistent with the requirements of company and other relevant law and regulation, charities will need to ensure that any particular accounting requirements and disclosures applicable to them are also met.
20. Charities preparing receipts and payments accounts are not required to apply the accounting recommendations of this SORP. Such charities must refer to the regulatory requirements of their jurisdiction(s) of registration regarding the format and content requirements for receipts and payments accounts and the trustees' annual report.

The effective date of commencement

21. This SORP is applicable to the accounts of relevant charities for reporting periods beginning on or after 1 January 2026. Early adoption is permitted. Note, FRS 102 including the Periodic Review amendments 2024 must be applied at the same time as this SORP. In those jurisdictions where the applicable SORP under which accounts are prepared is specified in regulations, this SORP cannot be adopted until the new regulations are made allowing its use.

Transitional arrangements

22. Section 35 of FRS 102 sets out a number of simplifications for the preparation of the opening balance sheet and comparative figures when reporting under FRS 102 for the first time. Comparative information must be restated as far as practicable on

a like-for-like basis. Charities moving from preparing receipts and payments accounts to applying this SORP will be applying FRS 102 for the first time.

22A. Section 1 of FRS 102 sets out how charities should apply new or amended requirements of FRS 102 for the first time to ease the introduction of the new requirements.

23. Charities with a principal activity similar to those listed in the FRS 102 definition of a financial institution must make the additional disclosures required by Section 34 of FRS 102. This is likely to include charitable incorporated friendly societies. It excludes those charities which make social investments including concessionary rate finance, unless such lending is the charity's principal or sole charitable activity.

23A. For charities applying a requirement of this SORP for the first time that does not originate from FRS 102, comparative information must be restated as far as practicable on a like-for-like basis.

Choice of accounts preparation methods

24. Charities in the UK and the Republic of Ireland must apply FRS 102 when preparing their accounts on an accruals basis. Charities preparing cash-based receipts and payments accounts are not required to apply FRS 102 or this SORP.

25. The disclosure exemption in paragraph 33.1A of FRS 102 in relation to transactions entered into between two or more members of a group are not available to charities applying this SORP. This SORP requires charities applying this SORP to make the disclosures required by the SORP module '*Disclosure of trustee and staff remuneration, related party and other transactions*'.

How to use the modular SORP

26. For a charity to state that it has prepared its accounts and trustees' annual report in accordance with this SORP, it must adhere to the SORP's requirements for the preparation of both the accounts and the trustees' annual report.

27. The accounts of a charity comprise the following:

    - a statement of financial activities (SoFA), which provides an analysis of a charity's income and expenditure and movement in funds in the reporting period For charities that are companies, an income and expenditure account included either within the SoFA, or as a separate summary income and expenditure account in addition to the SoFA where necessary to meet the reporting requirements of company law
    - a balance sheet, which sets out a charity's assets and liabilities and retained funds at its reporting date
    - a statement of cash flows, if required (paragraph 14.1, Module 14 '*Statement of cashflows*')

- notes to the accounts that explain the accounting policies, provide more detail of how the income and expenditure is made up, and provide extra information about particular assets and liabilities, or about particular funds or transactions

28. The SORP has a number of core modules to which all charities must refer when preparing their accounts and report. Supplementing these core modules, there are additional modules (grouped in four selections) that apply only when a charity:
    - undertakes a specific type of transaction (selection 1: modules 15 -17)
    - needs to recognise, measure or disclose a specific asset or liability in a particular way (selection 2: modules 18 - 19)
    - has particular forms of investment (selection 3: modules 20 - 22)
    - adopts a particular legal form or group structure (selection 4: modules 23 - 29)

29. When preparing their accounts, charities must refer to the index of modules to ensure that they identify all of the SORP's recommendations that apply to their transactions, assets and liabilities. This should be done for each reporting period and whenever a charity undertakes a new type of transaction. In particular, charities must select those modules that apply to their specific transactions and circumstances.

30. This SORP provides guidance to charities on the application of FRS 102 and also provides recommendations on accounting and reporting of charity-specific transactions that are not addressed within FRS 102.

31. The SORP also offers advice on how a charity may disclose particular issues or provides examples or suggested layouts of particular notes which a charity may choose to follow.

32. See SORP module 3 '*Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors*' for details of the SORP compliance statement that a charity must provide within its accounting policy note and the additional disclosures that it must make in the event of a departure from the SORP's provisions.

Tiering

33. The reporting requirements are split between three tiers to reflect the range of sizes of charity that are present in the sector. The euro (€) amounts are relevant for charities in the Republic of Ireland applying this SORP.

Tier 1	All charities applying accruals accounts and with a **gross income** of not more than £500,000 (€500,000).

Tier 2	All charities with a gross income falling above the tier 1 threshold and with a **gross income** of not more than £15 million (€15 million).
Tier 3	All charities with a **gross income** falling above the tier 2 threshold.

34. Charities in tier 1 must comply with the requirements in tier 1; charities in tier 2 must prepare accounts on an activity basis and comply with the requirements in tier 1 and tier 2; and charities in tier 3 must prepare accounts on an activity basis and comply with the requirements in tier 1, tier 2 and tier 3.

35. The tier 2 threshold of £15,000,000 currently aligns with the turnover criteria for defining a small company as defined in company law. The criteria for defining a small company also align with the definition of a small entity in FRS 102. However, it should be noted that the additional criteria for defining a small company (i.e. employee numbers and total assets) are not considered in determining the thresholds for the SORP tiers. Therefore, charities in tiers 1 and 2 will need to also consider if they meet the other small company criteria to determine if they are exempt from certain requirements as permitted by FRS 102, for example, the preparation of a cash flow statement, see SORP module 14 '*Statement of cash flows*' for more information.

Use of the terms 'must', 'should' and 'may'

36. This SORP uses different terms to distinguish those requirements that must be followed in order to comply with the SORP from other recommendations which charities can opt to follow when preparing the trustees' annual report and accounts.

37. In many cases, a 'must' requirement in the SORP may be a requirement of FRS 102. This SORP also uses the term 'must' to indicate those elements that are important to the reader of the trustees' annual report that must be included within the report or to identify particular accounting treatments, disclosures or presentational requirements that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. Where this SORP states that a recommendation is one which must be followed, non-adherence to that recommendation is a departure from this SORP.

38. This SORP uses the term 'should' for an item in the trustees' annual report or the accounts for those recommendations aimed at advancing standards of financial reporting as a matter of good practice. While charities are encouraged to follow all the SORP's recommendations, a failure to follow a 'should' recommendation with respect to the report or the accounts is not regarded as a departure from this SORP.

39. This SORP uses the term ‘may’ for an item in the trustees’ annual report or an approach to a particular disclosure that a charity may choose to adopt or identifies that an alternative accounting treatment or disclosure of a transaction or event is allowed by the SORP. Charities may choose whether such examples or alternative treatments are adopted at their discretion.

Approval of a charity’s accounts

40. This SORP refers to accounts being approved by the charity trustees where relevant. FRS 102 refers to accounts being ‘authorised for issue’. For the avoidance of doubt, the references in this SORP to accounts being approved should be taken to mean that they have been authorised for issue.

Statement by the Financial Reporting Council on the Charities SORP (FRS 102) consultation draft (third edition – 2026)

In accordance with the FRC's Policy on Developing Statements of Recommended Practice (SORPs) the FRC carried out a review of the proposed SORP focusing on those aspects relevant to the financial statements but also including aspects relevant to the FRC's broader responsibilities where appropriate.

Index of SORP modules

	Paragraph numbers
Core modules	
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Selection 3: Accounting for investments

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Selection 4: Accounting for branches, charity groups and combinations

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Accounting for groups and the preparation of consolidated accounts 24.1–24.43

Branches, linked or connected charities and joint arrangements 25.1–25.27

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Charity mergers 27.1–27.17

Accounting for associates 28.1–28.20

Accounting for joint ventures 29.1–29.22

Appendices

Appendix 1: Glossary of terms

Appendix 2: The Charity Accounting (SORP) Committee

Appendix 3: Charity law thresholds for the UK and the Republic of Ireland

Appendix 4: Basis for conclusions

1. Trustees’ annual report

Introduction

1.1. Charities in all tiers must prepare a trustees’ annual report. The trustees’ annual report is a narrative account of what has happened in the charity in the financial period and helps to explain the numbers in the accounts.

1.2. The reporting tiers applied for module 1 are specified in the table below.

Table 1.1A: Tiered reporting requirements for module 1

Tier 1	Charities in tier 1 must consider all the requirements in tier 1 (as specified in the table at paragraph 1.11).
Tier 2	Charities in tier 2 must consider all the requirements in tier 1 and tier 2 (as specified in the table at paragraph 1.11).
Tier 3	Charities in tier 3 must consider all the requirements in tier 1, tier 2 and tier 3 (as specified in the table at paragraph 1.11).

Overview and the purpose of the trustees’ annual report

1.3. The main purpose of the trustees’ annual report (the report) is to ensure that the charity is publicly accountable to its stakeholders for the stewardship of the funds it holds. To communicate relevant information in the most helpful way, trustees should ask themselves:

- Who are the users of the report?
- What are the information needs of users of the report?

Users may vary from charity to charity, but will normally include funders, donors, financial supporters, service users, members, beneficiaries and other stakeholders.

1.4. Trustees are responsible for preparing the report. They may seek the assistance of the charity’s staff or professional advisers to do so. However, trustees must approve the final text of the report.

1.5. The report should provide a fair, balanced and understandable review of:

- the charity’s structure
- the charity’s purposes
- objectives
- activities
- financial performance
- financial position

The report provides an essential link between a charity’s purposes as stated in its governing document, the charity’s aims and objectives and the activities it undertakes to achieve them.

1.6. The report must meet the requirements of law and regulation. This guidance

incorporates the following requirements relating to the trustees' annual report:

- The Charities (Accounts and Reports) Regulations 2008
- The Charities Accounts (Scotland) Regulations 2006 as amended
- The Charities (Accounts and Reports) Regulations (Northern Ireland) 2015 (NI Regulations)

These regulations are in force at the time of publication, but preparers of the report will need to check for any subsequent changes. There may be other requirements in Charities Act 2011, Charities and Trustee Investment (Scotland) Act 2005 (as amended) and Charities Act (Northern Ireland) 2008 that need to be included. Users of this SORP should refer to the legislation for the jurisdiction in which they are reporting. There are particular requirements for charitable companies, see paragraphs 1.73 and 1.74 below and charities that apply total return should refer to SORP Module 20 '*Total return (investments) – (England and Wales only)*'.

1.7. All charities in England and Wales that are subject to audit and raise funds from the public must disclose information on fundraising practices in their trustees' annual report. These requirements are in the Charities (Protection and Social Investment) Act 2016.

1.8. Good reporting explains what the charity is set up to do, how it is going about it, and what is achieved as a result of its work. The report should help users to interpret the accounts by linking the activities and achievements reported with the sources of income used to finance them and the expenditure incurred on those activities. A charity's accounts focus on its financial position and financial performance. The report and accounts taken together should provide a picture of what the charity has done (its outputs); what it has achieved (its outcomes); and what difference it has made (its impact). Information on how the charity achieves its mission is often the most important information need of stakeholder groups. Charities are encouraged to reflect carefully on how such a narrative is crafted in the trustees' annual report.

1.9. The report is an opportunity to reflect on the year and tell the charity's story, acknowledging both successes, failures and learnings. It should help the user to understand where the charity's money has come from and how and why the money has been spent in the way it has; to assess the charity's progress against its objectives and to understand its plans in relation to its purposes.

1.10. Stakeholders increasingly want to understand how charities are responding to environmental matters and trustees may wish to consider how their report could best address these expectations.

How to use this module

1.11. The reporting requirements are split between 3 tiers to reflect the range of sizes of charity that are present in the sector.

Table 1: Relevant paragraphs for each tier

	Tier 1	Tier 2	Tier 3
Objectives and activities	1.20 to 1.23	1.20 to 1.27	1.20 to 1.27
Achievements and performance	1.28	1.28 to 1.33	1.28 to 1.34
Financial review	1.35 to 1.43	1.35 to 1.46	1.35 to 1.47
Plans for future periods	1.48	1.48 to 1.50	1.48 to 1.50
Structure, governance and management	1.51 to 1.52	1.51 to 1.55	1.51 to 1.55
Reference and administrative details	1.56 to 1.57	1.56 to 1.57	1.56 to 1.59
Sustainability	1.60	1.60	1.60 to 1.65

1.12. The reporting requirements take account of the size of the charity so tier 1 charities are not required to provide as much information as tier 2 or tier 3 charities.

1.13. However, tier 1 charities are encouraged to include some or all of the additional information required of tier 2 and tier 3 charities if the charity trustees consider such additional information particularly relevant to users of their accounts.

Other considerations

1.14. Charities are required to comply with all the applicable reporting requirements prefixed with a **‘must’**.

1.15. Additional information may be included within the report or may accompany the accounts if it is considered helpful for users, for example a Chair’s Report, an environmental report, or an impact assessment.

1.16. Within the report, charity trustees can refer to other sources of information about the charity and what it is doing. Such information which is outside of the statutory reporting framework, is often tailored to the needs of particular audiences and presented through annual reviews, newsletters and websites. Although this information may be useful to users of the accounts, it is not a substitute for complying with legal requirements or the requirements of this SORP.

1.17. The report provides important, accompanying information to the accounts and therefore must be provided whenever a full set of accounts is made available. The report must show:

- the reporting period (financial year) of the charity to which it relates
- the date of its approval

One or more of the charity's trustees must sign and date the report on behalf of all the trustees to demonstrate it has been approved.

The content of the trustees' annual report

1.18. The SORP requirements that charities must follow are set out under the following headings:

- objectives and activities
- achievements and performance
- financial review
- structure, governance and management
- reference and administrative details
- sustainability
- exemptions from disclosure
- funds held as holding trustee on behalf of others

1.19. The headings used in the report may be amended to fit the preferences of the charity provided the information required by this module is clearly presented in the report.

Objectives and activities

Tier 1 charities must comply with the requirements in tier 1
Tier 2 charities must comply with the requirements in tier 1 and tier 2
Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1

1.20. Charities must provide a summary of:

- the purposes of the charity as set out in its governing document
- the main activities undertaken in relation to those purposes

1.21. Charities in England, Wales and Northern Ireland must also:

- explain the main activities undertaken to further the charity's purposes for the public benefit
- include in their report a statement confirming whether the trustees have had regard to the Charity Commission's guidance on public benefit

1.22. The report must include an explanation to help the user to understand the scale and nature of the activities undertaken by volunteers and the input from volunteers. This description is important as measurement issues, including valuing the contribution of general volunteers, often prevents this being included in the statement of financial activities (see the SORP module 6 '*Donated goods, facilities and services, including volunteers*').

1.23. The report should explain the activities, projects or services identified in the accompanying accounts. Financial information provided in the report about the resources spent on particular activities should be consistent with the analysis provided in the statement of financial activities and in the notes to the accounts, see Tables 3 and 4 and section B, Expenditure of SORP module 4 '*Statement of*

financial activities'. This is important so that users of the accounts gain a greater understanding of the detail in the financial statements.

Tier 2 – in addition to tier 1 requirements

1.24. Charities meeting tier 2 requirements should provide the user with a more detailed understanding of their short term and longer term aims and objectives and how those in the short term relate to those in the longer term. When explaining activities, it is important for the user to understand their scale and the resources used in their delivery; for example, it may be helpful to provide details of the amount spent on, or the number of staff engaged in, undertaking a particular activity.

1.25. The report must provide answers to the following questions:

- What aims and objectives have trustees set for the charity this year and what issues do they seek to address?
- What significant activities does the charity undertake (including its main programmes, projects or services provided) and how do these contribute to the achievement of the charity's stated aims and objectives?
- What are the changes or differences the charity seeks to make through its activities?
- What are the charity's strategies for achieving its stated aims and objectives?
- What criteria or measures does the charity use to assess success in the reporting period?

1.26. The report must include an explanation of the use the charity makes of the following:

- grant-making: where this forms a material part of its charitable activities, the report must explain the charity's grant-making policy for the selection of individuals or institutions who are to receive grants
- social investment: where this forms a material part of its charitable and investment activities, the report must provide an explanation of its social investment policies and explain how the investments contributed to the achievement of its aims and objectives

1.27. Charities reporting on the contribution of general volunteers should provide:

- information on the number of volunteers
- an explanation of the activities that volunteers support or help to provide

Charities may provide details of the contribution in terms of volunteer hours or staff equivalents, if practicable.

Tier 3 – tier 1 and tier 2 requirements

Achievements and performance

Tier 1 charities must comply with the requirements in tier 1
Tier 2 charities must comply with the requirements in tier 1 and tier 2
Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1

1.28. The report must contain a summary of the main achievements of the charity. To assist with this, trustees must provide answers to the following questions:

- In what way has the charity's work made a difference to the circumstances of its beneficiaries?
- Has the charity's work provided any wider benefits to society as a whole?

Use of infographics, statistics, beneficiary and volunteer testimonials may help communicate this information to users.

Tier 2 – in addition to tier 1 requirements

1.29. The report must set out how well the charity and any subsidiaries carried out their activities and the extent to which the achievements in the reporting period met the aims and objectives set by the charity for the reporting period.

1.30. The report must review investment performance against the investment objectives set where material financial investments are held.

1.31. The report must explain the impact the charity is making and must consider the long-term effect of its activities on individual beneficiaries and on society as a whole. The impact the charity has made is, arguably, the ultimate expression of its performance and charities are encouraged to demonstrate this in their report. In particular, the use of personal beneficiary or society-wide impact stories may be of value in communicating meaning.

1.32. The charity should include:

- a summary of the measures or indicators used to assess performance (including in relation to environmental or social issues, if applicable)
- an explanation of the outputs achieved by particular activities especially when numerical targets have been set (for example, the number of beneficiaries to be reached by a particular programme, or the number of events or interventions planned as part of an activity)
- information on activities, outputs, and outcomes (or impacts) in the context of how they have contributed to the achievement of the charity's aims and objectives

1.33. The report should comment on those significant positive and negative factors, both within and outside the charity's control, which have affected the achievement of its objectives and, where relevant, explain how this has influenced future plans. These factors might include relationships with employees, service users, beneficiaries and funders and the charity's position in the wider community.

Tier 3 – in addition to tier 1 and tier 2 requirements

1.34. Tier 3 charities must also report on their review of:

- the performance of material fundraising activities against the fundraising objectives
- if material expenditure was incurred to raise income, the report must explain the effect this expenditure has had, and is intended to have, on the net return from fundraising activities for both the reporting period and future periods

Financial review

Tier 1 charities must comply with the requirements in tier 1

Tier 2 charities must comply with the requirements in tier 1 and tier 2

Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1

1.35. The report must contain a review of the charity's financial position at the end of the reporting period. Any financial details used in the report must be consistent with the figures in the accounts.

1.36. The report must also identify any fund or subsidiary undertaking that is materially in deficit, explaining the circumstances giving rise to the deficit and the steps being taken to eliminate the deficit.

1.37. In this SORP the term "reserves" describes that part of a charity's unrestricted funds that is freely available to spend on its charitable purposes (see glossary for a fuller explanation).

1.38. The charity must explain:

- any policy it has for holding reserves
- state the amount of those reserves and why they are held
- if the trustees have decided that holding reserves is unnecessary, the report must disclose this fact and provide the reasons for this decision

1.39. The figure for reserves in the trustees' annual report must be consistent with the accounts and, where this is not evident, the charity must provide a reconciliation, either in the funds note or as a separate note.

1.40. The report must:

- compare the amount of reserves with the charity's reserves policy

- explain, where relevant, what steps the charity is taking to bring the amount of reserves it holds into line with the level of reserves identified by the trustees as appropriate given their plans for the future activities of the charity

1.41. The review of the charity's reserves must:

- identify and explain any material amounts that have been designated or otherwise committed as at the end of the reporting period
- indicate the likely timing of the expenditure of any material amounts designated or otherwise committed at the end of the reporting period

1.42. Going concern means the ability of an organisation to operate for the foreseeable future and its ability to pay its debts as they fall due (see paragraphs 3.17 to 3.19, module 3 '*Accounting standards, policies, concepts and principles, including estimates and errors*'). Where a charity has no reserves (or negative net assets on the balance sheet), it must explain why it is still operating as a going concern.

1.43. If, at the date of approving the report and accounts, there are material uncertainties about the charity's ability to continue as a going concern, the nature of these uncertainties must be explained.

Tier 2 – in addition to tier 1 requirements

1.44. The report must also comment on the significant events that have affected the financial performance and financial position of the charity during the reporting period. In particular the report must explain:

- the principal sources of income of the charity in the reporting period and how these resources have been spent to support the key objectives of the charity
- a description of the principal risks, including any risks arising from environmental issues, and uncertainties facing the charity and its subsidiary undertakings, as identified by the charity trustees, together with a summary of their plans and strategies for managing those risks

1.45. Where the charity holds material financial investments, the report must explain the policies adopted by the charity trustees for the selection, retention and realisation of investments including the extent (if any) to which it takes social, environmental or ethical considerations into account.

1.46. The financial review should also provide a narrative explanation of:

- the impact, if any, of a material pension liability arising from obligations to a defined-benefit pension scheme or pension asset on the financial position of the charity
- the impact of any material legacy income recognised in the accounts prior to the resources being received. This explanation is to help users of the accounts to understand the effect timing differences may have on resources available to the charity

Tier 3 – in addition to tier 1 and tier 2 requirements

1.47. The report must explain any factors that are likely to affect the financial performance or position going forward.

Plans for future periods

Tier 1 charities must comply with the requirements in tier 1
Tier 2 charities must comply with the requirements in tier 1 and tier 2
Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1

1.48. The report must provide a summary of the charity's plans for the future.

Tier 2 and tier 3

1.49. The report must provide a summary of the charity's plans for the future, including its aims and objectives and details of any activities planned to achieve them.

1.50. The report should explain the trustees' perspective of the future direction of the charity. It should explain, where relevant, how experience gained or lessons learned from past or current activities have influenced future plans and decisions about allocating resources to their best effect.

Structure, governance and management

Tier 1 charities must comply with the requirements in tier 1
Tier 2 charities must comply with the requirements in tier 1 and tier 2
Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1

1.51. The report must provide details of:

- the nature of the governing document (e.g. trust deed, memorandum and articles of association, Charity Commission scheme, Royal Charter, etc.)
- how the charity is (or its trustees are) constituted (e.g. limited company, unincorporated association, trustees incorporated as a body, charitable incorporated organisation, community benefit society, industrial and provident or friendly society etc.)
- the methods used to recruit and appoint new charity trustees, including details of any constitutional provisions for appointment (for example, election to post). Where any other person or external body is entitled to appoint one or more of the charity trustees, the report should explain this and give the name of that person or body

1.52. Charities may withhold certain governance and management details where the criteria for exemption from disclosure are satisfied (see 'Exemptions from disclosure').

Tier 2 – in addition to tier 1 requirements

1.53. The report must explain the charity's organisational structure and, where relevant, those of its subsidiary undertakings.

1.54. The report must explain the policies and procedures for the induction and training of trustees.

1.55. The report must provide the user with an understanding of how the charity is constituted and its governance and management structures. In particular, the report must explain:

- how the charity makes decisions, for example, which types of decisions are taken by the charity's trustees and which are delegated to staff
- the arrangements for setting the pay and remuneration of the charity's key management personnel and any benchmarks, parameters or criteria used in setting their pay
- if the charity is part of a wider network (for example, if it is affiliated with an umbrella group), how, if at all, this impacts on the operating policies adopted by the charity
- relationships between the charity and related parties, including its subsidiary undertakings, and with any other charities and organisations with which it co-operates in the pursuit of its charitable objectives

Tier 3 – tier 1 and tier 2 requirements

Reference and administrative details

Tier 1 charities must comply with the requirements in tier 1

Tier 2 charities must comply with the requirements in tier 1 and tier 2

Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Tier 1 and tier 2

1.56. The report must provide the following reference and administrative information about the charity and its trustees:

- the name of the charity, which in the case of a registered charity means the name by which it is registered
- any other name that the charity uses
- the charity registration number(s) for the jurisdiction(s) in which it is registered as a charity and, if applicable, its company registration number
- the address of the principal office of the charity, where appropriate, or an address where the charity can be contacted. A charitable company must provide the address of its registered office
- the names of all those who were the charity's trustees on the date the report was approved, or who served as a trustee in the reporting period
- where a charity has any corporate trustees, the names of the directors of the body corporate on the date the report was approved

- the names of any trustee for the charity

  (i) holding the title to property belonging to the charity (for example, holding trustee or nominee) on the date the report was approved; or

  (ii) who served as a trustee for the charity in holding the title to property belonging to the charity in the reporting period

1.57. Charities may withhold certain reference and administrative details where the criteria for exemption from disclosure are satisfied (see 'Exemptions from disclosure').

Tier 3 – in addition to tier 1 and tier 2 requirements

1.58. The report must state to whom the trustees delegate day-to-day management of the charity and from whom trustees are taking advice. In particular, the report must provide:

- the name of any chief executive officer or other senior management personnel to whom the charity trustees delegate day-to-day management of the charity on the date the report was approved, or who served in such a position in the reporting period in question
- the names and addresses of any other relevant organisations or persons providing banking services or professional advice to the charity, including its solicitors, auditor and investment advisers

1.59. Certain details may be withheld where the criteria for exemption from disclosure, as set out in the 'Exemptions from disclosure', are met.

Tier 1 charities must comply with the requirements in tier 1
Tier 2 charities must comply with the requirements in tier 1 and tier 2
Tier 3 charities must comply with the requirements in tier 1, tier 2 and tier 3

Sustainability

Tier 1 and tier 2

1.60. Trustees are encouraged to explain in the report how the charity is responding to and managing environmental, governance and social matters.

Tier 3

1.61. The report must provide a summary of how the charity is responding to and managing environmental, governance and social matters.

1.62. For example, the report could provide details of the key performance indicators used to assess progress against targets used to manage climate-related risks and realise climate-related opportunities and a description of the calculations on which those key performance indicators are based.

1.63. In relation to governance and social matters, reporting may include details of social opportunity, privacy and data security, board diversity and business ethics.

1.64. Where the charity is already reporting on these matters but the detail is not included in the report, a link may be provided. Otherwise, the details must be provided in the

report.

1.65. Charitable companies which fall within the scope of the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) 2018 Regulations must provide the disclosures required under these regulations. Charities in the Republic of Ireland which fall within the scope of the European Union (Corporate Sustainability Reporting) Regulations 2024 must provide the disclosures required under these regulations.

Exemptions from disclosure

1.66. On occasions, the disclosure of the names of trustees, or of the charity's principal address, or the disclosure of the name(s) of any chief executive officer or other senior staff member(s) could lead to that person (or others) being placed in personal danger (for example, in the case of a women's refuge). In such circumstances, the applicable law and regulations may permit the withholding of these details in the annual report. Where the annual report omits the name of a trustee, chief executive officer or senior staff member or the charity's principal address, it should give the reason for the omission.

1.67. Under the Charities (Accounts and Reports) Regulations 2008, charities in England and Wales may omit the names of trustees or the charity's principal address (or registered office in the case of charitable companies) from their annual report provided the Charity Commission has given the charity trustees the authority to do this. In Northern Ireland, there is also provision under charity law for such information to be excluded. In Scotland, there is provision under charity law for information to be excluded where it is likely to jeopardise the safety or security of any person or premises.

1.68. The directors of charitable companies registered in the UK should note that, with the exception of the name of the auditor, or senior statutory auditor in the case of an audit firm (section 506 of Companies Act 2006), there is no corresponding dispensation in relation to the disclosure of names.

Funds held as holding trustee on behalf of others – all tiers

1.69. If a charity is, or its trustees are, acting as holding trustees, the charity must refer to the SORP module 19 '*Accounting for funds received as agent or as holding trustee*'.

Parent charities

1.70. Parent charities preparing consolidated accounts must expand their report to include relevant information about their subsidiary undertakings. Users of this SORP should also refer to the regulations for the jurisdiction in which they are reporting.

Charitable companies

1.71. Trustees of charitable companies must also prepare a directors' report as required by company law. A separate trustees' annual report is not required provided that any statutory directors' report prepared also contains all the information that this SORP requires to be provided in the trustees' annual report. UK charitable companies that qualify as medium-sized or large companies must provide a 'strategic report' that meets the requirements of company law. For more information see the SORP module 15 '*Charities established under company law*'.

1.72. FRS 102 does not specify any requirements for narrative reporting, though the Financial Reporting Council (FRC) does issue guidance on the strategic report. This module specifies this SORP's requirements for a trustees' annual report and its content.

2. Fund accounting

Introduction

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

Table 2.1A: Tiered reporting for module 2

All tiers	The requirements of this module apply fully to all charities.

What is fund accounting?

2.2. Accounting for the particular classes of 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:

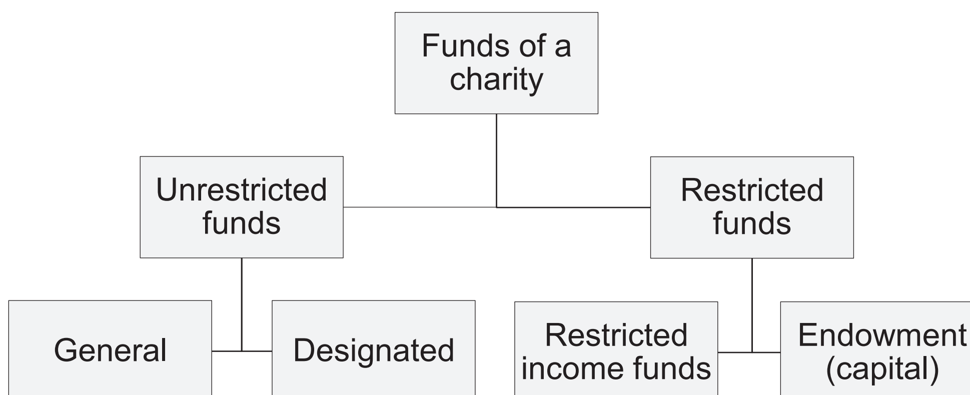
- those that are **unrestricted** in their use, which can be spent for any charitable purposes of a charity
- those that are **restricted** in their use

2.3. The proper management and administration of individual restricted funds is essential and failure in this respect can result in charity trustees acting in breach of trust.

2.4. Restricted funds are further analysed between restricted income funds and **endowment funds** (also known as capital funds). In England and Wales, restricted funds that must be lawfully used for a specific charitable purpose are known as special trusts.

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 trust and charity law and current accounting practice which charities adopting this SORP must follow. This module sets out:

- General principles of fund accounting
- How to account for tangible fixed assets funded through an appeal, grant or donation
- Transfers between funds
- 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 endowment, the income generated from the fund must be spent in accordance with the terms of that trust which may be for the charity's general purposes or for a narrower purpose (see paragraph 2.28). 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 do not have any restrictions or conditions on their use and can be 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 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 charity's unrestricted funds to be used for a particular future project or commitment. In this way, the trustees set up a **designated fund**, which remains part of the unrestricted funds of the charity. The designation does not create any legal restrictions. This means that the trustees can exercise their discretion in how to apply the designated fund and can change what the funds are designated for. Trustees can decide to remove the designation at a later date. Identifying the nature and amount of designated funds is necessary when considering and explaining the charity's reserves policy and the level of reserves it holds.

Restricted funds

2.9. Funds held for specific charitable purposes under charity law are classed as restricted funds (also known as special trusts in England and Wales). Special trusts may be restricted income funds or may be endowed. Restricted funds also

include endowment funds generating income for a charity's general purposes.

2.10. Restricted funds can be established in a range of ways. For example, the restricted fund may be declared by the donor when making the gift or may result from the terms of an appeal for funds. It is common for a charity to have a number of 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 such cases, the funds are held as part of the charity's 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 trusts over unrestricted funds. Where a charity's governing document sets out such a power and the trustees use it, the assets affected will form part of the charity's restricted funds. The trustees' discretion to apply that fund will then be legally restricted.

2.13. Restricted income funds are to be spent or applied within a reasonable or specified 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. Charities must separately identify each restricted fund and maintain the accounting records to show:

- the income received and expenses incurred on the specific purposes for each restricted fund
- the assets and liabilities separately for 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 to further the specific charitable purposes of the restricted fund(s). In addition to a reasonable allocation of support costs, any 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, or when a transfer will be made to the restricted fund from the unrestricted funds in the event of a shortfall.

2.17. Restricted funds fall outside of the definition of reserves but the nature and amount of the restricted funds may impact on a charity's reserve policy.

Endowment funds

2.18. Permanent Endowment - A permanent endowment will generally be indefinite but may be held until a specified event or date, at which point the restriction can cease. There are two types of permanent endowment:

- Investment permanent endowment is where the capital has an administrative restriction on its expenditure and is invested to generate income which must be used for the charity's general purposes or narrower purposes. 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 on trust for investment 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, which could be for example, an equity investment or land and buildings which will then form part of the endowment.
- Functional permanent endowment is land or other property such as an art collection which the trusts require to be used to carry out the general purposes of the charity or a specific purpose of the charity. The purposes of the fund must be amended before the trustees are permitted to hold or use the property in a different way including sale without replacement.

2.19. Expendable Endowment is the term used to describe a capital fund where the trustees have the power in the trusts to convert the capital funds into income.

2.20. 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 trust.

2.21. It is possible that a charity may have a number of investment endowment funds; the income from each endowment being restricted to a particular purpose within the charity's general purposes.

2.22. 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.

2.23. Endowment funds fall outside of the definition of reserves but the nature and amount of the restricted funds may impact on a charity's reserve policy.

Accounting for expenses related to endowment

2.24. A charity cannot use the capital held on permanent endowment trusts 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 capital 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
- the loss of value due to depreciation or impairment of an endowed property

2.25. 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

2.26. 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 on 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.

2.27. 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.

2.28. Trust law applies different rules to endowment funds. The income generated from endowment funds held for investment must be spent on furthering the specific purposes for which the funds are held (which may be the charity's general purposes or narrower 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. Charities applying the provisions of section 104A,104AA and 104B of the Charities Act 2011 in accordance with the Charities (Total Return) Regulations 2013 (as amended 2018 and 2023) should refer to SORP module 20, '*Total return (investments)*'.

2.29. If there is no restriction as to the use of the income, the income generated from the capital endowment investment is an addition to unrestricted funds.

2.30. Any gain or loss on investment is attributed to the capital. If a charity has several invested capital endowment funds, any gain or loss on investments must be allocated correctly to each individual fund.

Tangible fixed assets funded through an appeal, grant or donation

2.31. 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 appeal, grant or donation:

- require the charity to hold the tangible fixed asset acquired on an on-going basis for a specific purpose (narrower than the general purpose of the charity)
- 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. This would normally be presented as a transfer between funds (see 2.32 below)

Transfers between funds

2.32. 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, providing that unrestricted funds are available
- 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 specific purpose
- where restrictions on capital restricted funds have been lawfully released and transferred to unrestricted funds
- where the trustees have exercised a power to declare trusts over an unrestricted gift so that it is held for narrower purposes and/or the capital must be invested to generate income
- where the trustees have used powers in their governing document or statute to amend the purposes for which a restricted fund is held
- where charity law (such as the cy-près procedures in England and Wales) permits the purposes of restricted funds to be amended, for example the alternative use of the proceeds of a failed fundraising appeal, or the alternative use of excess of funds raised from an appeal

Fund disclosures in the notes to the accounts

2.33. 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.

2.34. 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 and endowment funds (both permanent and expendable). Table 2, 'Outline summary of fund movements' gives an example of how the movements in material funds may be shown.

2.35. 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
- details of the legal power(s) used to remove the capital restrictions on, or amend the purposes of, a restricted fund where there has been a transfer from restricted funds to unrestricted funds or use of restricted funds as part of unrestricted 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 20, '*Total return (investments)*')
- details of the planned use of any material designated funds, explaining the purpose of the designation and that the trustees can remove the designation. In deciding on the most suitable form of presentation, the charity should consider:
- the complexity of the fund structure
- the need for any separate fund statement(s) or note(s) to agree with the charity's SoFA and balance sheet for unrestricted funds, restricted income funds and endowment funds

Table 2: Outline summary of fund movements

Fund name	Fund balances brought forward	Income	Expenses	Transfers	Gains and (losses)	Fund balances carried forward
	£	£	£	£	£	£
Unrestricted funds						
Designated funds:						
Fund 1						
Fund 2						
Fund 3						
Total designated funds						
Total restricted fund						
Endowment funds:						
Fund 1						
Fund 2						
Fund 3						
Total endowment funds						
Total funds						

3. Accounting standards, policies, concepts and principles, including estimates and errors

Introduction

3.1. The reporting tiers applied for module 3 are as specified in the table below.

Table 3.1A: Tiered reporting requirements for module 3

All tiers	The requirements for accounting standards, policies, concepts and principles, including estimates and errors in this module apply fully to all charities.

3.2. This module explains how accounting standards, policies, concepts and principles are applied in charity accounting. Charities should refer to Sections 2, 2A, 3, 8 and 10 of FRS 102 for more information:

- Section 2 of FRS 102 describes the objective of financial statements. It also sets out the concepts and basic principles underlying the financial statements of entities within the scope of FRS 102
- Section 2A of FRS 102 describes fair value measurement when another section of FRS 102 requires or permits fair value measurement
- Section 3 of FRS 102 sets out that the financial statements of an entity are required to give a true and fair view, what compliance with FRS 102 requires, and what is a complete set of financial statements (note, however, the additional requirements of this SORP).
- Section 8 of FRS 102 sets out the principles underlying the information that is required to be presented in the notes and how to present it including the reporting requirements for accounting policies
- Section 10 of FRS 102 sets out the requirements for selecting accounting policies, accounting for changes in estimates and the accounting for corrections of errors

3.3. Accounting policies provide the basis on which the accounts are prepared and explain the accounting treatment of material transactions or items in the accounts. The concept of materiality is an important consideration when selecting accounting policies and is explained in more detail in paragraph 3.20 to 3.25 below.

3.4. This module covers:

- What are accounting standards, policies, concepts and principles?
- Length of the reporting period
- Presentation currency
- Going concern
- Materiality
- Offsetting

- Source of reporting and accounting disclosure requirements
- Alternative measurement bases
- Selection of accounting policies
- Compliance with the SORP
- Changes in accounting policies
- Changes in accounting estimates (including disclosure requirements)
- Correction of a prior period error
- Disclosure of accounting policies (including changes in accounting policies), and prior period errors
- Comparative information

What are accounting standards, policies, concepts and principles?

3.5. Accounting standards set out the basis for recognising and measuring assets, liabilities, income and expenses and for their disclosure in accounts. Charities following this SORP are required to follow FRS 100 Application of Financial Reporting Requirements and FRS 102, and in so doing, will normally meet the relevant legal requirements for their accounts to give a true and fair view of their financial position and activities.

3.6. The SORP supplements FRS 102 and has been developed in light of the special factors prevailing or transactions undertaken within the charity sector.

3.7. Accounting policies are the principles, bases, conventions, practices and rules by which transactions and items are recognised, measured and presented in the accounts. The accounting policies that a charity adopts must follow the requirements of FRS 102 unless the effect of not following a particular requirement would be immaterial, or in very rare circumstances, where to do so would conflict with the objectives of providing information useful for economic decision making by users of the accounts and/or the legal obligation for the accounts to give a 'true and fair' view.

3.8. In certain jurisdictions, it is a legal requirement for charities preparing their accounts on an accruals basis to adhere to the methods and principles of this SORP. Charities should refer to the guidance issued by the charity regulator in their jurisdiction(s) of registration to find out whether they are subject to a legal requirement to follow this SORP.

3.9. Accounting policies are supplemented by estimation techniques where judgement is required in measuring income and expenditure and assets and liabilities. It is essential that the accounts are accompanied by an explanation of the bases and estimation techniques used in their preparation (see paragraphs 3.46 to 3.50 for the description of accounting estimates and changes in accounting estimates).

3.10. FRS 102 specifies that if financial information is to be useful, it must both be relevant and faithfully represent what it claims to be showing. The usefulness of financial

information is enhanced if it is comparable, verifiable, timely and understandable.

3.11. Users of charity accounts must be able to compare charity accounts through time, users must also be able to compare the accounts of different charities. Comparability of charity accounts is enhanced by charities setting out the accounting policies adopted when preparing accounts. When information contained in charity accounts is verifiable it helps to assure users that the information is faithfully represented. Verifiable means that different knowledgeable and independent observers could reach consensus that a particular representation is a faithful representation.

3.12. Charity accounts must be prepared on a timely basis. Timeliness means having information available to decision makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. Information must be presented in a way that makes financial information understandable to users. Classifying, characterising and presenting information clearly and concisely makes it understandable. However, excluding information from financial statements about events that are inherently complex and cannot be made easy to understand would make these reports incomplete and therefore possibly misleading (more guidance on the enhancing qualitative characteristics of useful financial information is included in FRS 102 paragraphs 2.19 to 2.23 of FRS 102).

3.13. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. Reporting financial information that is relevant and faithfully represents what it is claiming to show helps users to make decisions with more confidence. An individual user, funder, donor or other stakeholder also receives benefits by making more informed decisions. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for the accounts.

3.14. When reporting transactions in the accounts, charities must consider the substance of the transaction and its legal form. In many situations the substance and legal form will be the same. If the substance and legal form are not the same providing information only about legal form would not faithfully represent the transaction. Determining the substance and legal form will require the exercise of judgement and may on occasion require the disclosure of more information than specifically recommended in this SORP.

Length of the reporting period

3.15. All charities must prepare a set of accounts annually and they should normally have a 12-month reporting period. If the accounts are prepared for a shorter or longer reporting period, the charity must disclose:

- that the reporting period is for less than or more than 12 months
- the reason for the shorter or longer accounting period
- the fact that the comparative amounts presented in the accounts (including the related notes) are not entirely comparable
- this SORP also requires a charity to state the legal authority it has for

the change to its reporting period

Presentation currency

3.16. The presentation currency is the currency in which the accounts are denominated. This SORP requires that a charity should normally prepare its accounts in the currency of the jurisdiction of its administration unless it operates predominantly by generating and spending its cash in a different currency. Where a charity operates predominantly in a different currency, it should prepare its accounts in that currency.

Going concern

3.17. Charities normally prepare their accounts on the basis of being a going concern. The trustees must make their own assessment of their charity's ability to continue as a going concern to assure themselves of the validity of this assumption when preparing their accounts. In making this assessment, a charity's trustees should take into account all available information about the future for at least, but not limited to, 12 months from the date the accounts are approved.

3.18. When a charity prepares its accounts on a going concern basis this must be disclosed along with confirmation that it has considered information about the future as set out in paragraph 3.17. Charities must also disclose any significant judgments made in assessing the charity's ability to continue as a going concern. This SORP requires that where there are no material uncertainties about the charity's ability to continue to report on a going concern basis, this judgment should be disclosed.

3.19. When the trustees are aware, in making their assessment, of material uncertainties related to events or conditions that may cast significant doubt on the charity's ability to continue as a going concern, the charity must disclose those uncertainties. A charity not reporting on a going concern basis must disclose that fact, together with the basis on which it prepared the financial statements and the reason why it is not regarded as a going concern.

Materiality

3.20. In preparing their accounts charities should give particular consideration to material items or transactions. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the users of the accounts make on the basis of those financial statements. An omission or misstatement of a material item may result in the accounts failing to give a true and fair view. Information is obscured if it is communicated in a way that would have a similar effect for users of financial statements to omitting or misstating that information. Examples of circumstances that may result in information being obscured could include:

- use of vague or unclear language
- inappropriate aggregation of dissimilar information or disaggregation of similar information
- including too much detail so that material information cannot be easily

identified

3.21. Materiality is entity specific. It depends on the nature or magnitude of information, or both. A charity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole. It depends on:

- the size of the omission or misstatement
- the nature of the omission or misstatement
- the impact of its omission or misstatement on the reported gross income or total expenditure and net assets
- the impact of its omission or misstatement on particular analysis headings within the statement of financial activities, balance sheet and, where applicable, statement of cash flows and on the disclosures made in the notes to the accounts

3.22. Assessing whether information could reasonably be expected to influence decisions made by the users of a charity's accounts, requires a charity to consider the characteristics of those users while also considering the charity's own circumstances.

3.23. Charities should only disclose accounting policies that apply to material items or transactions. Charities should avoid providing unnecessary information for non-material items or transactions.

3.24. Although FRS 102 and this SORP need only be applied to material items or transactions, it is inappropriate to make, or leave uncorrected, immaterial departures from this SORP to achieve a particular presentation of a charity's financial position, financial performance or cash flows.

3.25. This SORP specifies when a charity must always consider a particular item or transaction material, for example the disclosure of related party transactions. Also, as a matter of emphasis, SORP modules may make particular reference to materiality.

Offsetting

3.26. A charity must not offset assets and liabilities, or income and expenses, unless required or permitted by FRS 102 and reflected in this SORP. Measuring assets net of valuation allowances is not offsetting. Similarly, a charity reports any gains and losses on the disposal of its fixed assets by deducting the carrying amount of the asset and related selling expenses from the proceeds of the disposal.

Source of reporting and accounting disclosure requirements

3.27. This SORP distinguishes the accounting treatment(s) and the disclosures required in the notes to the accounts that:

- apply to charities in each of the tiers 1 to 3

- are required by FRS 102
- are required by this SORP due to charity law or in order to provide a higher standard of transparency and disclosure in the interests of funders, donors and users of charity accounts

3.28. In preparing the charity's accounts, the charity must:

- apply the relevant requirements of FRS 102
- apply the recommendations of this SORP
- select accounting policies that comply with FRS 102 and this SORP

Alternative measurement bases

3.29. For certain items in the accounts, FRS 102 permits a choice between measurement at historical cost or current value, see paragraph 2.73 of FRS 102. Current value measurement bases include:

- fair value
- value in use for assets and fulfilment value for liabilities
- current cost

3.30. Fair value measurements must follow the requirements of Section 2A Fair Value Measurement of FRS 102. Section 1 of FRS 102 sets out how charities should apply the relevant changes to FRS 102 relating to fair value measurement.

3.31. FRS 102 also requires donated services and facilities to be measured at the value of the donation to the charity. Where a balance sheet heading contains items measured at both historical cost and fair value, a charity must identify the accounting bases the charity has used in the relevant note.

Selection of accounting policies

3.32. Charities must refer to FRS 102 and the modules contained in this SORP when selecting their accounting policies for the treatment of particular items, transactions or events in the accounts.

3.33. Where FRS 102 offers an accounting policy choice and this SORP has not prohibited the use of that choice or limited its application, for example in the recognition of income from government grants, then a charity may exercise the accounting policy choice. If exercising a policy choice the charity must make any additional disclosures required by this SORP or FRS 102 when making such choices, for example in choosing to treat certain leases as short-term leases or leases for which the underlying asset is of low value.

3.34. If FRS 102 does not address the matter, then charities adopting FRS 102 should refer to the hierarchy of sources set out in Section 10 of FRS 102 (see FRS 102 paragraph 10.5).

3.35. In extremely rare circumstances a charity may conclude that compliance with a particular requirement of FRS 102 or this SORP would conflict with the objective of

providing information useful for economic decision making by users of the accounts and/or a legal obligation for the accounts to give a true and fair view.

3.36. Charities must not depart from either FRS 102 or the SORP simply because it gives the user a more appealing picture of the financial position or the results of the charity.

Compliance with the SORP

3.37. For a charity to state that its report and accounts are compliant with this SORP, both its trustees' annual report and its accounts must be prepared fully in accordance with the reporting and accounting recommendations of this SORP. To state that their accounts have been prepared in accordance with this SORP, a charity must:

- consider those SORP modules that apply to the activities, transactions and circumstances of the reporting charity
- comply with applicable format requirements and accounting treatments specified by this SORP and provide those disclosures that this SORP specifies 'must' be provided
- make any additional disclosures required by the FRS 102
- only depart from the requirements of this SORP or the FRS 102 if necessary for the accounts to give a true and fair view

3.38. This SORP uses the term 'must' to indicate those recommendations that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. Where the SORP states that an item is always material or the recommendation is one which 'must' be followed, non-adherence to that recommendation is a departure from this SORP.

3.39. The SORP also identifies particular recommendations that 'should' be followed. These recommendations are aimed at advancing standards of financial reporting as a matter of good practice. While charities are encouraged to follow all the SORP's recommendations, a failure to follow a 'should' recommendation is not regarded as a departure from this SORP.

3.40. Where the SORP states that a particular accounting treatment or disclosure 'may' be adopted, this provides an illustration of an approach to a particular treatment or disclosure that a charity may choose to adopt or identifies that an alternative accounting treatment or disclosure of a transaction or event is allowed by the SORP. Charities may choose whether such examples or alternative treatments are adopted at their discretion but any treatment chosen must ensure that the accounts give a true and fair view.

3.41. Charity accounts must also state that the charity is a public benefit entity.

Changes in accounting policies

3.42. FRS 102 requires accounting policies to be applied consistently for similar transactions, events and conditions and between reporting periods.

3.43. A change to an existing accounting policy is only justified if:

- it is required due to a change in FRS 102 that applies to the reporting period
- it results in the accounts providing reliable and more relevant information about the effect of transactions, other events or conditions that affect the reported financial position, financial performance or cash flows of the charity or group

3.44. A change in an accounting policy must be applied retrospectively to comparative information for all prior periods to the earliest date for which it is practicable, as if the new accounting policy had always applied. This is except where an accounting standard, FRS 102 or an amendment to FRS 102 requires or permits an alternative treatment on its first adoption.

3.45. When it is impracticable to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the charity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of funds for that period. Charities should refer to paragraph 10.12 of FRS 102.

Accounting estimates

3.46. An accounting policy may require items in financial statements to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, a charity must develop an accounting estimate to achieve the objective set out by the accounting policy. Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information. Examples of estimates include depreciation expense and the fair value measurement of an asset or liability.

3.47. A charity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques and valuation techniques.

Changes in accounting estimates (including disclosure requirements)

3.48. A charity may need to change an accounting estimate if changes occur in the circumstances on which the accounting estimate was based or as a result of new information, new developments or more experience.

3.49. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in accounting estimate. The effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimates unless they result from the correction of prior period errors. Except for a change to the cost model

when a reliable measure of fair value is no longer available (paragraph 10.9(c) of FRS 102) a change in the measurement basis applied is a change in an accounting policy and is not a change in an accounting estimate. The effect of a change in an accounting estimate, other than a change to assets, liabilities or funds, must be recognised prospectively by including it in the statement of financial activities in the period of change or the period of change and future periods. Where a change relates to assets, liabilities or funds a charity must recognise it in the period of change by adjusting the carrying amounts of the balance sheet items.

3.50. A charity must disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expenses for the current period. If it is practicable for the charity to estimate the effect of the change in one or more future periods, it must disclose those estimates.

Correction of a prior period error

3.51. Charities must correct material errors resulting from an omission or misstatement in a prior period by either:

- restating the comparative amounts for the prior period(s) in which the error occurred, or
- if the error occurred before the earliest prior period presented, restating the opening balance of the asset or liability for the earliest prior period presented

Charities should refer to paragraph 10.12 of FRS 102.

Disclosure of accounting policies (including changes in accounting policies), and prior period errors

3.52. In order to comply with FRS 100 *Application of Financial Reporting Requirements* and FRS 102 the notes to the accounts must:

- state whether the accounts were prepared in accordance with FRS 102
- state whether the accounts were prepared in accordance with this SORP
- set out a summary of material accounting policy information (see paragraph 3.54 below)

This SORP requires a charity to state whether the accounts were prepared in accordance with applicable charity and/or company law in the jurisdiction(s) of registration.

3.53. A charity must disclose material accounting policy information. Accounting policy information is material if, when considered together with other information included in a charity's accounts, it can reasonably be expected to influence decisions that the users of accounts make on the basis of those accounts. The disclosure must include the measurement basis (or bases) used in preparing the accounts. For more information on material and immaterial accounting policy information see paragraphs 8.5A to 8.5D of FRS 102.

3.54. A charity's accounts must disclose:

- along with its material accounting policy information, or other notes the judgements, apart from those involving estimations, that management has made in the process of applying the charity's accounting policies that have the most significant effect on the amounts recognised in the accounts
- the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period
- in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes must include details of their nature and their carrying amount as at the end of the reporting period

3.55. In special circumstances where there has been a material departure from the requirements of FRS 102, the notes to the accounts must:

- state that the trustees have concluded that the accounts present a true and fair view of the charity's financial position, financial performance (as reported in the statement of financial activities) and cash flows
- confirm that it has complied with FRS 102 or applicable legislation, except that it has departed from a particular requirement of FRS 102 or applicable legislation to achieve a true and fair view
- explain the nature and effect of the departure, including the treatment required by FRS 102 or applicable legislation, the reason why that treatment would be so misleading in the circumstances that it would conflict with the requirement to give a true and fair view, and the treatment adopted

3.56. Where charities have made a material departure from a recommendation of this SORP that must be followed, FRS 100 requires that the notes to the accounts must:

- provide a brief description of how the accounts depart from the recommended practice set out in this SORP
- for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the charity's particular circumstances
- give brief details of any disclosures required by this SORP that have not been provided, and the reasons why they have not been provided

This SORP requires that if the departure was necessary for the accounts to give a true and fair view, the effect of the departure must also be quantified.

3.57. Where a material departure from the requirements of FRS 102 is also a departure from requirements of this SORP, a combined note may be provided.

3.58. Where a charity has changed an accounting policy, the notes to the accounts must disclose:

- the nature of the change in accounting policy

- the reasons why applying the new accounting policy provides reliable and more relevant information
- to the extent practicable, the amount of the adjustment for each line item in the accounts affected for the current period, each prior period presented and the aggregate amount of the adjustment relating to periods before those presented

3.59. If it is not practicable to disclose the amount of the adjustment in paragraph 3.58 above the charity must give an explanation of the adjustment.

3.60. If a charity identifies material prior period errors, it must correct them and disclose in the notes to the accounts:

- the nature of the prior period error
- for each prior period presented in the accounts, to the extent practicable, the amount of the correction for each account line item affected
- to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented in the accounts

3.61. If it is not practicable to disclose the amount of the correction relating to prior period errors then an explanation must be provided.

Comparative information

3.62. FRS 102 requires that comparative information must be provided for all amounts presented in the current period's financial statements, which includes the notes. Therefore, charities must provide comparative information for all amounts presented in the accounts and notes to the accounts unless otherwise stated in FRS 102. This requirement for comparative information applies to all those disclosures that are additionally required by this SORP.

4. Statement of financial activities

Introduction

4.1. All charities must prepare a statement of financial activities (SoFA) for each reporting period (termed statement of comprehensive income in FRS 102). The 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. It also presents a reconciliation of the movements in a charity's funds for the reporting period.

4.2. The reporting tiers applied for module 4 are as specified in the table below.

Table 4.1A: Tiered reporting requirements for module 4

Tier 1	Charities within tier 1 may choose to adopt either the activity basis of reporting or the natural classification basis of reporting. This SORP requires charities within tier 1: that have adopted the **natural classification** basis of reporting to use the format of the SoFA as presented in **Table 3** that have adopted the **activity basis** of reporting to use the format of the SoFA as presented in **Table 4**
Tiers 2 and 3	This SORP requires charities within tiers 2 and 3 to adopt the activity basis of reporting. Charities in tiers 2 and 3 are therefore required to adopt the format of the SoFA as presented in **Table 4.**

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 is provided either on the face of the SoFA or prominently in the notes to the accounts.

4.4. Charities in tier 1 may report using natural classification or on an activity basis. An illustrative SoFA setting out the structure, format and suggested lines of the SoFA when prepared using natural classification is set out in Table 3. Where a charity in tier 1 adopts the natural classification basis of reporting the charity may choose its own line descriptors for the analysis of income, provided they are useful to the users of the accounts and noting the requirements of paragraphs 4.16 and 4.17 on the disclosure of material items of income.

4.5. This SORP requires charities in tiers 2 and 3 to report on an activity basis to show how the charity has used its resources to further its charitable aims for the public benefit.

4.6. The structure, format and lines of the SoFA required by this SORP when prepared on an activity basis are set out in Table 4.

4.7. 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*'). This SORP requires charities reporting on an activity basis to ensure that those activities

reviewed in the trustees' annual report are also reported on the face of the SoFA, using separate rows for multiple activities or in the notes to the accounts.

4.8. FRS 102 does not provide accounting guidance on the presentation of charitable funds within the statement of comprehensive income provided by the SoFA. The columns in Tables 3 and 4 headed 'Further details' provide references to later sections of this module that set out those transaction(s) and, in the case of Table 4, activities falling within each of the SoFA's lines.

Table 3: Statement of financial activities – Natural classification basis of reporting (note that this presentation is an option available to tier 1 charities only)

	Unrestricted funds	Restricted income funds	Endowment funds	Total funds	Prior period Total funds	Further details
	£	£	£	£	£	£
Income and endowments from:						
(e.g.) Donations and legacies						A1 - A5
(e.g.) Charitable activities						A1 - A5
(e.g.) Other trading activities						A1 - A5
(e.g.) Investments						A1 - A5
(e.g.) Other						A1 - A5
Total						
Expenses incurred:						
(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						B1
(e.g.) Impairment charges						B1
(e.g.) Other expenses						B1
Total						
Net gains/(losses) on investments in JCE and Associates						B5
Other net gains/(losses) on investments						B5
Net income/(expenditure)						
Transfers between funds						C
Other recognised gains/(losses):						
Gains/(losses) on revaluation of fixed assets						D1
Actuarial gains/(losses) on defined benefit pension schemes						D2
Other gains/(losses)						D3
Net movement in funds						
Reconciliation of funds:						E
Total funds brought forward						
Total funds carried forward						

Table 4: Statement of financial activities – Activity basis of reporting (this presentation is required for tier 2 and tier 3 charities and applicable to those charities in tier 1 who choose to use the activity basis of reporting)

	Unrestricted funds	Restricted income funds	Endowment funds	Total funds	Prior period Total funds	Further details
	£	£	£	£	£	£
Income and endowments from:						
Donations and legacies						A1
Charitable activities						A2
Other trading activities						A3
Investments						A4
Other						A5
Total						
Expenses incurred on:						
Raising funds						B1
Charitable activities						B2
Other						B3
Total						
Net gains/(losses) on investments in JCE and Associates						B5
Other net gains/(losses) on investments						B5
Net income/(expense)						
Transfers between funds						C
Other recognised gains/(losses):						
Gains/(losses) on revaluation of fixed assets						D1
Actuarial gains/(losses) on defined benefit pension schemes						D2
Other gains/(losses)						D3
Net movement in funds						
Reconciliation of funds:						E
Total funds brought forward						
Total funds carried forward						

4.9. 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 discontinued operations – all charities
    - Structure of the SoFA –charities in tier 1 using natural classification basis of reporting
    - 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)
    - E: Reconciliation of funds

Presentation of information

Structure of the SoFA – all charities

4.10. A charity's SoFA must:

- adopt the same format in subsequent reporting periods unless it is apparent, following a significant change in the nature of the charity's operations or a review of its financial statements that another presentation would be more appropriate. Note that a change in format from using the activity basis per Table 4 to presentation using natural classifications per Table 3 (or vice versa) is a change in accounting policy. Refer to the SORP paragraphs 3.42 - 3.45 which set out the circumstances in which a change in accounting policy is justified
- provide comparative amounts for the total funds presented on the face of the SoFA
- omit lines where there is nothing to report in either the current and preceding reporting period

4.11. The columns of the SoFA must be used to distinguish unrestricted funds, restricted income funds, and endowment funds (refer to the SORP module 2 '*Fund accounting*' for explanations of the different types of funds). Endowment funds are restricted funds which either cannot be spent (permanent endowment) or where there is no actual requirement to spend or apply the capital unless, or until, the trustees decide to spend it (expendable endowment).

4.12. 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.

4.13. If a class of funds is not material it may be combined with another class of funds and shown as a single total combined funds column. If a single combined total funds column is used, the heading description 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. Refer to the SORP module 2 '*Fund accounting*' for more information.

4.14. A charity may vary the order in which it presents lines within the income and expenses sections of the SoFA to meet its own presentational needs. Some charities may also find it informative for their users to insert additional sub-totals.

4.15. 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. 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.

Accounting for material items – all charities

4.16. 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.

4.17. The disclosure of material items must be made in the notes or where it is necessary for the presentation of a true and fair view by adding an additional line within the relevant heading on the face of the SoFA. For example, material items that should be disclosed separately are a material fraud or the loss of a material item of property, plant and equipment.

Accounting for discontinued operations – all charities

4.18. A discontinued operation is a component of a charity that has been disposed of and:

- represented a separate major line of charitable activity or geographical area of operations
- was part of a single co-ordinated plan to dispose of a separate major line of charitable activity or geographical area of operations
- was a subsidiary acquired exclusively with a view to resale

4.19. 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 necessarily represent discontinued operations.

4.20. 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.

4.21. Spending all the funds in a restricted fund does not constitute a discontinued operation.

4.22. 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 using natural classification basis of reporting

4.23. The analysis of income and expenses by activity is encouraged for all charities preparing accruals accounts. However, charities in tier 1 are not required to report their income and expenses on an activity basis and may adopt the natural classification basis. See section A1 and B1 for further details.

4.24. Where the natural classification basis of 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 4.4)
- total expenses incurred by the charity
- a relevant analysis of the components of expenses incurred
- gains/(losses) on investments (where applicable)
- net income/(expenses)
- transfers between funds
- gains on the revaluation of fixed assets (where applicable)
- actuarial gains/(losses) on any defined benefit pension scheme (where applicable)
- net movement in funds
- total funds brought forward from the previous reporting period
- total funds carried forward at the end of the reporting period

4.25. 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.

4.26. 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 (refer to the SORP module 9, '*Disclosure of trustee and staff remuneration, related party and other transactions*'). Table 3 illustrates how charities preparing their accounts using the natural classification basis of reporting could choose to present their SoFA.

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

4.27. This SORP requires that those charities reporting on an activity basis must classify their income and expenses by activity and must analyse income

according to the activity that produced the resource. Charities in tier 2 and 3 and those in tier 1 reporting on an activity basis are required to report income and expenses as set out in Table 4, sections A1 to A5 and B1 to B5 provide further information to assist charities with the analysis of income and expenses.

4.28. Where relevant to the understanding of material activities, the expense analysis lines 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 line A3 ('Income from other trading activities') and line B2 ('Expenses incurred on raising funds')
- a charity running a care home could use the description 'Residential care fees' within line A2 ('Income from charitable activities') and 'Residential care costs' in line 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 line A2 ('Income from charitable activities') and use the line description 'Operation of art gallery and touring exhibitions to schools and community' in line B3 ('Expenses incurred on charitable activities')
- an endowed grant-making charity mainly making grants to advance education could use the description 'Investment income' within line A4 ('Investment income') and 'Grants to education and research institutions, student bursaries and other grants' in line B3 ('Expenses incurred on charitable activities')

4.29. 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 8, '*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

4.30. Charities in tier 1 that adopt the natural classification basis of analysis may choose to use different descriptions for the analysis of income. See paragraph 4.4. However, charities in tier 1 may find this section helpful in determining the most appropriate line headings for the SoFA.

A1: Income from donations and legacies

4.31. 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).

4.32. Donations and legacies do not provide any significant benefit to the donor in return for their payment other than the knowledge that the charity will use the donation or legacy to further its purposes. Examples of income from donations and legacies include, but are not limited to:

- donations made by individuals and corporations, including any related tax refund or Gift Aid claimed on donations 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
- grants and donations implicit in a lease arrangement where the charity, as lessee, benefits from lease terms where the lessor, in furthering social purposes, made the lease at significantly below market rates (see module 10B of this SORP)
- membership subscriptions and sponsorships where these are, in substance, donations rather than payment for goods or services
- donated goods for the charity's own use or for distribution as well as donated services and facilities

A2: Income from charitable activities

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

4.34. Examples of income from charitable activities therefore include:

- 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
- payments from government or public authorities and other parties which fund the provision of particular goods or services, for example the provision of care
- the sale of goods or services made or provided by the beneficiaries of the charity
- grants with performance-related conditions where the income is conditional on delivering certain levels or volumes of a service or supply of goods

- ancillary trades connected to primary purpose trading
- the letting of non-investment property in furtherance of charitable purposes

A3: Income from other trading activities

4.35. 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 line, 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 line.

4.36. 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 4.34) 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
- income from sponsorships and social lotteries which cannot be considered pure donations

A4: Investment income

4.37. Investment income is earned from holding assets for investment purposes and includes dividends, interest, rents from investment property, finance income on the net investment in a lease and income from operating leases (see module 10B '*Lease Accounting*'). Any variable lease payments not included in the measurement of the net investment in a finance lease are also included in investment income. Where income from investments is material, it must be presented as a separate line on the face of the SoFA.

4.38. 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.

A5: Other income

4.39. Other income represents income that cannot be reported under the other analysis lines 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 line item 'Transfers between funds'.

4.40. The conversion of endowment into income includes:

- capital funds released to an income fund from expendable endowment
- 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

4.41. This line should also include all other sources of income unless the amount is sufficiently material as to require its presentation as a separate line in the SoFA. Other income may include:

- a gain on the disposal of an item of property, plant and equipment held for the charity's own use
- any royalties from the exploitation of intellectual property rights
- income from sub-leasing right-of-use assets
- any other income not falling into the other income categories

Analysis of income in the notes to the accounts

4.42. 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 line of the SoFA.

4.43. For charities adopting the activity basis of reporting, amounts for similar activities should be aggregated so as to provide an analysis of:

- donations and legacies, distinguishing between the types of income, 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 in the balance sheet or in the investment note to the accounts
- Income from finance and operating leases
- the nature and amount of other income receivable

4.44. 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)

4.45. 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. Charities in tier 1 may find this section helpful in determining the most appropriate line headings for the SoFA.

B2: Expenses incurred on raising funds

4.46. 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 costs of selling donated goods. However, any costs incurred in providing goods or services as a charitable activity must not be included in this line, even if a charge is made for their provision.

4.47. 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 (refer to module 8 for further information on allocating costs by activity)
- investment management costs

4.48. Investment management costs include the costs of:

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

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

4.50. 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 respectively. 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 their own holding in the scheme.

4.51. 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 2, '*Fund accounting*'.

4.52. 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.

4.53. Charities may choose to expand the analysis provided within this line, for example, by identifying separately 'Expenses incurred on 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

4.54. Expenses incurred on charitable activities include 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.

4.55. Additional categories 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 categories used should reflect the activity undertaken.

4.56. 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.

4.57. 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 16, '*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

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

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

4.59. 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 line 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.

4.60. 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 expenses lines 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 5.

4.61. Paragraph 8.13 of the SORP module 8 ‘*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 choose to include this disclosure alongside analysis of expenses incurred on charitable activities as illustrated in the column headed ‘Basis of Apportionment’ in Table 5.

Table 5: Analysis of expenses incurred on charitable activities

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

4.62. Paragraph 8.13 of module 8, ‘*Allocating costs by activity in the statement of financial activities*’, also requires disclosure of:

- the total amount of support costs incurred in the reporting period
- an analysis of material items or categories of expense included within support costs with the total amount of governance costs incurred, separately identified (refer to Appendix 1, ‘Glossary of terms’ for the definition of governance costs)
- the amount of support costs apportioned to each of the charity’s significant activities as disclosed in the SoFA or in the notes to the accounts

An illustrative example of a tabular format that charities may wish to use is presented below in Table 6.

Table 6: Analysis of support costs

Support cost (examples)	Raising funds	Activity 1	Activity 2	Activity 3	Grand Total	Basis of allocation
	£	£	£	£		
Governance	x	x	x	x	x	Text describing method
Finance	x	x	x	x	x	Text describing method
Information Technology	x	x	x	x	x	Text describing method
Human Resources	x	x	x	x	x	Text describing method
Function/ Activity Total	x	x	x	x	x	

B5: Gains/(losses) on investment assets

4.63. This line 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 and any profit or loss on the disposal of finance leases. Gains and losses on social investments will be recorded in this line. Gains and losses on jointly controlled ventures and associates must be shown as a separate line.

C: Transfers between funds

4.64. All transfers between the different classes of funds must be shown in the transfer line of the SoFA. The transfer line must always net to nil. Refer to the SORP module 2, '*Fund accounting*' for more information.

4.65. The transfer line 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

4.66. This line includes gains or losses on the revaluation of property, plant and

equipment, heritage assets and intangible assets used by a charity. This line must not be used when adjusting for a reversal in a previous charge for impairment.

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

4.67. This line is used to record actuarial gains or losses on defined benefit pension schemes and post-employment benefit plans.

4.68. Charities which operate defined benefit pension schemes must refer to the SORP module 17, '*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)

4.69. A charity must insert additional lines 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.

4.70. Items presented within this category include:

- where hedge accounting is adopted the portion of the change in fair value of the hedging instrument that cannot be recognised as income or expense should be recognised as other gains/(losses)
- 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 lines B4, D1 and D2

E: Reconciliation of funds

4.71. 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 in the balance sheet.

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:

- Understanding the nature of income
- Section one – exchange transactions
- Five steps of income recognition
- Exchange transactions – other considerations
- Income from membership subscriptions
- Income from royalties
- Long term contracts
- Contract costs
- Section two: non-exchange transactions
- General principles for recognising income from donations and grants
- Identification of terms and conditions
- Performance-related conditions
- Other terms that may limit the recognition of income
- Terms and conditions that do not prevent recognition
- Grants received for capital expenditure
- Recognising income from legacies
- Income from donated goods, facilities, and services
- Income from interest and dividends

- 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.

6. Donated goods, facilities and services, including volunteers

Introduction

6.1. The reporting tiers applied for module 6 are as specified in the table below.

Table 6.1A: Tiered reporting for module 6

All tiers	The requirements for donated goods, facilities and services, including volunteers in this module apply fully to all charities.

6.2. The donation of goods, facilities and services (including the services of volunteers) to a charity provides an economic resource for use by the charity to further its aims and objectives. Income is recognised by a charity in its accounts for goods, facilities and services donated to it once the appropriate criteria are met.

6.3. This module deals with how goods, facilities and services donated to charities are recognised, measured and disclosed in their accounts and sets out:

- Recognition criteria
- Measurement bases
- Accounting for donated facilities and services
- Accounting for volunteers
- Accounting for donated goods and services capitalised as tangible fixed assets
- Accounting for donated goods for distribution to beneficiaries
- Accounting for donated goods for resale
- Disclosures in the notes to the accounts

Charities should refer to Section 34, paragraphs PBE34.64 to PBE34.74 of FRS 102 for more information.

Recognition criteria

6.4. A charity must recognise receipts of donated goods, facilities and services when the value of the income, or economic benefits to the charity from non-cash items, can be measured reliably and when:

- it is receivable or received, whichever is the earlier
- performance related conditions have been satisfied for income that is subject to such conditions

When resources are received or receivable before the performance-related conditions are satisfied, a liability is recognised, but see 6.6 below.

6.5. In circumstances where a physical or financial asset is gifted, a charity can identify

when it is received because this is when the charity has title or physical custody of the asset. Income from a gift or donation will be receivable where for instance a physical or financial asset is gifted in advance of actually coming into the charity’s possession and other than the passage of time, there are no conditions that must be satisfied before the charity will receive the asset.

6.6. Where a gift takes the form of volunteer time, the charity does not have control over the resource but it has the right to control how the volunteer resource is used at the time the donation of volunteer time is received by the charity. Charities are not expected to be able to reliably measure and therefore recognise, many of the contributions made by volunteers but where for instance, the service provided by a volunteer would be normally provided as part of their trade or profession for a fee, it would be capable of reliable measurement and therefore will be recognised at the time it is received. For example, a professional accountant volunteering to be an unpaid independent examiner acts on the charity’s instruction, or a coding expert offering to develop a free website develops the website to the charity's specification.

6.7. Donated goods, facilities and services are unlikely to be subject to performance-related conditions. A restriction on the use of a donation does not prevent its recognition as income. For more information on restricted funds, refer to the SORP module 2.

6.8. Commercial discounts offered in the normal course of trade that reduce the price paid by the charity for a good or service must not be accounted for as a donation in the charity’s accounts. This is because it is an inducement to the charity to make a purchase by lowering the price paid.

6.9. Donated goods must only be recognised as income when the value of the incoming resources can be measured reliably. If the fair value of donated goods can be measured reliably, charities must recognise income from donated goods when received or receivable. In some cases it may be impracticable to estimate the value of the donated goods with sufficient reliability when the goods are received; for example, in the case of high volume, low value second-hand goods donated for resale. Refer to paragraph 6.12 for further information.

Measurement of donated goods

6.10. Donated goods must be measured at their fair value. The fair value of resources received or receivable is usually the price that the entity would have paid on the open market for an identical or comparable resource. (For additional guidance where there is no readily available market price refer to Section 2A of FRS 102 for the accounting treatment.)

6.11. When there is no direct evidence of fair value for an equivalent item, a value may be derived from:

- identifying what the economic benefits will be from using the donated asset in its highest and best use, a proxy for which is the probable income obtainable were it sold to another market participant that would use the asset in its highest and best use
- the cost of the item to the donor
- in the case of goods that are expected to be sold, the estimated

resale value after deducting the cost to sell the goods

6.12. If it is impracticable to measure the fair value of goods donated for resale or distribution at the point the goods are received, the donated goods must be recognised as income when they are sold or distributed.

6.13. The terms of a donation may require the charity to make on-going use of the donated item, so preventing its sale. In such instances, there may be costs involved in removing such a restriction before the asset could be sold. This would be reflected in a lower assessment of the fair value amount than if the use of that asset was not restricted. Charities may find it helpful to refer to paragraph 2A.4 of FRS 102 for more information.

6.14. The stock of any goods donated for distribution to beneficiaries held by the charity at the balance sheet date is measured at the lower of cost and estimated selling price. If the goods are held for free distribution or for distribution at a nominal amount, the carrying amount must be the lower of cost adjusted for any loss of service potential, if applicable, and replacement cost. Replacement cost is the cost that would be incurred if the charity was to replace the service potential of the donated goods at its own expense in the most economic manner. Service potential is the capacity to provide services that contribute to the charity's objectives without necessarily generating cash inflows.

Accounting for donated facilities and services

6.15. If a charity is given facilities and services for its own use which it would otherwise have purchased, these donations must be recognised in the charity's accounts when the donations are received or receivable assuming there are no performance related conditions specified.

6.16. Donated facilities and services are measured at the value of the donation to the charity. Donations of facilities such as office accommodation, or services provided by an individual or an entity as part of their trade or profession can usually be measured reliably.

6.17. The value of donated facilities and services to the charity is the price the charity estimates it would have paid in the open market for a service or facility of equivalent utility (economic benefit or service potential benefit) to the charity. The value to the charity may be lower than the market price, but cannot exceed the market price of the item. The value to the charity may be lower than the market price because the service or facility received was a premium service but the charity would otherwise only have paid for a standard service, and so the value to the charity may be the value of a standard service. Where the charity would not have purchased the service or facility at all had it not been donated, the value to the charity is expected to be nil.

6.18. Where donated facilities and services are consumed immediately by the charity, an amount equivalent to the income is recognised as an expense under the appropriate heading in the statement of financial activities (SoFA). Where consumption of the donated facilities and services by the charity is not immediate, an amount equivalent to the income is recognised as an asset.

6.19. A charity leasing a facility or service as a lessee must, where the lease contains a non-exchange transaction recognise the difference between the value in use to the charity and the lower rate charged as a donation to the charity. Refer to module 10B *Lease Accounting* for more information on the accounting treatment.

Accounting for volunteers

6.20. Charities often rely on the contribution of unpaid general volunteers in carrying out their activities. However, placing a monetary value on their contribution presents significant difficulties. For example, charities might not employ additional staff were volunteers not available, or volunteers might complement the work of paid staff rather than replace them. These factors, together with the lack of a market comparator price for general volunteers, make it impracticable for their contribution to be measured reliably for accounting purposes. Given the absence of a reliable measurement basis, the contribution of general volunteers must not be included as income in charity accounts.

6.21. However, it is important that the user of the accounts understands the nature and scale of the role played by general volunteers. Charities must refer to the SORP module 1 for details of information to be included in the Trustees' annual report.

Accounting for donated goods and services capitalised as tangible fixed assets

6.22. Goods donated for on-going use by a charity in carrying out its activities are recognised as tangible fixed assets with the corresponding gain recognised as income from donations within the SoFA.

- A charity leasing an asset from a lessor where the lease contains a non-exchange transaction must recognise the difference between the lease at market rates and the lower rate charged as a form of a donation by enhancing the measurement of the value of the right-to-use asset above the value of the recognised lease liability. Refer to module 10B *Lease Accounting* for more information on the accounting treatment.

6.23. If donated services are used in the construction of a tangible fixed asset, the value of services donated will only form part of the construction cost of the asset when the value to the charity of the donated services can be measured reliably. For example, the services donated by a firm of building or electrical contractors would be valued because these services would normally be provided as part of the donor's trade.

6.24. In common with any other tangible assets, donated goods held as tangible fixed assets must be subject to depreciation or amortisation and assessed for indications of their impairment at the reporting date.

Accounting for donated goods for distribution to beneficiaries

6.25. Donated goods held by the charity for distribution to its beneficiaries must be recognised as stock, with the corresponding income recognised within donations and measured at their fair value.

6.26. It may be necessary when valuing the donation to consider any restriction on the sale of the asset or the factors that may reduce the fair value of the asset, such as proximity to a product expiry date or the availability of lower-cost substitutes for the donated item, for example a generic version of a drug. Donated goods held in stock for distribution must be assessed for impairment at the reporting date following the requirements outlined in paragraph 6.24.

6.27. In the reporting period in which the stocks are distributed, they are recognised as an expense in the SoFA. The expense recognised is the carrying amount of the stocks at the point of distribution.

Accounting for donated goods for resale

6.28. In accepting donated goods for resale, the charity is receiving a gift in kind on trust for conversion into cash to fund the charity's activities. Where practicable, donated goods for resale are recognised when received or receivable, and measured at fair value. The fair value is likely to be the expected proceeds from sale less the expected costs of sale.

6.29. Charities accepting goods for resale under the UK retail Gift Aid scheme are acting as agent in selling the goods on behalf of the donor and are in law entitled only to an administration fee until such time as the donor waives their entitlement to the sale proceeds. Charities which have historical data may use an estimation technique to recognise income from such arrangements from the point of sale, for example by applying a formula or mathematical model to estimate the likely amount of the donations that will result from their subsequent sale. Income may be recognised from the point of sale where this reflects the substance of the transaction provided the income recognised is adjusted to reflect the risk that some sales will not result in a donation. Where a donor does not waive their entitlement to the sale proceeds, the administration fee is analysed as 'Income from other trading activities' in the SoFA.

6.30. Where donated goods for resale are not recognised as income until they are sold, the proceeds of sale are categorised as 'Income from other trading activities' in the SoFA.

6.31. If recognised at fair value on receipt, the value of the donated goods for resale should be treated as a component of 'Income from other trading activities' with the corresponding stock recognised in the balance sheet. On its sale the value of the stock is charged against 'Income from other trading activities' and the proceeds of the sale are also recognised as 'Income from other trading activities'.

Disclosures in the notes to the accounts

6.32. All charities receiving donated goods, facilities or services must disclose in the notes to the accounts:

- the accounting policy for the recognition and valuation of donated goods, facilities and services
- the nature and amounts of donated goods, facilities and services receivable from non-exchange transactions recognised in the accounts, for example seconded staff, use of property etc
- any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised as income in the reporting period
- an indication of other forms of resources from non-exchange transactions from which the charity has benefitted but not recognised in its accounts, for example the contribution of unpaid general volunteers or donated goods that have been received but which the entity does not expect to recognise until the goods are sold or distributed

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*'.

8. Allocating costs by activity in the statement of financial activities

Introduction

8.1. The reporting tiers are applied for module 8 as outlined in Table 8.1A below.

Table 8.1A Tiered reporting for module 8

Tier 1	Charities within tier 1 may choose to adopt the activity basis of reporting or the natural classification basis of reporting. This SORP requires that charities in tier 1 that have chosen to use the activity basis of reporting, apply this module in full. Charities in tier 1 that have chosen to use natural classifications **are not required** to apply this module.
Tiers 2 and 3	This SORP requires charities within tiers 2 and 3 to adopt the activity basis of reporting. The requirements of this module apply in full to charities in tiers 2 and 3.

8.2. When the activity basis of reporting is adopted, the statement of financial activities (SoFA) must distinguish between expenses incurred on charitable activities which contribute to furthering the charity's aims and purposes, and those undertaken to raise funds. Further analysis of significant activities included within these broad categories must be provided either on the face of the SoFA or in the notes to the accounts.

8.3. This module sets out:

- General principles for reporting activities
- Identification and treatment of support costs
- Methods of allocating costs to activities
- Accounting for costs shared between fundraising and charitable activities
- Disclosures required in the notes to the accounts

General principles for reporting activities

8.4. A charity's SoFA or related notes must provide an analysis of a charity's significant activities in a way that is relevant to both the charity and the users of its accounts. Significant activities are those which, due to their scale or importance, are key to the charity in meeting its aims and objectives.

8.5. The analysis of activities should provide an understanding of how a charity

raises its funds and uses them to further its purposes. For example, charitable activities may be analysed according to services provided, projects or programmes undertaken, or by the particular aims or objectives taken forward.

8.6. The activities reported should also be consistent with the significant activities noted in the trustees' annual report. The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenses incurred on them.

Identification and treatment of support costs

8.7. While some costs relate directly to a single activity, other costs are incurred indirectly to enable the delivery of all, or a range of, the charity's activities. The cost of such enabling (or support) functions may be shared across more than one activity undertaken by the charity. For example, governance costs, payroll administration, purchasing, budgeting and accounting, information technology, human resources (personnel), building management services and finance are functions that are likely to enable/support more than one area of activity. These costs must be apportioned across the activities that the function supports in order to arrive at the full cost for each reported activity. This would include relevant restricted funds unless prohibited by the terms of a gift.

Methods of allocating costs to activities

8.8. To ensure that the accounts present the costs of activities fairly, charities should ensure that the method(s) of cost allocation adopted are reasonable and consistently applied. In attributing costs to activities, the following principles must be applied:

- direct costs attributable to a single activity must be allocated directly to that activity (for example, the salary cost of someone solely employed on a particular activity, or the cost of running a vehicle used wholly for a particular activity)
- shared costs which contribute directly to more than one activity must be apportioned between those activities (for example the cost of a staff member whose time is divided between a fundraising activity and working on a charitable project)
- support costs (for example governance costs or the costs of IT equipment) that are incurred to enable a range of activities must also be apportioned between the activities that are being supported

8.9. The method(s) of apportionment adopted by a charity should be reasonable and be consistent between reporting periods unless circumstances change. Charities should also balance the benefits of greater accuracy with the costs involved when selecting methods of apportioning costs. Examples of bases for apportionment that may be applied include:

- usage of a resource or activity in terms of time taken, capacity used, requests made or other measure
- per capita, based on the number of people employed within an activity
- floor area occupied by an activity
- time, where staff duties span more than one activity

Accounting for costs shared between fundraising and charitable activities

8.10. Information about the aims, objectives and projects of a charity is frequently provided in the context of mail shots, websites, public fundraising collections and telephone fundraising. In determining whether costs are shared, a distinction should be drawn between:

- publicity or information costs involved in raising the profile of the charity which is associated with fundraising
- educational publicity or information to further the charity's aims and objectives

8.11. For publicity or information to be regarded as a charitable expense, it must be provided for an educational purpose. In the context of a fundraising activity, in order to achieve an educational purpose the information supplied must fulfil the following educational criteria:

- be targeted at beneficiaries or others who can use the information to further the charity's purposes
- be information on which the recipient can act in an informed manner to further the charity's purposes
- be related to other educational activities or objectives undertaken by the charity

8.12. For example, a health education charity might target high-risk beneficiary groups or medical professionals when distributing its fundraising material and, as part of the same mailing, also supply information on health risks and symptom recognition. The health information supplied would be a charitable expense because it is targeted at beneficiaries or others who could act on the information and has been distributed by the charity as part of its health education activity. The shared cost of producing and distributing the information should therefore be fairly apportioned between the fundraising and charitable activities. If the educational criteria had not been met, then all relevant costs would be attributed to fundraising activities.

Disclosures required in the notes to the accounts

8.13. This SORP requires that charities reporting on an activity basis must disclose:

- details of the accounting policy adopted for the apportionment of costs between activities and any estimation technique(s) used to calculate their apportionment

- the total amount of support costs incurred in the reporting period
- an analysis of material items or categories of expense included within support costs, separately identifying the total amount of governance costs incurred (refer to Appendix 1, '**Glossary of terms**', for the definition of governance costs)
- the amount of support costs apportioned to each of the charity's significant activities as disclosed in the SoFA or in the notes to the accounts

8.14. The information required for support costs and their apportionment may be provided in a tabular format (see Table 6 in SORP module 4 '*Statement of financial activity*' for an illustration of how the information might be disclosed).

9. Disclosure of trustee and staff remuneration, related party and other transactions

Introduction

9.1. A charity's accounts should inform the user and help them to assess a charity's financial performance and position, and the stewardship exercised by its trustees over the charitable funds held. The disclosure of certain transactions is important for stewardship purposes to provide assurance that the charity is operating for the public benefit and that its trustees are acting in the interests of their charity and not for private benefit.

Table 9.1A: Tiered reporting requirements for module 9

Tier 1	Charities in tier 1 that have chosen to use natural classifications apply this module in full except for the disclosure of total staff costs and employee benefits (see paragraph 9.27 below). Tier 1 charities that are companies must disclose the information required at 9.27 if they are not eligible for the small companies regime.
Tiers 2 and 3	This SORP requires charities within tiers 2 and 3 to adopt the activity basis of reporting. The requirements of this module apply in full to charities in tiers 2 and 3.

9.2. This SORP requires a transaction involving a trustee or other related party to always be regarded as material regardless of its size unless it falls within the exceptions set out at paragraph 9.20 below. A charity must make the same disclosures for de-facto trustees (see Appendix 1 '*Glossary of terms*') as for trustees.

9.3. Charities should refer to Section 33 of FRS 102 for more information about related party disclosures. This module sets out:

- Disclosure of trustees' remuneration and benefits
- Disclosure of trustees' expenses
- Transactions with related parties that require disclosure
- Exceptions to the disclosure of related party transactions
- Disclosure of related party transactions
- Disclosure of audit, independent examination and other financial service fees
- Disclosure of ex-gratia payments
- Disclosure of staff costs and employee benefits

- [Remuneration and benefits received by key management personnel]
- [Exemptions from disclosure of the names of related parties]

Disclosure of trustees' remuneration and benefits

9.4. Most trustees are volunteers who give their time and expertise without charge. However, provided the arrangement is legally authorised, a trustee may be remunerated for their role as a trustee. On occasions, a trustee may also be employed in some other role, either directly by the charity or by a related entity, including a subsidiary, joint venture or associate of the charity.

9.5. This SORP requires that all charities must disclose in the notes to the accounts that either:

- none of the trustees have been paid any remuneration or received any other benefits from an employment with their charity or a related entity; or
- one or more of the trustees has been paid remuneration or has received other benefits from an employment with their charity or a related entity

9.6. This SORP requires the following information to be provided for each individual trustee who received remuneration or other benefits in the reporting period:

- the legal authority under which the payment was made (for example a provision in the governing document of the charity, an Order of the Court, or the charity regulator for the jurisdiction(s) of registration)
- the name and role of the remunerated trustee
- the period that the payment covered if different to the dates for which they were a trustee
- details of why the remuneration or other employment benefits were paid
- the amount of remuneration paid
- the amount of any pension contributions paid by the charity for the reporting period; and
- the amount of any other benefit, for example any termination benefits, private health cover or the provision of a vehicle

9.7. If a trustee receives remuneration or other benefits from their employment with the charity in addition to their trusteeship, the note may distinguish between remuneration and benefits received as a trustee, if any, from that received for other services or other employment with the charity.

Disclosure of trustees' expenses

9.8. Trustees may incur costs in fulfilling their duties, for example in travelling to meetings or visiting charity facilities or activities to understand or monitor what is taking place. The reimbursement of properly incurred expenses is not considered a payment for goods or services or the remuneration of a trustee, nor does it count as any kind of personal benefit.

9.9. Trustee expenses include the reimbursement by a charity of costs incurred by its trustees in carrying out their duties and similar payments made by a charity direct to third parties on their behalf. For example, a charity may purchase travel tickets or pay for accommodation used by its trustees when carrying out their duties.

9.10. This SORP requires that all charities must disclose either:

- that no trustee expenses have been incurred; or
- that one or more of the trustees has claimed expenses or had their expenses met by the charity

9.11. If expenses have been incurred, this SORP also requires that charities must disclose:

- the total amount of expenses reimbursed to trustees or paid directly to third parties
- the nature of those expenses (for example travel, subsistence, accommodation, entertainment etc.)
- the number of trustees reimbursed for expenses or who had expenses paid by the charity

Transactions with related parties that require disclosure

9.12. A related party is a person or entity that is related to the entity that is preparing its financial statements, for further details see paragraph 33.2 of FRS 102. Related parties include a charity's trustees and their close family members and those entities which they control or in which they have a significant influence. Entities related to a charity include any subsidiary, joint venture or associate of the charity. Appendix 1 '*Glossary of terms*' provides a full definition of persons or entities that must be regarded as a related party for disclosure purposes.

9.13. In considering a possible related party relationship, a charity must assess the substance of the relationship and not merely its legal form. For example, if a person has significant influence over a charity's decision making or if a charity acts on their instructions, then that person must be treated as related to the charity.

9.14. This SORP requires charities to disclose transactions with former related parties when the transaction in the current reporting period is directly related to a time when the former related party was a related party of the charity. An example of this could be a settlement that is paid to a former related party in the current period but relates to a time when they were a related party.

9.15. A decision by a charity to enter into any transaction must be made in the charity's own interests and for the benefit of its beneficiaries. The disclosure of related party transactions is an important element of transparency in financial reporting because:

- related parties may enter into transactions that unrelated parties would not
- transactions between related parties may not be made at the same amounts or on the same terms as those between unrelated parties
- the existence of the relationship may be sufficient to affect the transactions of the charity with other parties

9.16. Users of the accounts need to be able to assess whether the relationship between the charity and the other party or parties to a transaction may have been influenced by interests other than those of the charity. Disclosing related party transactions also shows how far, if at all, the reported financial position and activities may have been affected by such transactions.

9.17. Donations to the reporting charity from a trustee or a related party may not need to be disclosed separately provided the donor has not attached conditions which would, or might, require the charity to alter significantly the nature of its existing activities if it were to accept the donation. Examples of conditions that make the donation a transaction that must be disclosed separately include: requiring the charity to purchase goods or services from a specified supplier; making an interest bearing loan to the charity; or requiring that payments be made to a specified third party. However, charities must provide an aggregate disclosure of the total amount of donations received without conditions.

9.18. This SORP requires that all transactions (including ex-gratia payments) between a charity and a related party, including transactions entered into between two or more members of a group, to be disclosed subject to the exceptions set out in the following paragraphs.

Exceptions to the disclosure of related party transactions

9.19. This SORP requires a transaction involving a trustee or other related party to always be regarded as material regardless of its size unless it falls within the following exceptions set out at 9.20.

9.20. The transactions involving trustees or related parties, may not need to be disclosed unless there is evidence to indicate that they have influenced the charity's activities or use of resources. However, consideration must be given to any outstanding balances that will need to be disclosed (see paragraph 9.22 of this module). Exceptions to the disclosure of related party transactions are as follows:

- services provided on a voluntary basis to a charity as an unpaid general volunteer by a trustee or other related party
- contracts of employment between the charity and its employees (except where the employee is a trustee or other related party)

- the purchase from the charity by a trustee, or other related party, of minor articles which are offered for sale on the same terms as they are offered to the general public, for example a small purchase made from a charity shop
- the provision of services to a trustee or other related party where the services are received on the same terms as they are received by other beneficiaries of the charity. Examples include the use of a village hall by members of its committee of management as inhabitants of the area of benefit
- the payment or reimbursement of out-of-pocket expenses where the trustee acts as agent for the charity (but certain details of trustee expenses must be disclosed – see 'Disclosure of trustees expenses')
- the amount of any expenses waived by a trustee need not be disclosed unless the amount is material in the context of a charity's total expenditure

Disclosure of related party transactions

9.21. If there have been no related party transactions in the reporting period that require disclosure, this SORP requires that this fact must be stated.

9.22. All charities that have one or more related party transactions must disclose:

- the description of a relationship between the parties (including the interest of the related party or parties in the transaction)
- a description of the transaction(s)
- the amounts involved
- outstanding balances and commitments with related parties at the reporting date and any provisions for doubtful debts
- any amounts written off from bad or doubtful debts relating to balances with related parties during the reporting period
- the terms and conditions, including any security and the nature of the consideration to be provided in settlement
- details of contingent assets and liabilities (refer to the SORP module 10A and Section 21 of FRS 102)
- details of any guarantees given or received
- any other elements of the transactions which are necessary for the understanding of the accounts
- this SORP requires the disclosure of the name(s) of the transacting related party or parties

Further details and examples of disclosures of related party transactions are included in paragraphs 33.8 to 33.12 of FRS 102.

9.23. The reporting charity must not state that related party transactions were made at open market value or on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated (see paragraph 33.13 of FRS 102).

Disclosure of audit, independent examination and other financial service fees

9.24. This SORP requires that charities must disclose in the notes to the accounts the amounts payable to their auditor or independent examiner, analysed between fees payable for:

- statutory audit or independent examination
- assurance services other than audit or independent examination
- tax advisory services
- other financial services, for example consultancy, financial advice or accountancy services

Disclosure of ex-gratia payments

9.25. An ex-gratia payment is a payment, or the waiver of a right to an asset which the trustees have no legal obligation or legal power to make from a charity's funds but which they believe they have a moral obligation to make. For the purposes of disclosure, occasional gifts of small and inexpensive items such as flowers or chocolates should not be regarded as ex-gratia payments.

9.26. This SORP requires that charities must disclose details of all ex-gratia payments made including those where the charity has obtained the authority of the Court, the Attorney General or the charity regulator for the jurisdiction(s) of registration to sanction the payment or waiver. For each payment the notes to the accounts must:

- provide an explanation of the reason and nature of the payment
- state the legal authority
- state the amount of the payment (or value of any waiver of a right to an asset)

Disclosure of staff costs and employee benefits

9.27. This SORP requires that charities reporting on an activity basis must provide details of their total staff costs and employee benefits for the reporting period, analysed between:

- wages and salaries
- social security costs

- employer’s contribution to defined contribution pension schemes
- the operating costs of defined benefit pension schemes (excluding pension finance costs related to defined benefit pension schemes)
- other forms of employee benefits

9.28. Charities that are companies that have chosen to report on the natural classification basis must disclose this information if they are not eligible for the small companies regime.

9.29. The recognition of expenditure relating to staff costs and employee benefits is dealt with in the SORP module 7 ‘*Recognition of expenses and liabilities*’. Liabilities for the cost of benefits that employees are entitled to must be recognised even if not yet paid.

9.30. In addition for any redundancy or termination payments relating to the reporting period, charities must state:

- the total amount for the reporting period
- the nature of the payment
- its accounting policy
- the extent of funding at the reporting (balance sheet) date

9.31. The information provided for staff costs and employee benefits must also include any expenditure on staff working for the charity whose contracts are with and are paid by a related party.

9.32. This SORP requires that all charities must disclose the average head count (number of staff employed) during the reporting period. Charities may also provide details of the average number of full-time and part-time staff for the reporting period together with an estimate of the equivalent number of full-time staff. Further analysis of staffing according to the number of staff engaged in particular activities of the charity may also be provided where this information helps the user of the accounts understand how staff are deployed.

9.33. This SORP also requires that all charities must disclose:

- the fact that there are no employees who received employee benefits (excluding employer pension costs) of more than £60,000 (€70,000)
- the number of employees whose total employee benefits (excluding employer pension costs) for the reporting period fell within each band of £10,000 (€10,000) from £60,000 (€70,000) upwards

Employer National Insurance Contributions must be excluded from this calculation.

Remuneration and benefits received by key management personnel

9.34. Although the trustees control and manage the administration of a charity, the day-to-day management of its activities may be delegated to senior management personnel who report to the trustees. FRS 102 uses the term ‘key management

personnel' to describe the trustees and senior management of the charity. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director of that entity.

9.35. All charities must disclose the total amount of any employee benefits received by trustees and its key management personnel for their services to the charity. When calculating employee benefits for this purpose, the definition of employee benefits must include Employers National Insurance Contributions, refer to paragraph 28.4 FRS 102. Where key management personnel have been employed in post for part of a financial year this should be disclosed alongside the amounts.

9.36. In addition to the disclosure set out above at paragraph 9.33, the trustees of charities, particularly tier 2 and 3 charities, should give consideration to the information needs of their funders and other stakeholders in making their accounting disclosures. For example, it may be helpful to provide details of the employee benefits received by the charity's Chief Executive Officer or highest paid staff member, or a charity may choose to disclose the amount of employee benefits paid to its key management personnel on an individual basis.

10. Balance sheet

Introduction

10.1. The reporting tiers applied for Module 10 are as specified in the table below.

Table 10.1A: Tiered reporting requirements for module 10

All tiers	The reporting requirements for the balance sheet apply fully to all charities.

10.2. All charities preparing accruals accounts must prepare a balance sheet at the end of each reporting period which gives a true and fair view of their financial position. The balance sheet provides a snapshot statement of a charity's assets and liabilities and how these are represented by the different classes of funds held by a charity.

10.3. The objective of the balance sheet is to show the resources available to the charity and whether these are available for all purposes of the charity or have to be used for specific purposes because of legal restrictions placed on their use.

10.4. This module applies to all charities and sets out:

- Structure of the balance sheet
- Fixed assets – classification and disclosures
- Current assets – classification and disclosures
- Liabilities – classification and disclosures
- Funds of the charity – classification and disclosures

10.5. Each section explains:

- the detail to be included in each line item of the balance sheet
- the recognition principles and the measurement methods used for balance sheet items
- the information that must be, or should be, provided in the notes if not shown on the face of the balance sheet

10.6. For information on the recognition and measurement of financial assets and liabilities charities must refer to the SORP module 11 'Accounting for financial assets and financial liabilities'.

Structure of the balance sheet

10.7. Table 7 sets out the format of a charity's balance sheet and the headings used to present its assets, liabilities and funds. A charity's balance sheet must:

- adopt the same format in subsequent reporting periods unless there are special reasons for a change that are explained in the notes

- provide corresponding amounts for the previous reporting period for each line item disclosed in the balance sheet

10.8. Additional requirements apply to charitable companies. For more information see the SORP module 15 ‘Charities established under company law’.

Table 7: Balance sheet

Note ref.		Total funds	Prior year funds	Further details
		£	£	
	Fixed assets:			A
	Intangible assets			A1
	Property, plant and equipment			A2
	Heritage assets			A3
	Investments			A4
	Total fixed assets			
	Current assets:			B
	Stocks			B1
	Debtors			B2
	Investments			B3
	Cash at bank and in hand			B4
	Total current assets			
	Liabilities:			C
	Creditors: Amounts falling due within one year			C1
	Net current assets or liabilities			
	Total assets less current liabilities			
	Creditors: Amounts falling due after more than one year			C2
	Provisions			C3
	Lease liabilities			C4
	Net asset or liabilities excluding pension asset or liability			
	Defined benefit pension scheme asset or liability			C5
	Total net assets or liabilities			
	The funds of the charity:			D
	Endowment funds			D1
	Restricted income funds			D2
	Unrestricted funds			D3
	Revaluation reserve			D4
	Pension reserve			D5
	Total unrestricted funds			
	Total charity funds			

10.9. If there is a nil amount for a particular balance sheet line item in the current reporting period, a corresponding amount for the reporting period must still be disclosed unless that amount is also nil. If the amount for both the current and previous reporting periods is nil, then the line item should be omitted from the balance sheet.

10.10. The balance sheet must be signed by one or more trustees, each of whom

has been authorised to do so by the trustee body, and must specify the date the accounts, including the balance sheet, were approved by the trustee body.

10.11. Where necessary to give a true and fair view of a charity's financial position, additional information must be provided in an additional line item in the balance sheet or given in a note to the accounts. Charities may choose to analyse the items included in any balance sheet line item in greater detail either on the face of the balance sheet or in a related note. The balance sheet may also be presented in a columnar format that analyses balance sheet items by class of fund: unrestricted, restricted income and endowment.

10.12. Where the corresponding amount for the previous reporting period is not comparable due to a change in accounting policy it must be adjusted if material and the reason for the adjustment explained in the notes to the accounts.

10.13. The sections that follow are cross-referenced to the line items shown in Table 7.

A: Fixed assets – classification and disclosures

10.14. Fixed assets provide an economic resource to the charity on an on-going basis (i.e. for more than one reporting period) through their ability to:

- generate income and/or gains
- contribute to furthering the charity's objectives

10.15. Charities that hold or have received donated fixed assets in the reporting period must refer to the SORP module 6 'Donated goods, facilities and services, including volunteers'.

10.16. Fixed assets are generally recognised when:

- a present economic resource is controlled by the charity as a result of past events, for example the purchase of equipment by a charity;
- it is probable that the expected future economic benefits associated with the asset will flow to the charity; and
- the historical cost or fair value of the asset can be measured reliably

Alternatively, a fixed asset is recognised when it qualifies as a right-of-use asset (refer to SORP module 10B 'Lease accounting').

Recognition criteria for intangible assets are set out at paragraph 10.22 below.

Disclosure in the notes applying to all classes of fixed assets

10.17. The following analysis must also be provided for each class of fixed assets that is subject to depreciation, amortisation, or impairment provisions:

- the cumulative amount of depreciation or impairment provided at the beginning of the reporting period
- amount adjusted on disposal
- amount of depreciation or amortisation provided in the reporting period

- amount of any impairment provision in the reporting period
- amount of any impairment reversals in the reporting period
- amount of any transfer or other adjustment in the reporting period
- the cumulative amount of depreciation, amortisation or impairment provided at the end of the reporting period

10.18. The carrying amount for each class of fixed assets must also be provided at the beginning and end of the reporting period.

10.19. In regard to right-of-use assets if these are not shown separately in the balance sheet from other property, plant and equipment assets then the lessee shall:

- include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned
- disclose which line items in the balance sheet include those right-of-use assets

A1: Intangible assets

10.20. Intangible assets are non-monetary assets that do not have physical substance but are identifiable and are controlled by the charity through custody or legal rights. Intangible assets include goodwill purchased on the acquisition of a business and/or purchased intangible assets such as concessions, patents, licences, trademarks and similar rights. Although such assets lack physical substance they provide an on-going economic benefit to the charity. The recognition, measurement and disclosure requirements for intangible assets are included in Section 18 of FRS 102.

10.21. A charity is required to recognise an intangible asset as an asset if, and only if:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the charity
- the cost or value of the asset can be measured reliably

10.22. Internally generated intangible asset is a type of intangible asset that is created through the charity's own activities, rather than being acquired externally. To assess whether an internally generated intangible asset, for example, development costs, meets the criteria for recognition, a charity classifies the generation of the asset into:

- a research phase
- a development phase

For more on the recognition of an internally generated intangible assets see paragraphs 18.8A to 18.8K of FRS 102.

10.23. The cost of internally generated goodwill or intangible assets such as brands and logos must not be capitalised and is written off as expenditure as incurred. Expenditure on research must always be written off but the

costs incurred in the development phase of an internal project may in certain circumstances be recognised as an intangible asset.

10.24. Intangible assets must be initially measured at cost. The residual value of intangible assets is nil when calculating the charge for amortisation unless reliable evidence exists to the contrary. **Amortisation** on intangible assets must be charged as an expense to the relevant statement of financial activities (SoFA) category reflecting the use of the asset.

10.25. Charities may opt, after initial recognition at cost, to use the revaluation model; for more information refer to paragraphs 18.18B to 18.8H of FRS 102.

10.26. Capitalised goodwill and intangible assets must be amortised on a straight-line (or a more appropriate systematic) basis over their useful lives, which must be reviewed at each reporting date. If, in exceptional cases, the useful life cannot be estimated reliably the life shall not exceed 10 years.

Disclosures

10.27. The notes to the accounts for all charities must:

- explain the accounting policies adopted for intangible assets, including the measurement basis adopted, the useful lives or amortisation periods and methods used, the reasons for choosing those amortisation periods and, where relevant, the policies for the recognition of any capitalised development expenditure
- for intangible assets acquired by way of grant, their value on initial recognition and their carrying amount
- the carrying amounts of any intangible assets to which the charity has restricted title or that are pledged as security for liabilities
- the amount of contractual commitments for the acquisition of intangible assets
- the amount of research and development expenditure recognised as expenditure in the year
- the heading(s) in the SoFA in which a charge of amortisation of intangible assets is included
- if an accounting policy of revaluation is adopted, the effective date of the revaluation, whether an independent valuer was involved and the methods applied
- for each revalued class of intangible assets, the carrying amount that would have been recognised had the assets been carried under the cost model
- a description of any individual intangible asset that is material, together with its carrying amount and remaining amortisation period
- provide a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:

- additions, indicating separately those from internal development and those acquired separately
- disposals
- acquisitions through business combinations
- revaluations
- amortisation
- impairment losses recognised or reversed in profit or loss (refer to SORP module 12 ‘Impairment of assets’)
- other changes

This reconciliation need not be presented for prior periods.

A2: Property, Plant and Equipment

10.28. Property, plant and equipment, such as land and buildings, plant, vehicles and equipment, are held to provide an on-going economic benefit to a charity through their contribution, directly or indirectly, to the provision of goods or services by the charity. The recognition, derecognition, measurement and disclosure requirements of property, plant and equipment described in this SORP as tangible assets are included in Section 17 of FRS 102.

10.29. Charities leasing these assets, for example land or buildings, must also refer to SORP module 10B ‘Lease accounting’ for the required accounting treatment for lessees in respect of initial recognition and subsequent measurement of right-of-use assets and disclosures relating to right-of-use assets.

10.30. Property, plant and equipment must be measured initially in the balance sheet at cost. All costs incurred to bring a property, plant and equipment into its intended working condition must be included in the measurement of cost.

10.31. A charity may adopt an accounting policy of capitalising borrowing costs, including interest, that are directly attributable to the acquisition, construction or production of property, plant and equipment that meet the definition of a qualifying asset, or may write off such borrowing costs as an expense in the SoFA as they are incurred in accordance with the requirements of Section 25 of FRS 102.

10.32. Where a charity has acquired an item of property, plant and equipment to satisfy future performance obligations in a contract and it does not meet the definition of property, plant, and equipment under Section 17 of FRS 102, the charity may instead recognise a contract asset if these costs are recoverable from the customer.

10.33. A charity must account for the costs incurred in fulfilling a contract with a customer in accordance with the relevant Section of FRS 102 for those costs (e.g. for example Section 13 Inventories, Section 17 Property, plant and equipment, or Section 18 Intangible assets other than goodwill). On occasion a charity may incur costs in fulfilling a contract which are not within the scope of these sections and would recognise those costs as an asset. In these

circumstances the charity must refer to paragraphs 23.117 to 23.123 of FRS 102.

Accounting for depreciation

10.34. A charity must allocate the depreciable amount of an item of property, plant and equipment on a systematic basis over its useful life. The depreciable amount is the cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value. The residual value of an asset is the estimated amount that a charity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The charity must choose a depreciation method which reflects the use of the asset and the expected timing or pattern of consumption of its economic benefits.

10.35. Paragraph 17.21 of FRS 102 provides guidance on the factors which determine the useful life of an item of property, plant and equipment.

10.36. Land is not normally subject to depreciation because it will not generally wear out and its residual value is likely to be at least equal to its cost or valuation. However, land is tested for impairment when there is an indicator of impairment.

10.37. Where an asset comprises two or more major components which have substantially different useful lives, each component must be depreciated separately over its useful life.

10.38. The depreciation charged for the reporting period must be recognised as an expense in the SoFA. The expense is charged or apportioned to the relevant SoFA line item(s) reflecting the asset's use.

Accounting for the revaluation of property, plant and equipment

10.39. A charity may choose to adopt an accounting policy of revaluing one or more classes of the property, plant and equipment it holds. For example, a charity may choose to revalue land and buildings but not motor vehicles. If a policy of revaluation is adopted, then all assets within that particular class must be revalued. Buildings of a similar nature, function or use held by the charity constitute a class of property, plant and equipment.

10.40. In some cases, there may be an active second-hand market for the asset, or appropriate indices may exist, allowing a valuation to be made with sufficient reliability.

10.41. If a policy of revaluation is adopted, then charities must:

- carry all assets within the relevant class of property, plant and equipment at their revalued amount, its fair value (see Section 2A of FRS 102) at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. However, if there is no market-based evidence of fair value then the charity may need to estimate fair value using an income or depreciated replacement cost approach
- undertake valuations, with sufficient regularity, to ensure that the

carrying amount does not differ materially from the fair value of the asset at the end of the reporting period. For example, a charity may undertake a review of land and buildings on a rolling basis over a five-year period. This appraisal of land and buildings is normally undertaken by professionally qualified valuers

10.42. If a policy of revaluation is adopted, then revaluations and recognised gains and losses must be presented in the accounts as follows:

- a separate revaluation reserve must be provided within the funds section of the balance sheet
- revaluation gains must be recognised as 'Gains on the revaluation of fixed assets' within the SoFA, unless they reverse a charge for impairment that has previously been recognised as a cost within the expenses line items in the SoFA
- revaluation losses must be recognised as an expense in the relevant expenses line items in the SoFA except to the extent to which they offset any previous revaluation gains, in which case the loss is shown in the 'Gains/(losses) on the revaluation of fixed assets' section of the SoFA

Accounting for the derecognition of property, plant and equipment

10.43. A charity must derecognise an item of property, plant and equipment:

- on disposal
- when no future economic benefits are expected from its use or disposal

10.44. A charity must determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item. This gain or loss on disposal must be recognised in 'Other' income in the SoFA.

Disclosures of property, plant and equipment

10.45. The notes to the accounts must:

- set out the depreciation method used and the useful lives of assets or the depreciation rate used
- state the amount of borrowing costs, if any, capitalised in the construction of property, plant and equipment assets and, where applicable, the capitalisation rate used
- state the amount of contractual commitments to acquire property, plant and equipment
- provide a reconciliation (example give in Table 8) of the carrying amount at the beginning and end of the reporting period showing separately:
    - additions
    - disposals

- acquisitions through business combinations
- revaluations
- transfers to or from investment property (see paragraphs 16.9 to 16.9C of FRS 102)
- impairment losses recognised or reversed in profit or loss (refer to SORP module 12 ‘Impairment of assets’)
- depreciation
- other changes

This reconciliation need not be presented for prior periods.

10.46. The disclosures in paragraph 10.45 are also relevant to a charity that chooses to measure investment property rented to another group entity under the cost model, as permitted by paragraph 10.59.

10.47. This SORP requires that the notes to the accounts identify the existence and carrying amounts of property, plant and equipment to which the charity has restricted title or that are pledged as security for liabilities.

Table 8: Analysis of opening and closing carrying amounts for property, plant and equipment

	Freehold land and buildings	Leasehold land and buildings	Plant and machinery	Fixtures, fittings and equipment	Total
	£	£	£	£	£
Cost or valuation					
At beginning of the year					
Additions					
Disposals					
Revaluations					
Transfers					
At end of the year					
Depreciation and impairments					
At beginning of the year					
Disposals					
Depreciation					
Impairment					
Transfers					
At end of the year					
Net book value at beginning of the year					
Net book value at end of the year					

10.48. If any class of property, plant and equipment has been revalued, charities must disclose:

- the effective date of the revaluation
- whether an independent valuer was involved
- the methods and significant assumptions applied in estimating the items’ fair value
- for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the historical cost model

A3: Heritage assets

10.49. A heritage asset is a tangible asset or intangible asset with historic, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.

10.50. Heritage assets are a distinct class of property, plant and equipment or intangible asset. Charities holding heritage assets must refer to the SORP module 18 ‘Accounting for heritage assets’. This module explains the recognition, measurement and disclosures relevant to heritage assets.

A4: Investments

10.51. Fixed asset investments are held to generate income or for their investment potential, or both. This includes investment property owned by the charity and also right-of-use assets that the charity holds as an investment property and leases out to other parties. Investments may include 'social investments' where the purpose of making the investment is both to generate a financial return and to further the investing charity's purposes.

10.52. Fixed asset investments exclude those investments held specifically for sale or those investments which the charity expects to realise within 12 months of the reporting date.

10.53. Investment gains and losses, whether realised or unrealised, are combined and shown in the heading 'Gains/(losses) on investments' in the SoFA.

Investments listed or traded on a recognised stock exchange

10.54. Fixed asset investments in quoted shares, traded bonds and similar investments must be measured initially at cost and subsequently at fair value in accordance with Section 2A of FRS 102 at the reporting date. This treatment is in accordance with paragraph 11.14(d) of FRS 102.

Investment properties

10.55. An investment property is property (land or a building or both) held by the owner or by the lessee under a lease to earn rentals or for capital appreciation, or both rather than for use in the production or supply of goods and services or for administrative purposes, or sale in the ordinary course of business.

10.56. Land and/or buildings are excluded from investment properties and treated as property, plant and equipment instead if:

- the construction work and development has not been completed
- the property is occupied by the charity for its own purposes
- the property is held for sale in the ordinary course of business (in which case the property must be included as a current asset)

10.57. Mixed use property must be separated between investment property and property held for operational use as an item of property, plant and equipment if the resulting portions could be sold separately (or leased out separately under a finance lease). However, if the fair value of the investment property component cannot be measured reliably, the entire property shall be accounted for as property within property, plant and equipment or in the case of property held by the charity as lessee, as a right-of-use asset. Investment properties must be measured initially at cost and subsequently at fair value at the reporting date (see Section 2A of FRS 102 for the measurement at fair value), except where that property is rented to another group entity. Depreciation is not provided on investment property measured at fair value.

10.58. A charity that rents investment properties to another group entity may choose to account for those properties in its individual financial statements either: at fair value with any gain or loss taken through the SoFA; or transfer them to property, plant and equipment, and measure them using the cost model. Investment property measured using the cost model is carried at cost less any accumulated depreciation and any accumulated impairment losses.

10.59. When only part of a property is rented to another group entity, paragraph 10.58 only applies to the component of that property that is rented to another group entity.

Unlisted investments

10.60. Unlisted equity investments must be measured initially at cost and subsequently measured at fair value unless fair value cannot be measured reliably in which case it is measured at cost less impairment (see FRS 102 11.14(d)(iv) and (v)). Where the charity holds an interest in subsidiaries, associates and joint venture entities, it must refer to the relevant SORP module(s) for consideration of the recognition and measurement of their interests in these entities (refer to modules 23 to 29 of this SORP).

Social investments

10.61. Charities holding social investments must refer to the SORP module 21 'Accounting for social investments', which explains their recognition, measurement and disclosure.

Disclosure of investments and investment properties

10.62. The notes to the accounts must:

- state the accounting policies for investments, including the basis on which investments are measured
- provide an analysis of investments by class of investment identifying the amounts held within each class, with those investments held at fair value differentiated from those held at historical cost less impairment
- provide an analysis reconciling the opening and closing carrying amounts of each class of fixed asset investment held

10.63. The classes of investments disclosed in the note will vary from charity to charity reflecting the differing nature of the investments held. This SORP requires that the analysis must as a minimum identify material amounts held in the following classes of investment:

- cash or cash equivalents
- listed investments
- investment properties
- lease receivables
- loans to group undertakings
- equity investment in group undertakings
- social investments

- other investments

10.64. Charities must also refer to the SORP module 11 ‘Accounting for financial assets and financial liabilities’ for the further disclosures that apply to investments in financial instruments.

10.65. Charities holding investment property must also disclose:

- the methods and significant assumptions applied in determining the fair value of investment property
- the extent to which the fair value of investment property is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the property being valued (or if there has been no such valuation this fact must be disclosed)
- the existence and amounts of any restrictions on the ability to realise investment property or on the remittance of income and proceeds of disposal
- any contractual obligations for the purchase, construction, or development of investment property or for repairs, maintenance or enhancements
- the carrying amount at the end of the reporting period of investment property rented to another group entity, where the charity has chosen to account for such property using the cost model
- a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:
    - additions, disclosing separately those additions resulting from acquisitions through business combinations
    - net gains or losses from fair value adjustments
    - transfers to and from property, plant and equipment (see paragraphs 16.9 to 16.9B of FRS 102)
    - transfers to and from inventories (see paragraphs 16.9, 16.9A and 16.9C) of FRS 102
    - other changes

This reconciliation need not be presented for prior periods.

B: Current assets – classification and disclosures

10.66. Current assets are the assets of the charity which are not intended for use on a continuing basis in the charity’s activities and are usually consumed, realised or expended as part of the charity’s activities, within 12 months of its reporting date. Current assets include stocks, debtors, investments held for sale and cash. The sections that follow set out how these categories of assets are measured and disclosed in the accounts.

10.67. Charities that hold donated assets for distribution or resale or have

received them in the reporting period must refer to the SORP module 6 ‘Donated goods, facilities, and services, including volunteers’.

B1: Stocks

10.68. Stocks are items that will be used by the charity in providing goods and services. Stocks may include goods held for distribution to beneficiaries, or educational literature or brochures for distribution.

10.69. Stocks held for sale as part of a non-charitable trade must be measured at the lower of the cost and estimated selling price less costs to complete and sell of the separate items of stock or groups of similar items.

10.70. When goods are provided as part of a charitable activity either at no or nominal consideration, they shall be measured at the lower of cost adjusted, when applicable, for any loss of service potential and replacement cost. For example, if goods are held for free distribution and the item continues to meet the need(s) for which it was purchased, then it should not be written down to a nil selling price except where the item of stock is damaged or obsolete. Damaged or obsolete stocks should be written down as an expense and charged to the relevant SoFA line items(s) reflecting their intended use.

Disclosures

10.71. The notes to the accounts must disclose:

- the accounting policies adopted in measuring the value of stocks and, if applicable, work in progress and any cost formulae used
- the carrying amount of stocks and, if applicable, work in progress analysed between activities
- any charges for impairment or reversal of impairment losses
- the carrying amount of any stocks pledged as security for liabilities

B2: Debtors

10.72. Debtors include amounts owed to the charity for the provision of goods and services or amounts the charity has paid in advance for the goods and services it will receive. Debtors also include amounts receivable on grant funding. For more information refer to the SORP module 11 ‘Accounting for financial assets and financial liabilities’.

Disclosures

10.73. The notes to the accounts must set out, within the disclosure of accounting policies, the basis on which debtors are measured.

10.74. This SORP requires that the notes to the accounts must also provide an analysis of the amounts, including comparatives for the previous reporting period, of the following items:

- trade debtors
- amounts owed by group and associated undertakings

- prepayments and accrued income
- other debtors

10.75. If material to the disclosure of debtors, the amount of debtors recoverable more than a year after the reporting date, if not shown as a separate line on the balance sheet, must be separately disclosed in the notes to the accounts.

10.76. A lessor must disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

B3: Current asset investments

10.77. Current asset investments are:

- investments which a charity holds for resale or pending their sale
- cash or cash equivalents with a maturity date of less than one year that are held for investment purposes rather than to meet short-term cash commitments as they fall due

10.78. To be classified as a current asset, the charity should not intend to hold the cash or cash equivalents as part of its on-going investment activities for more than one year from the reporting date. However, cash and cash equivalents that are held from time to time as part of a fixed asset investment portfolio should be presented as part of fixed asset investments. Current asset investments which do not qualify as 'basic' financial instruments must be measured at their fair value. For more information refer to the SORP module 11 'Accounting for financial assets and financial liabilities'.

Disclosures

10.79. The notes to the accounts must explain, within the disclosure of material accounting policies, the basis on which current asset investments are measured and how the charity has defined any short-term, highly liquid investments as current asset investments.

10.80. This SORP requires that the notes must provide an analysis of amounts, including comparatives for the previous reporting period, of the following items included within current asset investments:

- cash equivalents on deposit
- investment properties held for sale (charities may opt to include any properties previously classified as investment properties which have been redesignated as held for sale)
- investment in group undertakings held for sale
- listed investments
- other investments

B4: Cash at bank and in hand

10.81. Cash at bank and in hand is held to meet short-term cash commitments

as they fall due rather than for investment purposes and includes cash equivalents held in the form of short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. A cash equivalent will normally have a short maturity of, say, three months or less from the date of acquisition.

Disclosures

10.82. The notes to the accounts must explain, within the disclosure of material accounting policies, how the charity has identified any short-term, highly liquid investments included as cash at bank and in hand, including cash equivalents.

C: Liabilities (C1 to C4) – classification and disclosures

10.83. A liability is a present obligation of the charity to transfer an economic resource as a result of past events. Typically, liabilities for charities are amounts due to creditors and any provision made as a result of an obligation to transfer economic resources, often in the form of a cash payment, to a third party. Obligations to transfer an economic resource also include obligations to deliver goods and services and obligations to transfer an economic resource if a specified uncertain future event occurs. For a charity, liabilities must be measured at their settlement amount except for certain types of financial liabilities. A liability is recognised for the amount that the charity anticipates it will pay to settle the debt or the amount it has received as an advance payment for goods or services it must provide.

10.84. A provision is a liability where the amount and/or timing of its settlement is uncertain (see SORP module 10A ‘Provisions, contingent liabilities and contingent assets and funding commitments’ and Section 21 Provisions and contingencies of FRS 102 for the recognition, measurement and disclosure requirements of provisions and contingent liabilities).

Disclosures

10.85. In the balance sheet, creditors and provisions must be analysed between:

- (C1) creditors: amounts falling due within one year
- (C2) creditors: amounts falling due after one year
- (C3): provisions
- (C4): lease liabilities (lessee) for liabilities

10.86. The notes to the accounts must explain, within the disclosure of material accounting policies, the basis on which creditors are recognised and measured.

10.87. A lessee must show any outstanding lease liabilities (C4) as a separate item in the balance sheet. Refer to module 10B ‘Lease accounting’ for more information.

10.88. A lessee that adopts the simpler accounting approach (as permitted by Section 20 of FRS 102) for short-term leases or leases of low-value assets must disclose separately the amount of its lease commitments for short-term leases and for leases of low-value assets at the end of the reporting period, for each of the following periods:

- not later than one year
- later than one year and not later than five years
- later than five years

10.89. This SORP requires that in the notes, creditors falling due within one year and after one year must be analysed between:

- accruals for grants payable
- bank loans and overdrafts
- trade creditors
- amounts owed to group and associated undertakings
- payments received on account for contracts or grants with performance related conditions
- accruals and deferred income
- taxation and social security
- other creditors

C5: Defined benefit pension scheme asset or liability

10.90. Charities that participate in a defined benefit pension scheme must refer to the SORP module 17 'Retirement and post-employment benefits' for the recognition, measurement and disclosure of defined benefit pension scheme assets and liabilities.

D: Funds of the charity (D1 to D5) – classification and disclosures

10.91. The assets and liabilities administered by a charity are referred to as its funds.

10.92. Charities must refer to the SORP module 2 'Fund accounting', which sets out the required disclosures for the separate funds a charity may hold. A charity may choose to disclose the amount identified in its reserves policy statement as its reserve fund under a sub-heading of its unrestricted funds provided that this amount is positive.

10.93. A revaluation reserve arises on the revaluation of an asset subsequent to its initial recognition. While a revaluation reserve will often form part of the unrestricted funds of the charity, any part of the reserve derived from the revaluation of assets held within a restricted fund must be shown as part of restricted funds.

10.94. Charities participating in a defined benefit pension scheme may show the

equivalent value of the pension asset or liability as a separate pension reserve. The pension reserve will often form part of the unrestricted funds of the charity. The circumstances when part of a pension reserve may be allocated to a restricted fund are set out in the SORP module 17 'Retirement and post-employment benefits'. In the case of those multi-employer pension schemes, where sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, the pension reserve may also include the value of any provision made to meet the obligation resulting from a funding agreement to make good a deficit related to a defined benefit pension scheme.

10A. Provisions, contingent liabilities and contingent assets and funding commitments

10A.1 The reporting tiers applied for Module 10A are as specified in the table below.

Table 10A.1: Tiered reporting for module 10A

All tiers	The requirements for provisions, contingent liabilities and contingent assets and funding commitments in this module apply fully to all charities.

10A.2 Charities should refer to Section 21 *Provisions and Contingencies* of FRS 102 for more information on the recognition and measurement (both initial and subsequent) of provisions and contingent liabilities and assets including the relevant disclosure requirements. Charities should also refer to Appendix A and paragraphs 34.57 to 34.63 of FRS 102 on the treatment of funding commitments.

10A.3 This module covers:

- Provisions, contingent liabilities and contingent assets
- Recognition and measurement of provisions
- Recognition of a funding commitment as a liability
- Accounting for onerous contracts
- Treatment of commitments not recognised as provisions or liabilities
- Disclosure of provisions and funding commitments
- Disclosure of contingent liabilities and contingent assets
- Prejudicial disclosures

Provisions, contingent liabilities and contingent assets

10A.4 A provision is a liability where the amount and/or timing of its settlement is uncertain.

10A.5 A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because:

- a transfer of economic benefit to settle the possible obligation is not considered probable; or
- the amount of the obligation cannot be estimated reliably

10A.6 A contingent asset is a possible asset that arises from a past event but is not recognised in the balance sheet. Its existence will be confirmed only by the

occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the charity. When the existence of the asset is considered virtually certain, it is no longer a contingent asset and must be recognised as an asset.

Recognition and measurement of provisions

10A.7 A provision must be recognised by a charity when:

- there is a present obligation (either legal or constructive) at the reporting date as a result of a past event
- it is probable (i.e. more likely than not) that a transfer of economic benefit, usually in the form of cash, will be required in settlement
- the amount of the settlement can be estimated reliably

10A.8 This module uses the term **liability** in a way that differs in some respects from the definition of a liability in paragraph 10.84 and the Glossary of this SORP, and paragraph 2.38 of FRS 102. For the purposes of this section, when it refers to provisions, a liability is a present obligation of the charity arising from past events, the settlement of which is expected to result in an outflow from the charity of resources embodying economic benefits (for more on initial recognition on provisions see paragraphs 21.4 to 21.6 of FRS 102).

10A.9 A charity must initially measure a provision at the best estimate of the amount required to settle the obligation or to transfer it to a third party at the reporting date. When calculating this amount, consideration must be given to:

- when the payments are likely to be made
- future events and uncertainties which may affect the amount required to settle the obligation

10A.10 Where the effect of the time value of money is material, the present value (i.e. the amount in today's terms) of the provision must be calculated using an appropriate discount rate. If the obligation is likely to be settled within a short period of time, it is less likely that the provision will need to be adjusted for the time value of money.

10A.11 The discount rate used must reflect the cost of money to the charity, its current assessment of the time value of money and the risks specific to the provision. Depending on the charity’s circumstances, the appropriate discount rate may be the market rate of interest at which the charity could borrow over the relevant time period or, if the charity has significant funds invested, the opportunity cost of income from investments foregone (for more on initial measurement of provisions see paragraphs 21.7 to 21.9 of FRS 102).

10A.12 Where provisions are discounted to present value, the discount must be 'unwound' at the discount rate in subsequent reporting periods. The unwinding of the discount must be treated as a financing cost in the statement of financial activities (SoFA). It must be allocated to the appropriate expense line item. For example, the unwinding of a discount resulting from a grant liability must be allocated to expenses incurred on charitable activities.

10A.13 Following initial recognition a charity must review the best estimate of a provision at each reporting date and adjust it to reflect the current best estimate of the settlement amount.

10A.14 A charity must review the likelihood of settlement of a provision at each reporting date following initial recognition. If a transfer of resources to settle the obligation is no longer considered probable, the obligation should no longer be recognised as a liability and must be reversed in the balance sheet. This will require a corresponding credit to the expense line item in the SoFA against which the provision was originally charged.

Recognition of a funding commitment as a liability

10A.15 The award of a grant is a non-exchange transaction. The decision to award a grant may create a funding commitment. This is recognised as a liability with a corresponding expense only when the definition and recognition criteria for a liability have been satisfied and:

- the criteria for an obligation (either legal or constructive) are met
- payment is probable
- the liability can be measured reliably
- there are no performance-related conditions attaching to its payment that limit its recognition. For more information on funding commitments see paragraphs 34.57 to 34.63 and Appendix A to Section 34 of FRS 102 and module 7 of this SORP

10A.16 Where a grant is payable over a period of more than one year, payments for later years may be subject to performance-related conditions and the donor charity may be able to legitimately withdraw from its commitment (if, for example, a particular condition attaching to the grant is not met). In this situation, the recognition of a liability is not required.

10A.17 Funding commitments can be made that give the funder the discretion to avoid future expenses based on their assessment of whether the performance-related conditions attached to the commitment will be met by the recipient. Where the donor charity retains the discretion to avoid the expense, a liability must not be recognised. For example, where a commitment is made to provide grant funding over a number of years,

future payments may be subject to a review by the donor charity which gives it discretion to terminate the funding agreement. Provided the performance-related condition and review process has been communicated to the recipient as part of the funding agreement and the review process has substance (i.e. the review has a potential impact on future payments), then the criteria for recognition of a liability are unlikely to be met.

10A.18 Alternatively, when there is no performance-related condition attached to the grant that allows the donor charity to realistically avoid the commitment, a liability for the full funding obligation must be recognised. Where the time value of money is material, the amount recognised as a liability must be discounted to present value.

10A.19 Not all terms attaching to a funding commitment create a situation that gives a donor charity discretion to withdraw from its funding obligation. For example, a term in a grant offer might relieve the donor charity from a future obligation in the event of a lack of funds at a future settlement date. Such a term does not allow the charity to withdraw from the funding commitment at the charity's discretion, therefore would not normally prevent the recognition of a liability and a corresponding expense (assuming payment of the grant is probable). The liability would only be derecognised (removed from the balance sheet) if a future event required the funding offer to be rescinded. Where a provision has been previously recognised, its removal (derecognition) must be made in the SoFA and deducted from the line item to which the expense was originally charged.

10A.20 Grant commitments may contain conditions that are outside the control of the donor charity. For example, a charity may promise a grant payment on the condition that the recipient finds matching funding. When a condition falls outside the control of the donor charity, a liability arises and expenditure must be recognised if the payment of the grant is probable.

Treatment of funding commitments not recognised as provisions or liabilities

10A.21 Not all funding commitments are recognised as liabilities or provisions. For example, where a grant offer is made, but there is uncertainty as to whether the recipient will be able to proceed with its proposal.

10A.22 If payment of a funding commitment is considered possible but not probable, a liability for the commitment must not be recognised. Instead, the funding commitment must be disclosed as a contingent liability. This requirement applies to funding commitments entered into within the current reporting period and to existing funding commitments for which payment was considered probable in a previous reporting period, but is considered possible rather than

probable at the end of the current reporting period. Where this occurs the liability that was recognised in the previous reporting period should be removed (derecognised) from the balance sheet in the current reporting period.

10A.23 It is important that charities disclose the existence of unrecognised commitments and explain how these will be funded.

10A.24 A charity may intend to use unrestricted funds held at the reporting date to meet a funding commitment and may decide to designate a portion of unrestricted funds for this purpose. This SORP permits the use of a designation in the notes to the accounts to identify that portion of unrestricted funds that have been set aside to meet the commitments. However, where activities are to be wholly financed from future income, existing unrestricted funds must not be designated for the purpose of financing such activities.

Accounting for onerous contracts

10A.25 Situations may arise where the unavoidable costs of fulfilling a contract exceed the expected economic benefit derived from it. Such a contract would be considered an onerous contract.

10A.26 If a charity has a contract that is onerous, the charity recognises and measures the present obligation under the contract as a provision. The unavoidable costs are the least net cost of exiting the contract, being the lower of:

- the cost of fulfilling it
- any compensation or penalties arising from failure to fulfil it, offset against any economic benefit that is derived from the contract

The cost of fulfilling a contract comprises the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling it.

10A.27 Routine purchase orders and contracts which can be cancelled by agreement without paying compensation should not be regarded as onerous. However, a charity must make a provision for a material loss-making contract which cannot be cancelled without the payment of compensation. If a charity identifies a contract as onerous, it must make an immediate provision for the unavoidable costs.

10A.28 A charity may choose to provide a level of service to its beneficiaries over and above the minimum requirements of a contract as part of its charitable activities. Any additional costs incurred in providing a level of service above contractual requirements do not create an onerous contract even when these costs cannot be recovered. Costs that are incurred on a discretionary basis from which the charity can withdraw should be excluded from any

assessment of whether a contract is onerous.

10A.29 Before calculating the provision for an onerous contract, the charity must undertake an impairment review of the fixed assets used in supplying the contracted service(s). For more information refer to the SORP module 12 'Impairment of assets'.

10A.30 A contract entered into on a full cost recovery or 'cost plus margin' basis is only likely to become onerous if unavoidable costs arise in meeting the contract that cannot be recovered under the terms of the contract.

Disclosure of provisions and funding commitments

10A.31 Charities must include a separate line item for provisions in the balance sheet (see paragraph 10.86 of this SORP).

10A.32 All charities must analyse the expenses resulting from provisions and recognised funding commitments across the appropriate lines(s) in the SoFA and disclose in the notes to the accounts:

(a) a reconciliation of the movements in provisions and funding commitments showing:

  i. the carrying amount at the beginning of the reporting period

  ii. additions during the reporting period, including adjustments that result from changes in measuring the discounted amount

  iii. amounts charged against the provision during the reporting period

  iv. unused amounts reversed during the reporting period

  v. the carrying amount at the end of the reporting period

(b) a brief description of the nature of the provision or commitment made and the expected amount and timing of any resulting payments

(c) an indication of the uncertainties about the amount or timing of those payments, including any performance-related conditions attached to recognised funding commitments

(d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement

Comparative information for prior periods is not required.

10A.33 For any funding commitment that is not recognised as a liability or provision, charities must disclose:

- details of the commitment made

- the time frame of that commitment
- any performance-related conditions attached to that commitment
- details on the sources of funding for how the commitment will be funded

10A.34 This SORP requires that if unrestricted funds have been designated to fund a commitment, the notes to the accounts must disclose:

- the nature of any amounts designated
- if not explained in the trustees' annual report, the likely timing of any payments

Disclosure of contingent liabilities and contingent assets

10A.35 Contingent liabilities must be disclosed unless the possibility of their existence is remote. Contingent assets must be disclosed when their existence is probable.

10A.36 The notes to the accounts must provide for each class of item:

- a brief description of each contingent item; and
- where practicable, an estimate of its financial effect

10A.37 Charities must, where practicable, also provide:

- an indication of the uncertainties relating to the amount or timing of settlement
- the possibility of any reimbursement

10A.38 If it is impracticable to make one or more of the disclosures in paragraph 10A.37, that fact must be stated

Prejudicial disclosures

10A.39 In extremely rare cases, disclosure of some or all of the information required by paragraphs 10A.31 to 10A.37 can be expected to prejudice seriously the position of the charity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such circumstances, charities must refer to paragraph 21.17 of FRS 102 for disclosure requirements.

10B: Lease accounting

Introduction

10B.1 The reporting tiers applied for module 10B are as specified in the table below.

Table 10B.1A: Tiered reporting requirements for module

All tiers	The requirements for presentation and disclosure of leases in this module apply to all charities.

10B.2 This module aims to cover the most common types of transactions that charities enter into but for more information, charities should refer to Section 20 Leases of FRS 102.

10B.3 A lease is a contractual agreement between the charity and another party for the use of an asset, usually property, plant or equipment for an agreed lease term in exchange for an agreed series of payments. The party granting the lease is called the lessor and the lessor makes the lease to the party making use of the asset, the lessee.

10B.4. Section 20 of FRS 102 excludes certain lease agreements. These lease agreements are accounted for in accordance with the relevant sections of FRS 102.

10B.5. With the exception of rights held by a lessee under licensing agreements within the scope of Section 18 Intangible Assets other than Goodwill of FRS 102, Section 20 of FRS 102 may be applied to leases of intangible assets but is not required to be.

10B.6. As a lessee there is no longer a distinction between lease agreements that transfer all the risks and rewards of ownership of the asset (finance leases) and lease agreements that do not (operating leases). There is now a single accounting treatment for lessees. Under the new approach the lessee recognises, at the commencement of the lease, an asset and a liability with part of the consideration being paid to the lessor treated as a cost of financing the arrangement. The distinction between finance leases and operating leases is retained for lessors.

10B.7. In recognition of the complexity of lease accounting, Section 20 of FRS 102 provides recognition exemptions for those leases that meet the definition of short-term leases, and leases of low value assets. By opting to take a recognition exemption where available, lessee charities can adopt a simpler accounting approach and treat payments made under short-term leases and leases of low value assets as expenses on a systematic basis over the lease term in a similar way to operating lease arrangements. Lessees may wish to refer directly to the relevant sections of this module at paragraphs 10B.15 to 10B.20.

10B.8. Lease accounting involves a number of terms and familiarity with these is important in order to understand the approach to lease accounting. These terms are:

- Commencement date is the date on which a lessor makes an underlying asset available for use by a lessee.
- Lease liability is the liability recognised at the commencement date by a lessee measured at the present value of the lease payments that are not paid at that date discounted using the interest rate applicable to that lease.
- Right-of-use asset is an asset that represents a lessee's right to use an underlying asset for the lease term.
- Interest rate implicit in the lease is the rate of interest that causes the present value of the lease payments and the unguaranteed residual value, to equal the sum of the fair value of the underlying asset and any indirect costs of the lessor.
- Lease term is the aggregate of: (a) the non-cancellable period of a lease; (b) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and (c) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
- Licence agreement is a term used in this SORP to describe an arrangement that allows temporary (a period of 12 months or less), non-exclusive, use of an asset.
- Low value asset is where in a lease arrangement, the underlying asset is of low value on an absolute basis, regardless of whether such leases would be material to the lessee. The value of lease payments has no bearing on the assessment of whether an underlying asset is of low value.
- Social donation lease is defined in this SORP as a lease where the lessor chooses to accept a lower rent for the philanthropic intention of providing a benefit to a public benefit entity.
- Short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less. (A lease that contains a purchase option is not a short-term lease.)
- Peppercorn arrangements – in this SORP such arrangements are considered to have the legal form of a lease, but with nil or nominal consideration and are unlikely to meet the FRS 102 definition of a lease but are considered therefore to be a form of non-exchange transaction.

10B.9. An important feature of a lease is that the lessee has a contractual right to control the use of the asset for the term of the lease. This right of control prevents another party from using the asset at the same time except with the lessee's consent.

10B.10. Section 1 of FRS 102 sets out how charities should apply the requirements of Section 20 of FRS 102 for the first time to ease the introduction of the new requirements. Charities must refer to that section of FRS 102 for further detail.

How to use this module

10B.11. This module firstly sets out how to determine whether or not a lease exists. If not, the requirements of Section 20 of FRS 102 do not apply.

10B.12. Where a lease does exist, the charity must then identify the commencement date and lease term. Following that, it can then consider whether the recognition exemptions provided by Section 20 of FRS 102 apply to the arrangements it has. If so, and a decision is made to apply a recognition exemption, further consideration of this module will be limited in respect of those arrangements. The recognition exemptions are explained in paragraphs 10B.15 to 10B.20.

10B.13. Where a lease does exist and a recognition exemption is not applicable or utilised, further consideration of the remainder of the module will then be required. The module goes on to explain the recognition and measurement of leases from the viewpoint of the lessee and then from the viewpoint of a lessor.

10B.14. To assist users of the SORP navigate the sections of this module relevant to them, each section is shown in Table 9.

Table 9: Elements of accounting for leases

Topic	Module paragraph(s)
Recognition exemptions	10B.15 to 10B.20
Lessee and Lessor accounting:	
Identifying a lease agreement	10B.21 – 10B.34
Commencement date and lease term	10B.35 – 10B.40
Separating the components of an agreement	10B.41 – 10B.42
Lessee accounting:	
Lease elements and recognition	10B.43 – 10B.55
Subsequent measurement of the right-of-use asset	10B.56 – 10B.59
Subsequent measurement of the lease liability	10B.60 – 10B.61
Reassessments of a lease after the commencement date	10B.62 - 10B.65

Lease modifications	10B.66 - 10B.67
Arrangements below market rate or for nominal amounts	10B.68 - 10B.73
Nominal or peppercorn arrangements	10B.74 - 10B.77
Social donation leases and non-exchange components of a lease	10B.78 - 10B.84
Lease incentives	10B.85
Provisions for dilapidation or similar costs of making good	10B.86 - 10B.87
Adjustments to lease payments for work carried out by a lessee	10B.88
Sale and leaseback transactions	10B.89
Lease liabilities and the identification of reserves	10B.90
Transition to accruals accounting for leases	10B.91 - 10B.92
Disclosure of lease obligations	10B.93 - 10B.103
Lessor accounting:	
Identifying whether a lease is a finance lease	10B.104 - 10B.110
Accounting for finance leases	10B.111 - 10B.113
Subsequent measurement post recognition	10B.114 - 10B.115
Lease modifications	10B.116 - 10B.117
Operating leases recognition and measurement	10B.118 – 10B.121

Subsequent measurement post recognition	10B.122
Lease modifications	10B.123
Leases as a social investment	10B.124- 10B.126
Sale and leaseback transactions	10B.127
Lessor disclosures	10B.128- 10B.133

Recognition exemptions

10B.15. Before applying lease accounting to the leased assets, the charity's trustees should consider the options offered by Section 20 of FRS 102 and decide whether these apply and whether they wish to exercise an accounting policy choice and take them up.

10B.16. Section 20 of FRS 102 provides exemptions which cover short-term leases and leases involving low-value assets. If an exemption is used, then the lease payments are recognised as an expense on either a straight-line basis over the lease term or on an alternate basis reflecting the pattern of benefit to the charity from using the asset. Application of the recognition exemption for short term leases is to the class of underlying asset - leases where the assets are of similar character, however application of the recognition exemption for low value assets is done by reviewing each lease in turn.

10B.17. Short-term leases are defined as having at the commencement date, a lease term of 12 months or less (FRS 102 Appendix 1 Glossary new definition). However, if there is a purchase option then it cannot be treated as a short-term lease.

10B.18. For an asset to be classed as a low value asset, it cannot be highly dependent on, or highly interrelated with, other assets and it must be capable of use on its own or together with other resources that are readily available to the lessee. This option can be taken even if the item might otherwise be viewed as material to the charity as it is the asset that is considered low value. Section 20 of FRS 102 provides examples of assets that cannot be viewed as low value; these include the lease of cars, vans and lorries, boats, production equipment and land and buildings. This is not an exhaustive list however and judgement must be exercised.

10B.19. Examples of low value assets would typically include personal computers, tablet devices, small items of office furniture and telephones.

10B.20. The disclosure requirements applicable where a charity has applied a recognition exemption are set out in paragraph 10B.100.

Identifying a lease agreement

10B.21. As a practical expedient, a charity may initially wish to consider whether a recognition exemption could apply and if so whether it would wish to apply that exemption to an agreement it has in place for the use of an asset. Where a recognition exemption would not apply or a charity would be unlikely to choose to apply a recognition exemption where it is relevant, the first step is to identify whether an agreement for use of an asset is a lease.

10B.22. A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration (Appendix 1 Glossary FRS 102 revised definition). The lease contract will normally be documented and communicated in writing. Where there is a lack of clarity in the wording or in the terminology used, the charity may need to exercise judgement to determine substance over form in differentiating a lease agreement from a licence agreement. For a contract to be a lease the identifying features of a lease must be present.

10B.23. The identifying features of a lease contract are:

- A contractual agreement is agreed by the parties for the identified asset.
- The contract may specifically identify the asset or the asset may be implicit when it is made available for use by the lessee
- The agreement gives the lessee the right to control the use of an identified asset. The agreement does this when the lessee has both the right to:
  - direct the use of the identified asset, and
  - obtain substantially all the economic benefits from that use
- There will be a commencement date when the lessee obtains the right of control over the asset from the lessor
- There will be a period of use specified when the lessee has the right of control over the asset. This can be viewed in terms of time or amount of use of an identified asset. For example, where an identified asset is a piece of equipment the amount of use could be the number of units of a product that the asset will be used to produce.
- There are payments due by the lessee to the lessor for the right of control over the asset

10B.24. In some instances it may be appropriate to combine two or more lease contracts that were entered into at or near the same time with the same lessor and treat them as though they were a single contract. Section 20 of FRS 102 requires contracts to be combined where one or more stated criteria are met.

Identified asset

10B.25. For an identified asset to exist, the supplier must not have a substantive right to substitute the asset throughout the period of use. A right to substitute is substantive only where the supplier has both the ability to substitute alternative assets throughout the period of use and would benefit economically from doing so.

10B.26. A portion of an asset can be an identified asset if it is physically distinct, e.g. a floor of a building. A portion of an asset that is not physically distinct can

only be an identified asset where it represents substantially all the capacity of the asset and therefore provides the lessee with the right to obtain substantially all of the economic benefits from the use of the asset.

The right to control the use of the asset

10B.27. The right to control is where the lessee has both the right to direct the use of the identified asset and the right to obtain substantially all of the economic benefits from that use throughout the lease term (period of use). These benefits include the ability to generate cash or further the charity's objects.

10B.28. For example, a charity may lease a building or another asset and during the term of the lease the trustees decide on how the asset will be used to further the charity's purposes and direct the activities that are carried out using the asset, including to what extent, if any, it allows others to make use of the asset. If the asset were a building this could be by way of renting out space or subletting space in it to others.

10B.29. A charity has the right to direct the use of an identified asset throughout the period of use only if either:

- the charity has the right to direct how and for what purpose the asset is used throughout the period of use, in a manner that affects the economic benefits derived from its use; or
- the relevant decisions about how and for what purpose the asset is used are predetermined and:
    - the charity has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
    - the charity designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

10B.30. An example of a predetermined purpose would be a machine for drilling wells to source water that is developed for the particular conditions in the locality and which cannot be readily adapted for an alternate use. A custom design would include a new building designed by the charity for its specific needs which the charity leases from the developer.

10B.31. An example of a lease agreement is a vehicle leasing agreement where the lessor grants the charity as lessee, the right to control the use of the vehicle for a term of three years. During the three years, the charity has the right to direct the use of the vehicle and the right to obtain substantially all the economic benefits from that use. At the end of the term the charity has no right to buy the vehicle and must return the vehicle in an agreed condition to the lessor. The lessor assumes control over the vehicle and can then choose whether to lease it out again or dispose of it.

10B.32. Another common example is a charity leasing space in the form of a whole building or one or more floors of a building to carry out some of its charitable activities. The lessor grants the charity the right to use the space in the building for an agreed lease term, say 10 years, at the end of which the charity as lessee must give up its right of control and vacate the building

leaving the building or leased space in an agreed condition. During the 10 year term, the charity has the right to direct the use of the building or leased space and the right to obtain substantially all the economic benefits from that use. The lessor regains control over the building or space in the building which it can then lease to a new occupier.

10B.33. Following consideration of the arrangements that the charity has, where the charity determines that a lease does not exist, the requirements of Section 20 of FRS 102 do not apply and the charity should treat the payments made under the arrangement as an expense over an appropriate basis over the term of the arrangement.

10B.34. Where the charity has determined that a lease does exist, the next step is to identify the commencement date and lease term.

Identifying the commencement date and lease term – for lessees and lessors

10B.35. The commencement date is the date on which a lessor makes an asset available for use by the charity and includes any rent-free periods provided to the charity by the lessor.

10B.36. Determining the term of a lease involves exercising judgement where there are options to extend or terminate the lease.

10B.37. At the commencement date, an assessment must be made of what the term of the lease is. The term comprises the non-cancellable period and any additional period which the lessee is reasonably certain to choose to lease the asset.

10B.38. Section 20 of FRS 102 sets out five factors that are expected to be considered when assessing whether an option in a lease is reasonably certain to be exercised which impacts on the term of the lease:

- the contractual terms and conditions compared with market rates
- significant leasehold improvements expected to have significant economic benefit when the option becomes exercisable
- the costs relating to the termination of the lease
- the importance of the underlying asset to the lessee's operations
- conditionality associated with exercising the option

There may also be other relevant factors to consider.

10B.39. Regard should be had for the existence of break clauses and the effect these may have in identifying the non-cancellable lease period. A break clause in a lease contract enables the lessor, the lessee or both to terminate the lease early before the fixed term ends provided the agreed period of notice is given and any conditions met. For example, a charity agrees to lease a building for 25 years with options at the end of years 10 and 20 to terminate the lease. The contract also affords the opportunity for the charity to extend the lease for a further 5 years. The non-cancellable period is therefore the first 10 years. If the charity trustees are reasonably certain that they would not exercise the option to terminate the lease after 10 years but

are not reasonably certain that they would not exercise the option to terminate the lease after 20 years, perhaps because they are fundraising to buy their own building, then the term is assessed to be 20 years in total. However, if the charity trustees are reasonably certain that they will remain for the full 25 years and are also reasonably certain that, barring unforeseen events, they will exercise the option to extend the lease, then the term is assessed as 30 years.

10B.40. If only the lessor has the option to terminate the lease, then the term is for the full period set out in the lease agreement. Taking the example of the 25-year lease on the building with an option to extend for 5 years, if the options to terminate the lease after 10 and 20 years can only be exercised by the lessor but not the charity, the non-cancellable period, is assessed as the 25 years specified in the agreement.

Separating the components of an agreement

10B.41. Some agreements may combine the leasing of an asset with other non-lease elements, for example the provision of cleaning, catering or office-related services. In these circumstances the non-lease components of the agreement and their related charges or fees must usually be accounted for separately.

10B.42. The lessee must identify the stand-alone price of the lease and non-lease components using information in the contractual agreement or knowledge of the prices charged by the lessor or similar supplier for the non-lease components. If this information is unavailable, then the price of each component can be estimated. As a practical expedient, Section 20 of FRS 102 permits a lessee to elect, by class of underlying asset, to account for the components as a single lease component.

Accounting for leases as a lessee

10B.43. Once a charity has established that a lease agreement exists, along with its commencement date and lease term and a recognition exemption is not being applied, the charity must proceed to recognise, and therefore measure it.

Lease elements and recognition

10B.44. On initial recognition, the lessee must measure the right-of-use asset at cost and measure the lease liability. The lessee will need to identify the interest element of the lease arrangement. This is necessary because the charity benefits from the use of the asset over the lease term and so the economic benefit gained and the associated cost needs to be attributed to each reporting period over the term of the lease.

10B.45. The calculation is normally done lease by lease but if the charity has a number of leases with similar characteristics, then a portfolio approach can be taken with estimates and assumptions applied at the aggregate portfolio level. These estimates and assumptions must reflect the size and composition of the portfolio.

10B.46. An example of a portfolio might be a charity leasing a fleet of similar sized vehicles for the same period of time to use for delivering aid to beneficiaries. The potential simplifications this offers includes the assessment made of lease terms, the assumptions used in calculating the right of use and associated liability and calculating the ongoing charges for depreciation on the right-of-use asset. However, a portfolio approach can only be taken where the leases have similar characteristics such as having a similar term and being with the same lessor.

10B.47. A charity undertakes to lease an asset to gain a capability, whether it is the capability of occupying a building or space in a building or having the ability to use the capacity of an asset such as equipment or a vehicle to undertake its activities. The right of use represents the economic value that the charity as lessee has in having control over the asset for the term of the lease. Although the charity does not own the asset it enjoys the economic benefits during the lease term just as it would were it to have owned the asset or a similar asset.

10B.48. Measuring the right of use involves calculating the cost. The cost comprises several components:

- the initial measurement of the lease liability assumed upon entering into the lease
- adjustments for any lease payments made at or before commencement date less any lease incentives received. Lease incentives include costs of agreed enhancements or improvements undertaken by the charity as lessee where these costs are assumed by the lessor
- any initial direct costs incurred by the lessee in taking up the lease
- allowance for the expected dilapidation or similar costs of making good in order to return the asset in an agreed condition to the lessor at the end of the lease term (refer to paragraph 20.47(d) of FRS 102)
- an adjustment for any non-exchange transaction component (see paragraphs 10B.78 to 10B.84)

10B.49. The initial lease liability is not measured by simply counting the total amount of money (or consideration) payable to the lessor by the charity over the lease term as an allowance is made for the time value of money.

10B.50. Measuring the lease liability involves calculating the present value of the lease payments due after the commencement date using an interest rate. This is similar to identifying the principal sum advanced when taking out a loan. The charity must identify the rate most appropriate to its circumstances from the permitted options.

10B.51. The default is if the charity can readily determine the interest rate implicit in the lease, then this must be used. The lessor might be willing to advise the charity of the discount rate that it is using in respect of the lease. Where this cannot be readily determined, then the charity can choose the most appropriate of the following permitted options:

- the charity's incremental borrowing rate which is defined as the rate of interest a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment (Appendix 1

Glossary FRS 102 revised definition). (A charity already borrowing money for another purpose may be able to ask their bank for this information)
- the charity's obtainable borrowing rate which is the rate of interest the charity would have to pay to borrow, over a similar term, an amount similar to the total undiscounted value of the lease payments to be included in the measurement of the lease liability (Appendix 1 Glossary FRS 102 new definition)

10B.52. Where a charity is unable to readily determine either the interest rate implicit in the lease, or the charity's incremental or obtainable borrowing rate, the charity is required to use the rate of interest that it could otherwise obtain on deposits held with financial institutions. This might be the option most suitable for charities that never or seldom borrow money.

10B.53. Measuring the finance component of the lease payments involves identifying the total amount to be paid or expected to be paid after the commencement date over the term of the lease and applying the interest rate to work back to the lower value representing its cost. The value of the lease payments comprises the following payments that are not paid at the commencement date:

- fixed payments less any lease incentives receivable
- variable lease payments that depend on an index or rate (using the index or rate values as at the commencement date)
- amounts, if any, expected to be payable by the lessee under residual value guarantees
- the exercise price, if any, of a purchase option if the lessee is reasonably certain to exercise that option
- anticipated payments of penalties for terminating the lease if the lease term reflects the lessee exercising the option to terminate the lease

10B.54. Payments made at the commencement date or prior to it are part of the cost of the right of use asset, but because these amounts have already been paid they are not part of the lease liability.

10B.55. This SORP requires lease liabilities to be shown as a separate item on the balance sheet. Refer to module 10 for more details.

Subsequent measurement of the right-of-use asset

10B.56. The charity must measure the right-of-use asset using the cost model, except for investment property or if the revaluation model is being used for property, plant and equipment.

10B.57. The cost model involves adjusting the carrying amount of the right-of-use asset by a deduction for accumulated depreciation and impairment losses and, where appropriate, any adjustment for any remeasurement of the lease liability. Depreciation is calculated using the same approach as that specified in SORP module 10 for fixed assets. Similarly, an assessment for impairment is made in accordance with SORP module 12. The economic life of the right-of-use asset is taken from the commencement date to the earlier of the end of its useful life or the end of the lease term. The exception to this is where either at the end of the lease term ownership of asset transfers to

the charity or the charity, in calculating the initial cost, has decided it is reasonably certain to exercise the option to purchase it. In this case depreciation is over the underlying asset's useful life.

10B.58. Depreciation charges and impairment losses are accounted for as items of expense.

10B.59. In respect of right-of-use assets held for investment purposes refer to SORP module 10 and for the revaluation model also refer to SORP module 10.

Subsequent measurement of the lease liability

10B.60. The carrying amount of the lease liability is increased by the interest charge for the period and reduced by the lease payments made and, if appropriate, adjusted to reflect modifications to the lease or a change in fixed lease payments due. The interest rate applied is determined at the commencement of the lease except where subsequent modifications to the lease require a new interest rate to be determined. Such modifications include agreed changes to the lease term, or a change in the decision about whether to exercise an option to purchase the asset.

10B.61. The interest charge on a lease liability and any variable lease payments not included in the measurement of the lease liability are accounted for as items of expenditure.

Reassessments of a lease after the commencement date

10B.62. Adjustments must be made to the carrying amounts of the right-of-use asset and related lease liability where changes to the lease affect the lease term and/or lease payments. If this happens there is a reassessment of the carrying amount.

10B.63. The required adjustment made to the lease liability is reflected in an adjustment to the right-of-use asset. When a reassessment of the lease liability is made, the interest rate must be reviewed to reflect the adjusted lease term and the prevailing economic conditions. The reassessment should consider any changes to any residual value guarantee or changes due to a market rental rate review or because of an index being applied to the scheduled payments.

10B.64. For example, if at the commencement date the charity had not been reasonably certain that it would exercise an option to extend the lease but subsequently changed that decision and exercises this option, then this is a variation to the lease term.

10B.65. If at the time of reassessment, the carrying amount of the right-of-use asset is reduced to nil and there is a further reduction in the lease liability, this adjustment is included in the other gains and losses section of the Statement of Financial Activities (SORP module 4).

Lease modifications

10B.66. In some circumstances a change counts as a modification to a lease. Some modifications must be treated as a separate lease. Reference must be made to Section 20 of FRS 102 where this situation arises. This is a change not in the original terms of the lease and it includes a change of scope, change of payments due, adding or terminating the right to use one or more underlying assets or shortening or extending the contractual lease term. A modification must be treated as a separate lease if both of the following apply:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets
- the consideration payable under the lease increases by an amount commensurate with the stand-alone price of the underlying assets included in the increase in scope

10B.67. For lease modifications that are not required to be treated as a separate lease, the charity must identify the effect the lease modification has on the components of the lease and reassess the lease liability and the interest element of the lease arrangement. The charity must remeasure the lease liability by discounting the revised lease payments using a revised discount rate determined at the effective date of the modification unless any additional consideration payable is insignificant, decreases the scope of the lease or reduces the amount of consideration payable.

Arrangements below market rate or for nominal amounts

10B.68. Certain lease arrangements are entered into for amounts that are nominal or below market rate. In some cases, such arrangements may be viewed as not having commercial substance or may not be intended to generate a commercial return to the lessor, but instead are arrangements serving a social purpose. Under these arrangements, the payments due may be:

- at nil value;
- of nominal value; or
- significantly below market rates but greater than a nominal amount

10B.69. The intention of a lessor which is a charity in such an arrangement would be to further its own charitable purpose(s). It may do this by making the asset available to:

- another charity;
- a beneficiary; or
- another party with aligned objects that is facilitating assistance to beneficiaries.

10B.70. In the case of a lessor which is a non-charitable organisation, the intention may be to make the asset available to a charity to use with the aim of furthering the charity's purposes. The lessor may be a government or public authority seeking to further a social purpose.

10B.71. In either case the payment due by the lessee allows the lessor to retain its underlying right of ownership and/or to maintain influence over the use of the asset through the terms of a lease.

10B.72. A charitable or social purpose of the lessor may lead to restrictive conditions or covenants that govern how the lessee exercises its right of use over the asset. For example, a ban on serving or consuming alcohol on the premises or a restriction that permits the asset only to be used by a specific faith group for a faith related activity. This can result in the payments due under the arrangement being low or for a nominal amount. However, the effect of such restrictions may mean that the payments are actually at market rate. Charities with such arrangements will need to consider whether the payments they make can be reasonably considered to be of nominal value or are actually at market rates as this affects how such arrangements are accounted for.

10B.73 Where the intention of the lessor is unclear or the lease is not granted to further a social or charitable purpose, the charity must have regard to substance over form to determine if the lease is classified as having a non-exchange component. An apparently low lease payment may be indicative of:

- an asset in a poor condition
- an asset offered for a significantly restrictive use

In such situations, the payments due over the lease term fairly reflect the market value of the asset and the lease is unlikely to have a non-exchange component.

Nominal or peppercorn arrangements

10B.74. Typically, leases granted for only a nominal amount are known as peppercorn or nominal consideration arrangements.

10B.75. While these arrangements may have the legal form of a lease, it is unlikely they will meet the definition of a lease under FRS 102 as the payments due are likely to be very small or there may be no payment due. Any nominal payments that are made are treated as an operating expense. Such arrangements are outside the scope of Section 20 of FRS 102.

10B.76. Where such arrangements do not meet the definition of a lease under FRS 102, in addition to accounting for the nominal payments due under such arrangements, charities need to consider the benefit that is being received and how that should be measured and accounted for. Module 6 should be referred to for further information on how to account for donated assets, services and facilities. It may be helpful to consider for instance:

- In the arrangement, is it an asset, facility or service that the charity is benefitting from?
- What use is the charity going to make of the asset, facility or service?
- Would the charity have purchased the asset, facility or service if the nominal arrangement had not been made?

- Has the charity in substance been gifted an asset for ongoing use in the delivery of its charitable activities? This may depend on the remaining useful life and the term of the arrangement. In addition, the absence of a break clause, rent review clause or rent escalator may indicate that the transaction is, in substance, a gift when coupled with other factors.
- Is the asset in the arrangement a heritage asset? SORP Module 18 provides details about how to account for heritage assets.

10B.77. The charity must consider the substance of the arrangement and how to account for it. Consideration of the use of the asset, facility or service and whether the charity would have purchased it if the nominal arrangement had not been entered into will be helpful. For example:

- If the arrangement means that an asset is available to the charity to use to carry out its charitable activities, the charity will need to identify the fair value of that asset and account for a donated asset in line with the treatment described in SORP module 6.
- If the arrangement means that a facility or service is now available to the charity, the value to the charity of the facility or service is used and a donation recognised for that amount. Details about the donation of facilities and services can be found in SORP module 6.

Social donation leases and non-exchange components of a lease

10B.78. Lease arrangements where the payments are below market rate but are higher than a nominal amount as a result of the lessor choosing to accept a lower rent for the philanthropic intention of providing a benefit to the lessee are social donation leases. A charity may enter into a social donation lease either as a lessee or lessor.

10B.79. A charity lessee must use the information readily available to it to determine whether it is party to a social donation lease. This could include:

- information provided by the lessor about the discount or reduction in lease payments being given to the charity
- information about the lease payments for very similar assets made by lessees who are not charities

In most cases it is expected to be reasonably obvious to the charity if there is a social donation lease.

10B.80. Social donation leases, by definition, contain a non-exchange component. Where a charity determines that it is party to a social donation lease, it must consider the nature of the incoming resources as this determines how to measure them. In some cases the incoming resource may be in effect the donation of an asset, whose fair value the charity is able to fully exploit. However, in many cases the incoming resource may be in effect the donation of a service or facility.

10B.81. The measurement of the non-exchange component will take into account the lease payments that are actually made and:

- Where the incoming resource is an asset, the fair value of that asset; or
- Where the incoming resource is a service or facility, the value of that service or facility to the charity .

10B.82. The value of the incoming resources from the non-exchange component is recognised as part of the cost of the right-of-use asset (see paragraph 10B.48) when the resources are received or receivable. The charity recognises the related income at the same time, assuming there are no performance-related conditions (which are considered unlikely in such lease arrangements). Where performance-related conditions do exist, the charity recognises the income when the performance-related conditions are met. Refer to SORP modules 5 and 6 for information about the recognition of income from non-exchange transactions.

10B.83 The incoming resources from the non-exchange component forms part of the cost of the right of use asset. This increases the value of the asset being included on the charity's balance sheet. As a result, the depreciation charges for the right of use asset will be greater than they would otherwise have been if the non-exchange component had not been recognised. The lease liability is the present value of the actual payments due to the lessor subsequent to the commencement date. The initial lease liability is consequently lower than the initial value of the right-of-use asset.

10B.84. The terms of the arrangement and information that is available to the charity as the lessee will determine the accounting for the arrangement. This can be best illustrated by way of examples based on a common set of facts with some critical variations as follows:

Common facts:

A charity enters into an agreement to use one floor of a five-storey office building for three years. The other four floors are occupied by the lessor, a commercial business. The market rent for this floor is £120,000/year.

Table 9A: Example accounting treatments

	Additional facts	**Accounting treatment**
Example 1	The lessor states that as part of its corporate social responsibility activities, it will give the charity a 50% discount on the office space, so the charity will pay £60,000/year instead. If the arrangement not been available, the charity expected to pay £72,000/year for office space elsewhere.	The information available to the charity indicates there is a non-exchange component in the lease. Where the charity determines that it is a facility it has received under this arrangement, it is the value to the charity of the office space that is important. The non-exchange component is £12,000/year - the difference between the value to the charity and the payment being made. Assuming no performance-related conditions exist in the

		arrangement, the charity will recognise the income when it is received or receivable. This will usually be at the commencement of the lease but may be over the term of the lease depending on the terms of the arrangement. Refer to SORP module 6 for more guidance.
Example 2	The lessor states that as part of its corporate social responsibility activities, it will allow the charity to use the office space for a nominal consideration of £10/year. Had this arrangement not been available, the charity expected to pay £72,000/year for office space elsewhere.	The payments made by the charity are very small so the arrangement does not meet the definition of a lease as there is no substantive consideration being paid. The availability of the facility to the charity is treated as a donation of £71,990 per year – the value to the charity less the consideration paid. This is further explained in SORP module 6.

Lease incentives

10B.85. Lease incentives are payments made by the lessor to the charity as an inducement to enter into the lease or a reimbursement or assumption (taking on) of costs by the lessor which the charity would otherwise have to meet that relate to taking on the lease (Appendix 1 Glossary FRS 102 revised definition). Incentives might include reduced payments for the first few years, rent free periods, or the lessor reimbursing the professional surveyor or legal fees associated incurred by the charity in taking on the lease. The economic effect of incentives is to reduce the consideration paid for the lease which is reflected in the value of the right-of-use asset and in the calculation of the lease liability and discount rate.

Provisions for dilapidation or similar costs of making good

10B.86. At the commencement date the charity must consider whether a provision needs to be recognised for the expected costs of making good the asset so that it is returned in the agreed condition at the termination of the lease (referring to SORP module 10A and Section 21 of FRS 102). Where a provision is required, it must estimate the likely cost and recognise that as a provision which must be presented separately on the balance sheet. The amount of any initial provision made is included in the value of the right-of-use asset.

10B.87. Any provision made is subsequently reviewed at each balance sheet date and any adjustment is treated either as impairment loss or a reversal of impairment as appropriate. Please refer to Module 10A on Provisions, Contingent Liabilities and Contingent Assets for more information.

Other considerations:

Adjustments to lease payments for work carried out by a lessee

10B.88 In certain cases the lessor may adjust the payments due under the lease in recognition of the agreed work to be undertaken by the charity as lessee. For example, a charity may enter into a lease for a dilapidated asset such as a building on the understanding that it would make improvements and/or undertake works to the building to bring it into a better state of repair in exchange for a low rent. A judgement needs to be made as to whether the lease is:

- a peppercorn arrangement because the state of the asset is so poor that it is not commercially viable – the payments made by the lessee are treated in line with paragraph 10B.75;
- an arrangement that does not meet the definition of a lease in FRS 102, perhaps due to a lack of commercial substance meaning the payments made by the lessee are treated in line with paragraphs 10B.33 and 10B.76 to 10B.77;
- a social donation lease made for a social purpose because the lease payments are below those that would have otherwise been demanded for the asset even in its current state – refer to paragraphs 10B.78 to 10B.84 for the accounting treatment: or
- a market lease whereby the lessor is anticipating a higher lease rental for subsequent lease agreements as a result of the agreed works to be undertaken by the charity – the charity should follow the requirements for a lessee set out in paragraphs 10B.35 to 10B.65.

Sale and leaseback transactions

10B.89. Charities involved in sale and leaseback transactions must refer to Section 20 of FRS 102 for the accounting treatment that must be followed.

Lease arrangements and the identification of reserves

10B.90. Charities should consider the implications of lease arrangements on the calculation of reserves and refer to SORP module 1 for more information.

Transition to accruals accounting for leases

10B.91. Section 35 of FRS 102 sets out the transitional arrangements that apply when first adopting FRS 102. For charities, this would occur when preparing accruals accounts for the first time. In respect of leases the lessee must:

- identify the lease arrangements in place at the date of its transition to lease accounting based on the facts and circumstances as at that date rather than the earlier commencement date specified in the lease agreement
- measure the lease liability as the present value of the remaining lease payments with the right-of-use asset measured at an amount equal to the lease liability adjusted for any amount prepaid or accrued for lease payments. This does not apply for investment property
- measure investment property held on a lease at fair value

10B.92. Section 35 of FRS 102 also permits the concessions for short-term leases to be taken if the lease ends within 12 months of the date of transition. Also, hindsight can be used in determining the lease term, for example regarding exercising options under the lease. A portfolio approach can also be taken for similar leases.

Disclosure of lease obligations

10B.93. A charity must provide a general description of its significant leasing arrangements.

10B.94. Where necessary to enable users to understand its significant leasing arrangements, all charities must provide additional qualitative and quantitative information. As a minimum, when relevant, a charity must disclose:

- information about future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities, including variable lease payments, extension options and termination options, residual value guarantees and leases not yet commenced to which the lessee is committed
- information about restrictions or covenants imposed by leases
- the types of discount rate (interest rate implicit in the lease, lessee’s incremental borrowing rate or lessee’s obtainable borrowing rate or where none of these can be readily determined, the rate of interest otherwise obtainable by the charity on deposits held with financial institutions) used in calculating lease liabilities and the proportion of the total lease liability calculated using each of those types of discount rate
- information about sale and leaseback transactions including all the disclosures required by Section 20 of FRS 102

10B.95. Where a charity has any leases classified as social donation leases or peppercorn arrangements, this SORP requires the charity to provide a general description of the lease term, the remaining term if not a perpetual lease, any restrictions or conditions as to the use of the right-of-use asset and the presence of any reversion clauses. In addition, where a charity has incoming resources from a non-exchange transaction as part of a social donation lease, it must fulfil the disclosure requirements set out in paragraph 6.32 of this SORP in respect of those resources and where key judgements have been made by the charity in applying the relevant accounting policies to those resources, the disclosure requirements set out in paragraph 3.54 of this SORP must also be followed.

10B.96. A charity that has either applied the portfolio approach to accounting for leases or for expediency included non-lease components associated with a lease and the lease as a single lease component must disclose taking these accounting treatment options.

10B.97. A charity that has remeasured a lease liability as a result of a lease modification and has used an unchanged discount rate, must disclose:

- that fact
- the carrying amount at the end of the reporting period of lease liabilities which have been remeasured in that manner

10B.98. All charities must disclose the following amounts for the reporting period:

- interest expense on lease liabilities
- the expense relating to short-term leases if applying the relevant recognition exemption (see paragraphs 10B.15 to 10B.20) except for any expense relating to leases with a lease term of one month or less
- the expense relating to leases of low-value assets if applying the relevant recognition exemption (see paragraphs 10B.15 to 10B.20) except for those expenses relating to short-term leases of low value assets
- the expense relating to variable lease payments not included in the measurement of lease liabilities
- income from subleasing right-of-use assets
- total cash outflow for leases
- gains or losses arising from sale and leaseback transactions.

10B.99. All charities must disclose the following amounts for the reporting period for right-of-use assets, by class of underlying asset:

- the gross carrying amount and the accumulated depreciation at the beginning and end of the reporting period
- a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
    - additions
    - disposals
    - acquisitions through business combinations
    - revaluations
    - impairment losses recognised or reversed in the Statement of Financial Activities
    - depreciation
    - other changes

This reconciliation need not be presented for prior periods.

10B.100. Where a charity has chosen to apply the recognition exemptions for short-term leases or leases of low-value assets, it must disclose that fact and disclose separately the amount of its lease commitments for short-term leases and for leases of low-value assets at the end of the reporting period, and for each of the following periods:

- not later than one year
- later than one year and not later than five years
- later than five years

10B.101. For right-of-use assets meeting the definition of investment property, a charity must apply the disclosure requirements in SORP module 10. In that case the disclosure of income from subleasing and the requirements of paragraph 10B.99 above are not required.

10B.102. For right-of-use assets meeting the definition of heritage assets, a charity must apply the disclosure requirements set out in SORP module 18. In that case the disclosure of income from subleasing and the requirements of paragraph 10B.99 above are not required.

10B.103. If a charity measures right-of-use assets classified as property, plant and equipment using the revaluation model then the charity must provide the disclosures required by SORP module 10 for those right-of-use assets.

Accounting for leases as a lessor

10B.104. As a lessor there remains a distinction between an operating lease and finance lease. The lessor must classify the lease to be a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset otherwise it is classified as an operating lease.

Identifying whether a lease is a finance lease

10B.105. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Section 20 of FRS 102 provides examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- the lease transfers ownership of the underlying asset to the lessee by the end of the lease term
- the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised
- the lease term is for the major part of the economic life of the underlying asset even if title is not transferred
- at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset
- the underlying asset is of such a specialised nature that only the lessee can use it without major modifications

10B.106. Section 20 of FRS 102 also sets out indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease:

- if the lessee can cancel the lease, the lessor’s losses associated with the cancellation are borne by the lessee
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (e.g. in the form of a rent rebate equalling most of the sales proceeds at the end of the lease)
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

10B.107. Judgement will need to be exercised based on whether substantially all the risks and rewards incidental to ownership transfer to the lessee. If it is clear from other features that the lease does not do this, the lease is classified as an operating lease. An example of a feature that may indicate the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset is where ownership of the underlying asset transfers to the lessee at the end of the lease term for a variable payment equal to its fair value at that time.

10B.108. If supplying non-lease services as part of a contract that contains a lease then the lessor must account for these separately and allocate the consideration between the lease and non-lease components.

10B.109. Lease classification is made by the charity at the inception date. A charity must review the classification of a lease if it is subsequently modified, however changes in estimates including an asset's economic life or residual value, or changes in circumstances, for example default by the lessee, do not warrant reclassifying the lease (paragraph 20.91 of FRS 102).

10B.110. An intermediate lessor must refer to Section 20 of FRS 102 in regard to sub-leases and their classification as a finance lease or operating lease.

Accounting for finance leases

10B.111. Paragraphs 10B.35 to 10B.40 explain how to identify the commencement date and lease term.

10B.112. At the commencement date the lessor recognises the value of the asset in the balance sheet and presents it as a receivable at an amount equal to the net investment in the lease inclusive of initial direct costs. In substance the lessor has acquired an asset in order to make it available to the lessee to use the asset over its economic life and so it is similar to a loan financing arrangement even though legal title has not been transferred. The figure for the net investment is derived by allowing for the time value of money represented by the interest rate implicit in the lease. Different accounting treatments apply in the case of manufacture or dealer lessors. It is unlikely that charities will undertake the activities of manufacturers or dealers as lessors of assets but where they do, they must refer to Section 20 of FRS 102 for the accounting treatment.

10B.113. The lease payments included in the measurement of the net investment in the lease comprise the payments made by the lessee for the right to use the underlying asset that have not been received at the commencement date. These are:

- fixed payments including payments that although described as variable that are in-substance fixed lease payments, less any lease incentives payable
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date
- any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee

- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Subsequent measurement post recognition

10B.114. The lessor charity must apply the payments received from the lessee to reduce both the principal and the unearned finance income (the difference between the gross investment in the lease and the principal sum). The payments from the lessee comprise the element that reduces (pays off) the principal (the net investment in the lease which is the lease receivable debtor) and the interest income (earnings to the lessor). The lessor must recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease. The gross investment in the lease, which is defined as the total of the lease payments receivable by the lessor under a finance lease plus any unguaranteed residual value accruing to the lessor is therefore not necessarily equal to the payments from the lessee because of the profit (investment return) to the lessor and any variable lease payments receivable.

10B.115. The charity must review at each balance sheet date whether the financial asset of the lease receivable is impaired. Refer to SORP module 11 for the treatment of an impairment loss. Also, if there has been a reduction in the estimated unguaranteed residual value, the lessor must revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.

Lease modifications

10B.116. In some circumstances a lease modification exists and some lease modifications are treated as a separate lease. Reference must be made to Section 20 of FRS 102 where this situation arises. A modification must be treated as a separate lease if both of the following apply:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets
- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract

10B.117. For a modification to a finance lease that is not accounted for as a separate lease, a lessor charity must account for the modification as follows:

- if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor charity must:
  - account for the lease modification as a new lease from the effective date of the modification
  - measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification

- otherwise, the lessor charity must refer to the treatment of financial assets in SORP module 11

Operating leases

10B.118. The lessor charity treats the leased asset as property, plant and equipment (refer to SORP module 10) since it will only be leased for part of its economic life leaving the lessor with the ability to make use of the asset. The lessor charity has not transferred to the lessee substantially all the risks and rewards incidental to ownership of an underlying asset. A charity with activities of a manufacturer or dealer lessor must refer to Section 20 of FRS 102 for the accounting treatment of any selling profit on entering into an operating lease.

Recognition and measurement

10B.119. The charity must add any initial direct costs incurred in effecting an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the letting income from the operating lease.

10B.120. The lessor charity must recognise lease payments from operating leases as income on a straight-line basis, unless either:

- another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished
- the lease payments are structured to increase in line with expected general inflation to compensate the charity for the effect of inflation in increasing costs

10B.121. The charity applies a consistent approach to its depreciation policy for depreciable underlying assets subject to operating leases treating them in the same way as its normal depreciation policy for similar assets.

Subsequent measurement post recognition

10B.122. The charity must review assets subject to an operating lease for impairment (refer to SORP module 12).

Lease modifications

10B.123. A charity must account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Leases as a social investment

10B.124. A charity granting a lease on nominal or peppercorn terms is not considered to have made a lease of commercial substance. Charities may do so to further their charitable purposes where the lessee is a beneficiary, or it may be a route to assisting the ultimate beneficiaries of the charity.

The charity retains title to the asset and because it is leasing it as means of furthering its charitable purposes, treats the asset in the same manner as other assets that it owns (refer to SORP module 10 Balance sheet) with appropriate charges for depreciation and an annual review for impairment. This SORP requires income receivable under such arrangements to be treated as an annual rental income.

10B.125. A charity entering into a finance lease at below market rate to a lessee is making a social investment and is in substance offering a concessionary loan to the lessee. Under this SORP, the measurement of the net investment in the lease and recognition of the finance income is the same as a finance lease but this SORP requires the charity to class these as a separate component of its concessionary loans (refer to SORP module 21 Accounting for social investments).

10B.126. A charity entering into an operating lease as a social investment is making an asset available on concessionary terms but its treatment is no different to that of any other operating lease. While the lease payments may be significantly below market rates, this is unlikely to be an indicator of impairment of the asset because the asset is performing its intended purpose of providing social or charitable benefit.

Other considerations:

Sale and leaseback transactions

10B.127. Charities involved as lessor in sale and leaseback transactions must refer to Section 20 of FRS 102 for the accounting treatment that must be followed.

Lessor disclosures

10B.128. A charity must disclose a general description of its significant leasing arrangements, including, if necessary to enable users to understand those arrangements, information about variable lease payments, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

10B.129. Where a charity grants a lease as a social investment or arrangements with nil or nominal consideration, e.g. peppercorn arrangements, this SORP requires the charity to provide a general description of the lease term, the remaining lease term if not a perpetual lease, and the charitable purpose effected by granting such leases.

10B.130. If necessary to enable users to understand its significant leasing arrangements, a charity must disclose additional qualitative and quantitative information.

10B.131. A charity must disclose the following amounts for the reporting period:

- for finance leases:
  - selling profit or loss
  - finance income on the net investment in the lease

    - income relating to variable lease payments not included in the measurement of the net investment in the lease
- for operating leases, lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate

10B.132. In respect of finance leases a charity must:

- provide a qualitative and quantitative explanation of the significant changes during the reporting period in the carrying amount of the net investment in finance leases
- disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation must identify the unearned finance income relating to the lease payments receivable and any discounted unguaranteed residual value. A lessor must disclose the accumulated allowance for uncollectible lease payments receivable

10B.133. In respect of operating leases a charity must:

- for items of property, plant and equipment subject to an operating lease, a lessor must apply the disclosure requirements of SORP module 10. In applying the disclosure requirements in SORP module 10, a lessor must disaggregate each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor must provide the disclosures required by SORP module 10 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor
- a lessor must apply the disclosure requirements as applicable in SORP module 10 for investment property, intangible assets other than goodwill, and for impairment (SORP module 12), heritage assets (SORP module 18) and social investment (SORP module 21) for assets subject to operating leases. A charity must also disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years

11. Accounting for financial assets and financial liabilities

Introduction

11.1. The reporting tiers applied for module 11 are as specified in the table below.

Table 11.1A: Tiered reporting requirements for module 11

All tiers	The requirements of financial assets and financial liabilities in this module apply fully to all charities.

11.2. All charities are likely to have financial assets and financial liabilities. A **financial asset** represents financial resources available to the charity and examples include financial investments in shares or bonds, debtors and cash. A **financial liability** is a contractual claim on the charity's resources. Examples include loans, trade creditors, and other liabilities arising from contracts to deliver cash or other financial assets.

11.3. FRS 102 uses the term '**financial instruments'** to include both financial assets and financial liabilities. Charities must refer to Sections 11 and 12 of FRS 102 for more detailed prescriptions on financial instruments to accompany this SORP module.

11.4. This module deals with the recognition and measurement of financial assets and financial liabilities except for those detailed below which are covered by other SORP modules and by FRS 102:

- investments in subsidiaries, associates and joint ventures
- lease accounting, except for the impairment of lease receivables held by a lessor (refer to paragraph 11.7(c) of FRS 102) and losses incurred on leases granted on non-standard terms. Impairment of right-of-use assets held by a lessee is addressed under Section 27 of FRS 102
- employers' rights and obligations under employee benefit plans
- rights and obligations that are financial instruments arising from exchange transactions, except for receivables from contracts with customers (refer to the SORP module 5 '*Recognition of income, including legacies, grants and contract income*' and also Section 23 of FRS 102), or where payment is deferred beyond normal business terms or is financed by the charity at a rate of interest that is not market rate, adjustments must be made to reflect the time value of money, in accordance with Section 11 of FRS 102

11.5. Table 10 lists the common basic financial instruments and the measurement bases that charities must use. Where FRS 102 uses different terminology, this is noted (in brackets).

11.6. Concessionary loans made or received by charities to further their charitable aims are financial instruments.

11.7. This module sets out:

- How to identify a basic financial instrument under FRS 102
- How all charities account for basic financial instruments
- The accounting treatment for transactions involving extended credit terms or where financed at a non-market rate of interest
- Subsequent measurement of financial assets and financial liabilities
- Impairment of financial assets
- Accounting for concessionary loans made or received
- Accounting for financial assets and financial liabilities which do not meet the FRS 102 description of basic financial instruments
- Examples of 'other financial instruments'
- Disclosures to be made in the notes to the accounts

How to identify a basic financial instrument under FRS 102

11.8. FRS 102 distinguishes basic financial instruments from other financial instruments. The simpler recognition and measurement requirements apply only to basic financial instruments.

11.9. If a charity has a type of financial asset or financial liability which is not listed in Table 10 'Common basic financial instruments', it must refer to the detailed criteria set out in Section 11 of FRS 102 to establish its accounting treatment (see paragraphs 11.8 to 11.11).

11.10. A non-exchange transaction such as a donation or a grant may involve a financial instrument, for example, donated cash. However, the promise itself to make a non-exchange transaction is not a financial instrument in scope of Sections 11 and 12 of FRS 102. A charity that commits to provide resources to another entity in the form of a funding commitment must account for this transaction in accordance with section 34 of FRS 102. Where a commitment to make a non-exchange transaction exists, it must be assessed to determine whether it gives rise to a liability or provision for the charity making the funding commitment. Where settlement of a funding commitment is delayed and the effect of the time value of money is material, the liability is recognised at the present value of the resources committed. Refer to SORP module 7 '*Recognition of expenditure*' for more guidance on accounting for funding commitments.

Table 10: Common basic financial instruments

Financial instrument	Measurement on initial recognition
Cash	Cash held
Debtors – including trade debtors and loans receivable (trade accounts and notes receivable)	Settlement amount after any trade discounts, provided normal credit terms apply, or amount advanced by the charity provided settlement is on normal payment terms and is due within 12 months of the invoice date
Creditors – including trade creditors and loans payable (trade accounts and notes payable)	Settlement amount after any trade discounts, provided normal credit terms apply, or amount advanced to the charity provided settlement is on normal payment terms and is due within 12 months of the invoice date
Overdraft (loan payable on demand)	Amount of the overdraft facility drawn down less separately incurred transaction costs
Qualifying long-term loans, that meet the debt instrument criteria in FRS 102	Principal amount advanced less separately incurred transaction costs
Bank deposit	Cash amount of deposit
Investment in a non-derivative instrument that is equity of the issuer e.g. most ordinary shares and certain preference shares that are free of any derivative or conditional element which could affect their market value or the charity's right to the shareholding	Transaction price (cost)
Loans advanced by the charity on market terms, that meet the debt instrument criteria in FRS 102	Amount of principal advanced plus transaction costs incurred by the charity

How all charities account for basic financial instruments

11.11. Charities preparing accounts normally measure a basic financial asset or basic financial liability on its initial recognition at the amount receivable or payable adjusted for any related transaction costs. However, if initially measured at fair value, transaction costs are not included in the measurement of financial assets or liabilities; instead, the transaction costs are treated as an expense. If extended credit is offered, the accounting treatment depends on those extended credit terms.

11.12. If an arrangement fee is charged on a loan made to the charity and it is material, it must be treated as a deduction from the amount of principal advanced. This is because the amount of principal advanced is effectively reduced by the arrangement fee charged. The effect of this accounting treatment is to treat the arrangement fee as a component of the finance charge. The effective interest rate on the loan must be calculated to reflect the arrangement fee being amortised over the period of the loan. However, arrangement fees that are not material should be treated instead as an expense under the relevant line(s) of the statement of financial activities (SoFA).

11.13. For more information on the effective interest method, refer to Section 11 of FRS 102. Paragraphs 11.15 to 11.20 of FRS 102 provide guidance on determining amortised cost using the effective interest method.

The accounting treatment for transactions involving extended credit terms or where financed at a non-market rate of interest

11.14. Where credit is offered by, or to, the charity on normal credit terms, the resulting debtor or creditor must be measured at the invoice price less any trade discounts. However, where credit terms are offered beyond normal credit terms and settlement is extended for a period in excess of 12 months after the invoice date, or where financed at a non-market rate of interest, then the financing element must be separately identified and included under the relevant line items of the SoFA.

11.15. The financing element is the difference between the settlement amount and the present value of that amount. The calculation of the present value of the settlement amount requires the identification of the timing and amount of future payment(s) due and then discounting these amounts at a market rate of interest for a similar debt instrument as determined at initial recognition having adjusted for transaction costs. A similar debt instrument may be an unsecured loan of an amount equivalent to the settlement value over a comparable time period. The unwinding of the discount is shown as a financing transaction (interest receivable or interest payable as appropriate).

Subsequent measurement of financial assets and financial liabilities

11.16. The subsequent measurement of financial assets and financial liabilities depends on their nature and settlement dates. The carrying amount must be calculated without any deduction for transaction costs that may be incurred on sale or disposal.

For example:

- current assets and current liabilities must be measured at the cash or other consideration expected to be paid or received and not discounted, unless they meet a definition of a financing transaction under paragraph 11.13 of FRS 102

- debt instruments, for example a bank loan, must be measured at amortised cost using the effective interest method. Refer to paragraphs 11.15 to 11.20 of FRS 102 for guidance on determining amortised cost using the effective interest method
- investments in shares which can be publicly traded must be measured at fair value see Section 2A of FRS 102
- investments in shares which cannot be publicly traded must be measured at cost less impairment if fair value cannot be established using a valuation technique

Impairment of financial assets

11.17. Financial assets measured at cost or amortised cost must be reviewed for impairment at each reporting date.

- for an instrument measured at amortised cost, the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial instrument has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract
- for an instrument measured at cost less impairment the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the charity would receive for the asset if it were to be sold at the reporting date

11.18. The charge for impairment is taken to the appropriate line in the SoFA under which any initial gain was recognised. For example, a downward adjustment of a previous revaluation of a fixed asset investment would be charged to gains and losses on investments within the SoFA.

11.19. For information about the indicators of impairment and on accounting for the impairment of financial assets see paragraphs 11.21 to 11.26 of FRS 102.

Accounting for concessionary loans made or received

11.20. Concessionary loans are those loans made or received by a charity to further its purposes. They are not repayable on demand and any interest charged is below the prevailing market rates. See SORP module 21 '*Accounting for social investments*' for the accounting treatments for concessionary loans.

Accounting for financial assets and financial liabilities which do not meet the FRS 102 description of basic financial instruments

11.21. The accounting treatment for basic financial instruments is available only for financial assets and financial liabilities that fall within the description set out in Section 11 of FRS 102.

11.22. The accounting treatment of other financial assets and financial liabilities which

are not basic financial instruments is set out in Section 12 of FRS 102 and requires a more complex accounting approach.

11.23. More complex arrangements that charities may enter into include advance fee schemes and contracts or options to buy or sell foreign currency and ‘derivatives’.

11.24. A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to a change in a specified financial variable (for example, the interest rate) or non-financial variable (for example, tonnage shipped)
- it requires no or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factor
- it is settled at a future date

11.25. This category of ‘other financial instruments’ includes derivatives such as:

- interest rate swaps that do not meet the definition of a basic financial instrument
- options and forward contracts

11.26. Other financial instruments must be both initially recognised and then subsequently measured at fair value (see paragraph 12.7 of FRS 102 for initial measurement and paragraphs 12.8 to 12.9 of FRS 102 for subsequent measurement).

11.27. A charity may apply hedge accounting if it meets the qualifying conditions. Paragraphs 12.15 to 12.25A of FRS 102 explain what is meant by the term ‘hedge accounting’, the qualifying conditions that must be met to apply hedge accounting and the accounting treatment to be followed for hedging transactions including treatment when they are discontinued.

11.28. Charities using hedge accounting must recognise the change in the fair value of the instrument in the ‘other recognised gains and losses’ section in the SoFA until such time as the instrument is realised or the hedging relationship ends. The gain or loss is then reclassified and shown under the relevant income or expenditure line items of the SoFA.

Examples of other financial instruments

Advance fee schemes

11.29. Advance fee arrangements can take several forms and the accounting treatment will depend on the substance of the arrangement. Examples include:

- the charity offers a fixed price or a guarantee to cap the amount of fees that might otherwise be payable in return for a fixed payment that buys two or more years of services from the charity in advance. In this case, the customer avoids having to pay any inflation increases. The cost to the charity is the revenue foregone from fee increases, in exchange for which the charity receives the cash-flow advantage of the lump sum prepaid. This is a type of 'other financial instrument' where the financing cost is not an interest rate but is the financial effect of the fee increase foregone spread over the term of the arrangement expressed as a discount rate
- an advance payment is received on which interest is paid by the charity on the advance, in return for a discount applied each year to the applicable academic fees due. In this case the transaction is in substance a loan and is classed as a basic financial instrument. The financing cost is the interest paid and this must be treated as an interest expense. (If the interest rate paid is below the market rate for an equivalent loan, then the loan may qualify for treatment as a concessionary loan
- a simple discount is offered by the charity on the prevailing fee rates payable in return for payment in advance for the academic year is not a financial instrument. The advance payment must be treated as deferred income until the criteria for income recognition are met

Foreign exchange contracts and options

11.30. A contract for purchasing foreign exchange is a contract to buy an amount of foreign currency at an agreed rate at a future date. The transaction cost of entering into the contract is treated as an expense. The contract itself is a financial instrument.

11.31. Where the contract is to manage an exchange risk associated with a liability such as a known purchase or a grant payment, the charity may opt to apply hedge accounting when the criteria in Section 12 of FRS 102 are met.

11.32. If the contract is not classed as a hedging instrument at its inception, the gain or loss on the contract at the reporting date is taken to the relevant expenditure line(s) in the SoFA. At the end of each subsequent reporting period or when the contract is fulfilled, whichever is the earlier, any gain or loss not previously recognised is also taken to the SoFA.

11.33. An option for purchasing foreign exchange is an arrangement whereby, for a fee, the charity has purchased an option to buy or sell an amount of foreign currency at an agreed rate at a future date. The charity is not bound to exercise the option

and if not exercised, the option lapses. The fee or premium for the option is treated as an 'other financial instrument' but any separately identifiable transaction cost incurred in acquiring the option is treated as an expense. The option is subsequently measured at fair value.

11.34. Where an option is purchased to manage an exchange risk associated with a liability such as a known purchase or a grant, the charity may opt to apply hedge accounting when this treatment is permitted by Section 12 of FRS 102. If a charity intends to treat an option as a hedging instrument, reference must be made to Section 12 of FRS 102 for the criteria that must be met in order for the transaction to be treated as a hedging instrument.

11.35. If the option does not qualify for hedge accounting under Section 12 of FRS 102, or if eligible is not classed as a hedging instrument at its inception, then any unrealised gain or loss at the reporting date is taken to the relevant expenditure line(s) in the SoFA. The minimum carrying amount of an option is nil. At the end of each subsequent reporting period or when the option is exercised or expires, whichever is the earlier, the gain or loss on exercising the option or the writing off of any residual carrying amount is charged to the SoFA.

Disclosures to be made in the notes to the accounts

11.36. All charities must provide the detailed disclosure of assets and liabilities required by the SORP module 10 '*Balance sheet*'.

11.37. Charities with basic financial instruments must follow the disclosure requirements in Sections 11 and 12 of FRS 102, this includes:

- the measurement bases and the accounting policies used for financial instruments
- the carrying amount of financial assets measured at fair value through income and expenditure (termed profit or loss in FRS 102)
- the carrying amount of financial liabilities measured at fair value through income and expenditure (termed profit or loss in FRS 102)
- information about the significance of financial instruments to the charity's financial position or performance, for example the terms and conditions of loans or the use of hedging to manage financial risk
- for all financial assets and financial liabilities measured at fair value, the basis for determining fair value, including any assumptions applied when using a valuation technique
- if the charity or its subsidiary has provided financial assets as a form of security, the carrying amount of the financial assets pledged as security and the terms and conditions relating to its pledge
- the income, expense, net gains and losses, including changes in fair value, for financial assets and financial liabilities measured at fair value, and financial assets and financial liabilities measured at amortised cost

- the total interest income and expense for financial assets and financial liabilities that are not measured at fair value
- the amount of any impairment loss for each class of financial asset

11.38. When the risks arising from financial instruments are particularly significant to the charity (for example, because they are principal financial risks for the charity) additional disclosure may be required. Reference should be made to Section 34 of FRS 102 for examples of disclosure requirements for risks arising from financial instruments that may be relevant in such cases.

11.39. If the charity makes or receives a concessionary loan, reference must also be made to the SORP module 21 '*Accounting for social investments*'.

11.40. If the charity defaults on the terms of a loan, refer to Section 11 of FRS 102 for the disclosures required.

11.41. Where financial instruments are measured at fair value, refer to Section 11 of FRS 102 for any applicable disclosures relating to credit risk and the nature of the instrument.

11.42. Where a financial asset which does not qualify for de-recognition has been transferred to a third party, refer to Section 11 of FRS 102 for disclosures.

11.43. For charities with other financial instruments applying hedge accounting, refer to Section 12 of FRS 102 for additional disclosure requirements.

12. Impairment of assets

Introduction

12.1. The reporting tiers applied for module 12 are as specified in the table below:

Table 12.1A: The tiered reporting requirements for module 12

All tiers	The requirements for impairment of assets in this module apply fully to all charities.

12.2. An impairment loss occurs when the carrying amount of an asset exceeds its recoverable amount. The impairment loss reflects a decline in the future economic resource or service potential of an asset, over and above the depreciation charged for the asset's use. Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Charities should refer to Section 27 of FRS 102 for more information on the recognition, measurement and disclosure of impairment of assets. This module must be applied by charities when accounting for the impairment of all assets except:

- contract assets and assets arising from costs to obtain or fulfil a contract (see paragraphs 23.121 to 23.123 of FRS 102)
- deferred tax assets
- assets arising from employee benefits
- investment properties measured at fair value
- biological assets social investments which must be referred to the SORP module 12 '*Accounting for social investments*'
- financial assets that fall within the scope of sections 11 and 12 of FRS 102 which deal with basic and other financial instruments

12.3. This module sets out for all charities:

- Impairment of inventories
- Impairment of assets other than inventories
- What to do if impairment is indicated
- Indicators of impairment
- Identification of the recoverable amount
- Accounting for impairment losses and reversals
- Disclosures to be made in the notes to the accounts

Impairment of inventories

12.4. At each reporting date, a charity must assess whether any inventories are impaired. In assessing whether inventories are impaired charities will need to compare the carrying amount of each item of inventory with its selling price less costs to complete and sell. If the inventory is impaired the carrying amount of the inventory should be reduced. See paragraph 27.2 to 27.4 of FRS 102 for the impairment of inventories described in this SORP as 'stock'.

Impairment of assets other than inventories

What to do if impairment is indicated

12.5. At each reporting date, a charity must assess whether there is any indication that an asset may be impaired. If there is no indication of impairment, then it is not necessary to estimate the recoverable amount. If there is an indication that an asset is impaired, then its recoverable amount must be estimated. An impairment loss must be recognised if, and only if, the recoverable amount of an asset is less than its carrying amount.

Indicators of impairment

12.6. Charities must refer to Section 10 of FRS 102 (paragraph 27.9) and the examples of indicators of impairment. Indicators of impairment may arise from both external and internal sources of information and include:

- a significant decline in an asset's market value
- significant changes in technology or markets, or in the economic or legal environment, which have an adverse effect on the charity's activities
- an asset becoming idle, or plans being made for its disposal earlier than expected
- evidence of an asset's obsolescence or physical damage
- evidence of worse than expected results, or cash flows, from the use of an asset

12.7. The demand or need for the services provided by a charity using an asset may fluctuate over time and a temporary reduction in demand is not necessarily an indication of its impairment. Similarly, an asset's service potential may not always be fully utilised and surplus capacity at certain periods will not always indicate impairment. For example, it may be necessary to have the spare capacity to respond to urgent need, or have the capacity to provide services at all times in the face of fluctuating need. In such circumstances, the surplus capacity is part of the required service potential of the asset, and the asset is not impaired.

12.8. However, where demand for services significantly decreases permanently or ceases altogether, the assets used to provide those services may be impaired. Similarly, major social, demographic or environmental changes may have an impact on the number, nature or needs of a charity's beneficiaries and may therefore also provide an indicator of impairment.

Identification of the recoverable amount

12.9. The recoverable amount of an asset is the higher of its fair value less costs to sell the asset, and its value in use. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use as if either amount is equal to or exceeds the asset's carrying amount then the asset is not impaired.

12.10. Fair value less costs to sell is a measurement based on fair value. Section 2A of FRS 102 provides more guidance on fair value measurement. A fair value measurement must estimate the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date.

12.11. A charity's assets may be subject to a restriction as to their use. A restriction may be imposed by the donor or created by the terms of an appeal used to fund the purchase of an asset. While a restriction will affect how the charity uses an asset, it is unlikely that a restriction imposed by charity law on the use of an asset would be passed on to a purchaser of that asset. Therefore, a restriction on use of an asset imposed by charity law would not normally be considered in determining the fair value of an asset.

12.12. Occasionally, the terms of a donation will require the on-going use of a specified asset by the charity that would prevent its sale. In such instances, there may be costs involved in removing the restriction before the asset can be sold. For example, there may be a restriction on the use of an asset that specifies that a building must only be used for educational purposes and there may be costs associated with the relaxation of that restriction. In such circumstances, the additional cost of removing a restriction should be reflected in the estimate of the asset's fair value less costs to sell. A restriction could also apply to any potential purchaser of an asset and the restriction may affect the fair value of an asset.

12.13. The method used to determine the 'value in use' of an asset held by a charity will depend on whether the asset is primarily held to generate cash as a commercial return, or for its service potential to the charity's beneficiaries.

12.14. An asset is held to generate an economic return when it is used to generate a positive cash flow and earn a return that reflects the risks involved in holding the asset. When an asset is held to generate cash flows, its value in use will be the present value of the future cash flows expected to be derived from the asset.

12.15. The calculation of an asset's value in use involves estimating the amount of the net cash flow that will be generated from the asset's use and then applying a discount rate to establish the present value of those future cash flows. The discount rate used is normally the current market rate the charity would pay to obtain comparable credit over the remaining life of the asset. The market rate should be adjusted for uncertainty in the asset's ability to generate cash in the future. Consequently, the greater the uncertainty, the greater the risk, and therefore the higher the market rate used in the calculation. This will in turn result in a lower present value amount for the value in use of the asset (see also paragraphs 27.15 to 27.20 of FRS 102).

12.16. However, charities often hold assets primarily to provide services to their

beneficiaries rather than for generating cash flows. A charity may provide its services freely or at below commercial rates. Where an asset is primarily held for its service potential to beneficiaries, it would be inappropriate to measure value in use by reference to its cash flow. In such circumstances, it is more appropriate to regard value in use as the present value of the asset's remaining service potential rather than the present value of its cash flows.

12.17. The method used to value an asset's service potential should be reliable, relevant to the asset and capable of measurement (see paragraph 27.20A of FRS 102). Depreciated replacement cost is one method that may be used to provide a measure of an asset's service potential. The replacement cost of an asset is the lowest economical cost that would be incurred in replacing the asset's service potential. This value for replacement cost is then reduced to reflect the remaining useful life of the asset in its used condition.

12.18. Value in use measured on the basis of an asset's service potential will have particular relevance for specialist assets used by a charity. The market value of a specialist asset may not reflect the cost that a charity avoids by using that asset in providing services. For example, the market value of a specialist building may be less than its recent construction cost. However, provided the building continues to meet its intended service potential, then its value in use would be better reflected by its depreciated replacement cost (its construction cost) rather than the amount for which it could be sold in the market.

Accounting for impairment losses and reversals

12.19. If, and only if, the recoverable amount of an asset is less than its carrying amount, a charity must reduce the carrying amount of the asset to its recoverable amount. This reduction is an impairment loss which must be immediately recognised as expenditure in the statement of financial activities (SoFA). The impairment losses must be charged to the line items under which the asset is deployed.

12.20. If an asset is impaired, a review of its remaining useful life should also be undertaken; if its useful life has been significantly curtailed, the charge for depreciation should be adjusted accordingly. A similar review is undertaken if a previous charge for impairment is reversed, to identify whether the useful life of the asset has been extended.

12.21. On occasions, the recoverable amount of an asset may subsequently increase as a result of external conditions or an increase in the expected use of the asset. In these circumstances, for all assets other than goodwill, the carrying amount of the asset must be increased to the recoverable amount by reversing the impairment loss previously recognised. This reversal must be immediately recognised under the appropriate expense line(s) in the SoFA as a reduction in expenditure unless the asset is carried at the revalued amount in accordance with Module 10 of this SORP (for example, the revaluation model in module 10 for property, plant and equipment). Any reversal of an impairment loss of a revalued asset must be treated as a revaluation increase in accordance with the relevant section of this SORP or FRS 102. The reversal of an impairment loss must not increase the carrying amount of an asset above the amount that would have been its carrying amount if

no impairment had been recognised. An impairment loss recognised for goodwill must not be reversed in a subsequent reporting period.

Disclosures to be made in the notes to the accounts

12.22. For each relevant class of asset held by a charity, the following information relating to impairment must be provided in the notes to the accounts:

- the amount of impairment losses recognised in the SoFA during the period (shown in relation to the line items(s) under which the impairment losses are included)
- the amount of reversals of any impairment losses recognised in the SoFA during the period (again, shown in relation to the line items(s) under which the impairment losses were reversed)

The disclosures required above must be produced for each relevant class of asset (see paragraph 27.33 of FRS 102).

12.23. A charity must also disclose a description of the events and circumstances that led to the recognition or reversal of an impairment loss.

13. Events after the end of the reporting period

Introduction

13.1. The reporting tiers applied for module 13 are as specified in the table below. Charities should refer to Section 32 of FRS 102.

Table 13.1A: Tiered reporting requirements for module 13

All tiers	The requirements for events after the end of the reporting period in this module apply fully to all charities.

13.2. This module applies to the recognition, measurement and disclosure of events after the end of the reporting period but before the trustees formally approve the accounts.

13.3. When preparing the accounts, charities make estimates or judgements based on the information available at the time, so they are required to assess the effect of events occurring between the end of the reporting period and the approval of the accounts to see whether adjustments to amounts or disclosures are necessary. Events after the end of the reporting period include all events up to the date when the financial statements are approved.

13.4. Events occurring after the end of the reporting period fall into two categories:

- Adjusting events occurring after the end of the reporting period
- Non-adjusting events occurring after the end of the reporting period

Going concern

13.5 SORP module 3, '*Accounting standards, policies, concepts and principles*' paragraphs 3.17 to 3.19 explain how a charity should consider whether it is a going concern. A charity must not prepare its financial statements on a going concern basis if the trustees determine, after the reporting period, that they intend to cease operating or they have no realistic alternative but to do so.

13.6 If the charity is no longer a going concern, the financial statements must be restated on an appropriate basis. If the going concern assumption is no longer appropriate, the effect is such that a fundamental change in the basis of accounting is required, rather than an adjustment to the amounts recognised within the original basis of accounting and therefore the disclosure requirements of paragraph 3.19 apply.

Adjusting events occurring after the end of the reporting period

13.7 Adjusting events are those events occurring after the end of the reporting period, but before the accounts are approved for issue, that provide evidence of conditions existing at the reporting date that affect items in the accounts.

13.8 Charities must review and adjust the relevant amounts recognised in the accounts and any related disclosures in the notes to the accounts to reflect adjusting events.

13.9 Examples of events occurring after the end of the reporting period that require adjustment include, but are not limited to:

- settlement of a court case that confirms that the charity had a liability (a present obligation) at the end of the reporting period and not a contingent liability
- notification that the payment of a legacy from an estate is no longer probable as a result of the will being contested
- the determination of the amount of a Gift Aid payment to a parent charity by a subsidiary undertaking, when the subsidiary had a present legal obligation (for example, a deed) to make the payment at the reporting date
- new information allowing a better estimate of an amount designated (however, designation of funds for a new purpose after the reporting date is not an adjusting event)
- identification of a fraud, misstatement or error that show that the accounts are incorrect which has a material effect on an item in the accounts
- new information concerning an impairment of an asset that indicates the asset was impaired at the end of the reporting period, for example doubts over the authenticity of a heritage asset or a bad debt
- new information that indicates that the charity may not be a going concern

Non-adjusting events occurring after the end of the reporting period

13.10 Non-adjusting events are those events occurring after the end of the reporting period but before the accounts are approved for issue that relate to conditions that arose after the end of the reporting period. The disclosure of non-adjusting events provides useful and relevant information about the charity to users of the accounts. Examples of non-adjusting events that may occur after the reporting date that would generally result in disclosure include, but are not limited to:

- a decision that the charity is going to merge with another charity
- the opening of a new branch in a new locality, or a material expansion of the range or scale of activities undertaken
- the purchase of a new building to materially expand a charity’s capacity to further its purposes, or sale of a building which has a material effect on the charity
- the announcement or implementation of a major restructuring
- the announcement of a major new fundraising appeal or the degree of

success achieved by a fundraising appeal

- a material loss of assets, or diminution in the value (impairment) of assets subsequent to the reporting date, for example due to fire or flood
- a material decline in the market value of investments (the decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently)
- the commencement of major litigation arising solely out of events that occurred after the end of the reporting period
- the entering into significant commitments, the identification of material contingent liabilities or the giving of material guarantees after the end of a reporting period

Disclosure in the accounts for non-adjusting events after the end of the reporting period

13.11. For each category of non-adjusting event, the notes to the accounts must provide details of the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

13.12. The disclosures for non-adjusting events must reflect information that becomes known after the end of the reporting period but before the accounts are approved for issue.

13.13. A charity must disclose the date the financial statements were approved for issue and who gave that approval.

14. Statement of cash flows

Introduction

14.1. The reporting tiers applied for module 14 are as specified in the table below. Refer to Section 7 of FRS 102 for more information about how to prepare a statement of cash flows.

Table 14.1A: Tiered reporting requirements for module 14

Tier 1 and tier 2	Charities within tier 1 and tier 2 are not required to provide a statement of cash flows where they meet the definition of a small entity, in accordance with paragraph 7.1B of FRS 102, however, they may choose to do so.
Tier 3	Charities within tier 3 must provide a statement of cash flows. Note, the exemption in paragraph 7.1B of FRS 102 is not available to tier 3 charities even in those cases where they meet the definition of a small entity in FRS 102.

14.2. The statement of cash flows provides information about the ways in which a charity uses the cash generated by its activities and about changes in cash and cash equivalents held by a charity showing separately changes from operating activities, investing activities and financing activities.

14.3. The statement identifies a charity's cash flows and the net increase or decrease in cash and cash equivalents in the reporting period. Cash equivalents are defined as short-term, highly-liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.

14.4. Bank overdrafts which are repayable on demand and form an integral part of day-to-day cash management can be included as a component of cash and cash equivalents, and may be included as part of cash and cash equivalents. However, other forms of overdraft or loans always count as part of borrowings and related cash flows are shown as financing activities.

14.5. This module sets out:

- The structure of the statement of cash flows
- What cash flows are included as operating activities
- What cash flows are included as investing activities
- What cash flows are included as financing activities
- The methods of compiling the statement of cash flows

- [Template for a statement of cash flows]
- [Disclosures in the notes to the accounts]

The structure of the statement of cash flows

14.6. The format of the statement of cash flows must follow the requirements of Section 7 of FRS102. The statement of cash flows includes the movement in cash balances of unrestricted funds and restricted funds including endowment funds. The statement of cash flows must analyse cash flows using three standard headings:

- operating activities
- investing activities
- financing activities

14.7. A template for the statement of cash flows is provided in Table 11, which should be adapted as necessary for the reporting purposes of the charity. For example, a columnar presentation may be adopted to distinguish between cash flows relating to restricted funds and cash flows relating to unrestricted funds. When a charity is preparing consolidated accounts, a statement of cash flows must be prepared on a consolidated basis.

What cash flows are included as operating activities?

14.8. Operating activities are the principal income-producing activities of a charity that are recognised as income and expenditure in the charity's statement of financial activities (SoFA). The cash flow from operating activities indicates the extent to which operating activities have generated or consumed cash.

14.9. Examples of cash flows arising from operating activities include:

- cash receipts from donations and grants
- cash receipts from Gift Aid claims or repayments of tax
- cash receipts from contracts for the supply of goods and services
- cash receipts from fees, rents (excluding rent from investment properties) and royalties
- cash receipts from the repayment of loans made to further the charity's purposes
- cash payments of grants made
- cash payments to suppliers of goods and services
- cash payments to and on behalf of staff (for example, staff salaries and pension contributions)
- cash payments of interest on borrowing related to operational activities
- cash payments of interest made by a lessee for the interest portion of a lease liability measured in accordance with Section 20 Leases of FRS 102
- cash advances made to other parties as social investments

- cash payments of taxes on income (for example, tax paid on profit retained by a wholly owned subsidiary)
- cash payments for short-term leases, leases of low value assets and variable lease payments not included in the measurement of the lease liability as required by Section 20 Leases of FRS 102

Paragraph 7.4 of FRS 102 provides further information on operating activities.

What cash flows are included as investing activities?

14.10. Investing activities include the acquisition or disposal of investments and the cash generated from holding investment assets, but excludes those highly-liquid investments which are classed as cash equivalents in the accounts. It also includes the acquisition of, or disposal of, property, plant and equipment.

14.11. Examples of cash flows arising from investing activities include:

- cash receipts from interest and dividends received
- cash receipts from rent on investment properties
- cash receipts from the repayment of loans by a non-charitable trading subsidiary (charity entity accounts only)
- cash receipts from the sale of property, plant and equipment and other long-term assets
- cash receipts from the sale of investment properties and other long-term investments (including the sale of endowment investments)
- cash payments to acquire investments (including conversion of endowment from cash to another form of investment)
- cash payments to acquire property, plant and equipment, and other long-term assets (including conversion of endowment from cash to another form of fixed asset)

Paragraph 7.5 of FRS 102 provides further information on investing activities.

What cash flows are included as financing activities?

14.12. Financing activities relate to borrowing and gifts of permanent endowment or expendable endowment funds. Endowment funds are considered to be ‘capital’ in charity law as they must be invested or retained.

14.13. Examples of cash flows arising from financing activities include:

- cash receipts from donations of endowment, or the accumulation of cash under a power to create expendable endowment
- cash receipts from new borrowing by way of loan or mortgage, and other long- or short- term borrowings
- cash receipts from the use of a bank overdraft facility (if not

treated as a component of cash equivalents)

- cash repayments of borrowing, including mortgages, loans and other borrowing
- cash payments by a lessee for the principal portion of the lease liability

Paragraph 7.6 of FRS 102 provides further information on financing activities.

The methods of compiling the statement of cash flows

14.14. FRS 102 permits charities to use either the direct or indirect method when presenting the cash flow from operating activities. Paragraphs 7.7 to 7.9 of FRS 102 provide guidance on these methods. The indirect method is the method most commonly used, and is the method illustrated in Table 11.

14.15. The charity must choose to present the statement of cash flows using either:

- the indirect method, which involves deriving the cash flows from operating activities. The net movement of funds shown in the SoFA is adjusted for:
  - non-cash movements in the SoFA
  - any deferrals or accruals arising from cash receipts or payments
  - items of income or expenditure related to investing or financing cash flows
- the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed

14.16. A charity using hedge accounting for a transaction must show the cash flow of the hedging instrument as an item within the same heading as that of the linked transaction. For more information on hedge accounting, refer to Section 12 of FRS 102.

Template for a statement of cash flows

14.17. A template for a statement of cash flows using the indirect method is given in Table 11. Charities using this format must provide a reconciliation to show how the net income/ (expense) presented in the SoFA has been adjusted to arrive at the cash flows from operating activities presented in the statement of cash flows. An example of how this reconciliation may be set out is given in the ‘Cash flows from operating activities’ section of Table 11 below. A reconciliation presenting the components of cash and cash equivalents must also be provided, and an example is given in Table 12.

14.18. A reconciliation of net debt must also be provided. Net debt consists of the borrowings of a charity, any related derivatives, and obligations under leases, less any cash and cash equivalents. When several balances (or parts thereof) from the balance sheet have been combined to form the components of opening and

closing net debt, sufficient detail must be shown to ensure users can identify these balances. Section 7 of FRS 102 does not require the analysis to be presented for prior periods.

14.19. An example of how this reconciliation may be set out is given in Table 13, which should be adapted as necessary for the reporting purposes of the charity. For example, a layout may be adopted which distinguishes between debt used to finance property plant and equipment, and debt used to finance operational costs. A layout may also be adopted which distinguishes between the timing of the cash flows associated with debt financing and the purpose for which those cash flows were applied.

14.20. This SORP requires that charities include an adjustment for the change in cash and cash equivalents due to exchange rate movements, see Table 11. Accounting standards require foreign currency denominated financial assets and financial liabilities to be recalculated at the reporting date. This item is necessary if the statement of cash flows is to reconcile to the balance sheet. Refer to Section 30 of FRS 102 for more information on foreign currency translation. The template for a statement of cash flows set out in Table 11 must be adapted as necessary for any additional items that apply. An example would be cash flows arising from the payment of taxes. Similarly, any headings that do not apply must be omitted.

Supplier finance arrangments

14.21. Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts a charity owes its suppliers and the charity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid. These arrangements provide the charity with extended payment terms, or the charity's suppliers with early payment terms, compared to the related invoice payment due date. These arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements.

14.22. Arrangements that are solely credit enhancements for the entity (e.g. financial guarantee contracts) or instruments used to settle directly with a supplier the amounts owed (e.g. credit cards) are not supplier finance arrangements.

14.23. A charity which enters into a supplier finance arrangement must disclose the necessary information as set out in paragraph 7.20C of FRS 102.

14.24. Section 1.42 of FRS 102 explains how charities should first apply the changes introduced by FRS 102 in relation to supplier finance arrangements.

Disclosures in the notes to the accounts

14.25. Tables 11, 12 and 13 provide examples of disclosures required for cash flows. Refer to Section 7 of FRS 102 for more information.

14.26. Cash and cash equivalents held by a charity may not be available for use to further charitable activities because of, among other reasons, foreign exchange controls, legal restrictions or due to being held in endowment fund. When

significant cash or cash equivalents are held that are not available for use, the charity must disclose:

- the amount unavailable
- explain why it is unavailable for use

14.27. An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the financial statements in a way that provides all the relevant information about those investing and financing activities. Examples include the conversion of expendable endowments into income funds in advance of the relevant investments being sold, or the removal of the legal restriction on the expenditure of permanent endowments, enabling them to be spent in the future.

14.28. If the components of cash and cash equivalents presented in the statement of cash flows are different to the equivalent items in the charity's balance sheet, a reconciliation must be provided.

Table 11: Statement of cash flows

	Total funds	Prior year funds	Note
	£	£	
Cash flows from operating activities:			
Net income/(expenses) for the reporting period (as per the statement of financial activities)	**X**	**(X)**	
Adjustments for:			
Depreciation charges	X	X	
(Gains)/losses on investments	X	(X)	
Dividends, interest and rents from investments	(X)	(X)	
Loss/(profit) on the sale of fixed assets	X	(X)	
(Increase)/decrease in stocks	(X)	X	
(Increase)/decrease in debtors	(X)	X	
Increase/(decrease) in creditors	X	(X)	
Net cash provided by (used in) operating activities	X	(X)	
Cash flows from investing activities:			
Dividends, interest and rents from investments	X	X	
Proceeds from the sale of property, plant and equipment	X	X	
Purchase of property, plant and equipment	(X)	(X)	
Proceeds from sale of investments	X	-	
Purchase of investments	-	(X)	
Net cash provided by (used in) investing activities	X	X	
Cash flows from financing activities:			
Repayments of borrowing	(X)	(X)	
Cash inflows from new borrowing	X	-	
Receipt of endowment	X	X	
Net cash provided by (used in) financing activities	X	X	
Change in cash and cash equivalents in the reporting period	X	X	
Cash and cash equivalents at the beginning of the reporting period	X	X	(Table 12)
Change in cash and cash equivalents due to exchange rate movements	X	(X)	
Cash and cash equivalents at the end of the reporting period	X	X	(Table 12)

Table 12: Analysis of cash and cash equivalents

	Current year	Prior year
	£	**£**
Cash in hand	X	X
Notice deposits (less than 3 months)	X	X
Overdraft facility repayable on demand	(X)	(X)
Total cash and cash equivalents	**X**	**X**

Table 13: Analysis of changes in net debt

	At start of year	Cashflows	Acquisition/ disposal of subsidiaries	New leases	Fair value movements	Foreign exchange movements	Other non-cash changes	At end of year
	£	£						
Cash	x	(x)	-	-	-	-	-	**x**
Cash equivalents	x	(x)	-	-	-	x	-	**x**
Overdraft facility repayable on demand	(x)	(x)	-	-	-	-	-	**(x)**
		(x)						
Loans falling due within one year	(x)	(x)	(x)	-	-	-	x	**(x)**
Loans falling due after more than one year	(x)	(x)	(x)	-	-	-	(x)	**(x)**
Lease obligations	(x)	x	(x)	(x)	-	-	-	**(x)**
TOTAL	**(x)**	**(x)**	**(x)**	**(x)**	**x**	**x**	**-**	**(x)**

Selection 1: Special transactions relating to charity operations

15. Charities established under company law

Introduction

15.1. The reporting tiers applied for module 15 are as specified in the table below.

Table 15.1A: Tiered reporting requirements for module 15

All tiers	The requirements for module 15 apply to all charities established under company law.

15.2. Charities registered as companies under company law (charitable companies) must comply with the reporting requirements of company law. However, charitable companies must adapt the presentation and headings used in their accounts for the special nature of the company and its activities.

15.3. In jurisdictions where adherence to this SORP is not a legal requirement, there is a strong presumption that charitable companies will comply with this SORP in order for their accounts to give a true and fair view as required by company law.

15.4. Charitable companies using this SORP must adapt their statement of financial activities (SoFA) to meet the requirements of company law or prepare a separate summary income and expenditure account.

15.5. This module, which applies to all charitable companies, explains how the following requirements of company law must be met by companies when applying this SORP:

- Preparation of the directors' report
- Requirement for an income and expenditure account
- Preparation of a combined SoFA and income and expenditure account
- Summary income and expenditure account
- Additional considerations that apply when consolidated (group) accounts are prepared under company law
- Disclosure of equity on the balance sheet
- Disclosure of revaluation and fair value reserves (UK only)

Preparation of the directors’ report

15.6. Company law in both the UK and the Republic of Ireland requires certain information to be provided in the directors’ report, in addition to the information that this SORP requires to be included in the trustees’ annual report.

15.7. A combined directors’ report and trustees’ annual report can be prepared provided it includes all the information required by the SORP module 1 ‘*Trustees’ annual report*’ and applicable charity law. Charitable companies should ensure that the combined annual report makes it clear that it also contains a directors’ report as required by company law.

15.8. Charitable companies registered in the UK that are classified as medium or large companies must also prepare a strategic report which must be presented as a separate distinct section of the trustees’ annual report. Charitable companies registered in the Republic of Ireland should note that the Companies Act 2014 introduced a similar requirement for the directors’ report to include a business review.

15.9. The strategic report provides context for: the financial accounts, an analysis of the charity’s performance, its financial position, and an insight into the charity’s objectives and the risks and uncertainties it faces. The trustees’ annual report may be adapted to provide the required contents of the strategic report by grouping, under the heading ‘strategic report’, the content contained in the trustees’ annual report for ‘achievements and performance’ and ‘financial review’. The content of ‘plans for future periods’ may also be included within the strategic report if relevant to understanding the charity’s development, performance and position at the end of the year.

15.10. The strategic report must contain the information required by Section 414C of the Companies Act 2006. Charities should also refer to guidance prepared by the Financial Reporting Council when preparing their strategic report. When approving the report, trustees should also specifically state that they have approved the strategic report. For further information on the content of the trustees’ annual report, see the SORP module 1 ‘*Trustees’ annual report*’.

Requirement for an income and expenditure account

15.11. Company law sets out the form and content requirements for the accounts. These detailed requirements are set out in the relevant Companies Act, and in any Regulations made under that Act. The requirements set out in Section 3 of FRS 102 must also be followed when it comes to the format and presentation of the primary statements.

15.12. Not-for-profit companies reporting in the UK under the Companies Act 2006, or in the Republic of Ireland under the Companies Act 2014, must prepare an income and expenditure account as part of their accounts. The SoFA can often be adapted to include an income and expenditure account, and therefore the presentation of a separate income and expenditure account may not be required.

Preparation of a combined statement of financial activities and income and expenditure account

15.13. To ensure that the SoFA meets the requirements of company law for an income and expenditure account, a combined statement must:

- identify, within the statement's heading, that an income and expenditure account is included
- include a line identifying the amount of any tax on activities
- identify, as a prominent sub-total in the statement, the charity's net income/ expenditure for the reporting period

15.14. If a combined statement is not presented, then the charitable company must produce a separate summary income and expenditure account as part of its accounts.

Summary income and expenditure account

15.15. The amounts presented in a summary income and expenditure account must be derived from the corresponding figures in the SoFA but exclude any endowment funds. The reporting of income and expenditure need not distinguish between unrestricted and restricted income funds. Charities must refer to the applicable regulations in their jurisdiction of company registration for the form and content requirements for company accounts, and for those items that must be disclosed in the accounts. Normally, greater disclosures are required of those companies classed as medium or large.

15.16. In the UK, a charitable company must adapt the headings and sub-headings used in the income and expenditure account to reflect the special nature of its activities. In the Republic of Ireland, not-for-profit companies must produce an income and expenditure account which contains the line items specified in the Companies Act 2014. The example given in Table 14 is illustrative.

Table 14: Minimum requirements for a summary income and expenditure account

Summary income and expenditure account for (named) company year ending (day/month/year)

	Note	All income funds (current year)	All income funds (previous year)
		£	£
Income*			
Net gains/(losses) on investments in JCE and Associates		x	x
Other gains/(losses) on investments		x	x
Interest and investment income** ^		x	x
Gross income in the reporting period		**X**	**X**
Expenditure*		x	x
Interest payable** ^		x	x
Depreciation and charges for impairment of fixed assets** ^		x	x
Total expenditure in the reporting period		**(X)**	**(X)**
Net income (expenditure) before tax for the reporting period		X	X
Tax payable		(X)	(X)
Net income (expenditure) for the financial year		**X**	**X**

* Income and expenditure may be analysed in further detail using the analysis headings of the SoFA.

** Items marked in the case of the UK only may either be shown as separate line items or included within other line items and disclosed separately in a note to the accounts.

^ Items marked in the case of the Republic of Ireland must be shown as separate line items.

15.17. Charitable companies in the Republic of Ireland must also report, where applicable, the amount charged to cover provisions or adjustments to provisions (other than for depreciation and impairment).

Additional considerations that apply when consolidated (group) accounts are prepared under company law

15.18. Charitable companies prepare consolidated accounts (also known as group accounts) in the UK under section 399 of the Companies Act 2006, and in the Republic of Ireland under section 293 of the Companies Act 2014.

15.19. Charitable companies which are required to prepare consolidated accounts must prepare a summary consolidated income and expenditure account for the charity and its subsidiaries (the group) if the consolidated SoFA cannot be adapted to meet the requirements for an income and expenditure account.

Disclosure of equity on the balance sheet

15.20. Charitable companies are usually established as companies limited by guarantee. However, in rare cases, charitable companies may have issued share capital provided those shares have no right to receive a dividend or other distribution attached to them. Charitable companies that have issued share capital must modify the 'Funds of the charity' heading of the balance sheet to disclose called up share capital. Charitable companies with share capital must provide details as set out in paragraph 4.12 of FRS 102.

15.21. A charitable company, preparing its accounts under FRS 102, need not provide a separate statement of changes in equity for the reporting period if the only changes to its equity during the periods for which financial statements are presented arise from the correction of prior period material errors or changes in accounting policy.

Disclosure of revaluation and fair value reserves (UK only)

15.22. Regulations made under the UK Companies Act 2006 require a revaluation reserve to be set up when assets are revalued upwards. A revaluation reserve represents the difference between the cost or valuation of an asset when first recognised, less any depreciation, and its subsequent revalued amount.

15.23. Although the separate reporting of a revaluation reserve has less significance for charities, as (unlike commercial entities) they do not distribute profits, the amount of any revaluation reserve must still be disclosed by charitable companies.

15.24. Similarly, regulations made under the Companies Act 2006 require a fair value reserve to be set up for hedging instruments, under a hedge accounting system, when measured at fair value in the accounts.

15.25. To comply with the regulations made under the Companies Act 2006, charitable companies must present any revaluation and fair value reserves on the face of the balance sheet. These reserves will form part of the funds in which those assets carried at revaluation, or at fair value, are held. This can be done by showing these reserves as a separate component of the relevant class of fund.

16. Presentation and disclosure of grant-making activities

Introduction

16.1. The reporting tiers applied for module 16 are as specified in the table below. FRS 102 does not contain any specific requirements. However, this SORP sets out the specific disclosure requirements for charities.

Table 16.1A: Tiered reporting requirements for module 16

All tiers	The requirements for presentation and disclosure of grant-making activities in this module apply to all charities.

16.2. For the purposes of this module, a grant is a voluntary payment made by a charity to either a person or an institution, to further the purposes of the grant-making charity. Grant payments may be made to fund the general purposes of, or for a specific purpose of, the recipient (for example, funding a particular activity or service).

16.3. A grant payment may be unconditional, or subject to conditions which must be met before the recipient is entitled to the payment. Refer to the SORP module 7, '*Recognition of expenses*', for the basis on which any liability for grant commitments and obligations is recognised in a charity's accounts.

16.4. This module sets out for all charities:

- How charities present grant-making activities in their accounts
- How to present grant-making and support costs
- Accounting for activities partly undertaken through grant-making
- The treatment of grants to individuals
- The disclosure of grant-making activities in the notes to the accounts
- The exemptions from disclosure
- Information required in cases of serious prejudice
- The statutory exemption applicable in England and Wales

How charities present grant-making activities in their accounts

16.5. Grants made by a charity must be included under the heading of 'expenses incurred on charitable activities' in the statement of financial activities (SoFA).

16.6. The information provided in the notes to the accounts should help the user to

understand how grants made by a charity relate to its purposes and the policies adopted by the trustees in pursuing them.

16.7. The SORP module 1, '*Trustees' annual report*' provides further details of the narrative reporting of the grant-making activities and policies that must be provided in the trustees' annual report.

16.8. The notes to the accounts should provide the user of the accounts with an understanding of the activities or projects that are being funded and whether the financial support is provided directly to individuals or to assist an institution to undertake activities or projects.

16.9. In the case of grants to institutions, information as to the recipient(s) of the funding must be provided so that the user can appreciate the type and range of institutions supported. This information must be disclosed in the notes or in the trustees' annual report to the accounts unless the charity is eligible to (and chooses to) take advantage of certain exemptions to disclosure, or the charity has elected to provide this information via the charity's webpage. More information about the exemptions available is provided at the end of this module.

How to present grant-making and support costs

16.10. When reporting on the cost of grant-making activities, charities preparing their SoFA on an activity basis must include related support costs. Support costs related to grant-making activities will include:

- costs incurred as part of the grant application and decision-making processes prior to the award of a grant
- monitoring costs incurred following the award of a grant
- support costs incurred relating to grant-making activities (refer to the SORP module 8, '*Allocating costs by activity in the statement of financial activities*' for guidance on the allocation of support costs to activities)

Accounting for activities partly undertaken through grant-making

16.11. Charities may carry out their activities through a combination of direct service provision and grants to third party institutions. In such cases, the total cost of the activity is the total of expenses incurred directly by the charity and the funding provided to third party individuals or institutions through its grant-making activities.

The treatment of grants to individuals

16.12. A grant to an individual is one that is made for the direct benefit of the individual who receives it, for example, to relieve financial hardship or as an educational bursary. Charities are not required to name the recipients of individual grants (except where the recipient is a related party).

16.13. All other grants should be regarded as grants to institutions. For example, a grant which is made to an individual to carry out a research project should be regarded as a grant to the institution to which the individual is connected, rather than as a grant to the individual undertaking the research.

The disclosure of grant-making activities in the notes to the accounts

16.14. This SORP requires that the notes to the accounts must provide the following details which reconcile with the total of grants payable:

- the total amount of grants paid, analysed between grants to individuals and grants to institutions
- an analysis of the total amount of grants paid by nature or type of activity or project being supported
- the amount of support costs allocated to grant-making activities

16.15. This analysis of grants should provide the user of the accounts with an understanding of the nature of the activities or projects being funded by the grant-maker.

16.16. For example, in the case of activity funded exclusively through grant-making, this analysis may be set out as shown in Table 15.

Table 15: Analysis of grants

Analysis	Grants to institutions	Grants to individuals	Support costs	Total
	£	£	£	£
Activity or Project 1				
Activity or Project 2				
Activity or Project 3				
Total				

16.17. The analysis should relate to the grant-making charity's purposes. In the case of a general grant-maker, its grants may be analysed under project or activity headings such as social welfare, medical research, the performing arts, welfare of people in financial need, or help to people seeking to further their education. Alternatively, the analysis may be based on projects or programmes undertaken, or by type of activity or geographical location of the project being funded.

16.18. Charities that make grants to institutions must also disclose details of a sufficient number of these institutional grants so that the user of the accounts can develop an understanding of the range of institutions the charity has supported. This disclosure must include all grants made to each institution when these are material in the context of the charity's total charitable expenditure.

16.19. This information must be provided in the notes to the accounts, or by

providing details of the charity's webpage where this information can be accessed, or this information may be set out within the trustees' annual report.

16.20. This analysis, whether provided as a note to the accounts, or made available on the charity's website, or included within the trustees' annual report, must provide:

- the name of the institution(s) in receipt of material grants
- the total value of grants made to each institution in receipt of material grants in the reporting period
- a reconciliation of the amount of material institutional grants disclosed to the total amount of institutional grants made in the reporting period

16.21. Charities that provide a number of different grants to a single institution to undertake different activities or projects must disclose the total value of the grants to that institution. For example, a charity may have made grants to different officers or departments of a particular university for different projects. Such grants must be treated as made to the same institution.

16.22. When activities are carried out through a combination of direct service or programme activity, and grant funding of third parties, the notes to the accounts must differentiate between activities undertaken directly by the charity and grant-funded activities. The disclosures required may be presented in a format such as that shown in Table 16.

Table 16: Analysis of charitable activities

Activity or programme	Activities undertaken directly	Grant funding of activities	Support costs	Total
	£	£	£	£
Activity 1				
Activity 2				
Activity 3				
Total				

The exemptions from disclosure

16.23. Information provided in relation to grant-making need not be disclosed where:

- grants are made to individuals – in which case details of the recipient are not required (except those grants made to related parties)
- the grant-making activities in total are not material in the context of a charity's overall charitable activities – in which case no disclosures are required
- total grants to a particular institution are not material in the context of institutional grants – in which case the name of the recipient

institution need not be disclosed; or

- disclosure could result in serious prejudice to the grant maker and/or the recipient institution, or individual working for the recipient institution

16.24. In exceptional cases, it is possible that the disclosure of the details of one or more of those grants could seriously prejudice the furtherance of the purposes, either of the recipient institution or of the charity itself. Situations where serious prejudice is clearly indicated include those where disclosure could result in serious personal injury.

Information required in cases of serious prejudice

16.25. This SORP requires that where the circumstances amount to serious prejudice, a charity may withhold details of the recipient of any institutional grant but must, in such circumstances, state as part of its disclosure of material grants made to institutions:

- the total number, value, and general purpose of those grants where these details have not been disclosed
- that an exemption applies to disclosure on the grounds of serious prejudice.

16.26. It is very unlikely that all the material institutional grants of a charity would fall within this exemption

The statutory exemption applicable in England and Wales

16.27. Charity law provides an exemption to charitable trusts registered in England and Wales from providing the names of grant recipients and the amounts of such grants during the lifetime of the settlor who donated the funds from which the grants are paid or during the lifetime of any spouse or civil partner of the settlor. A charitable trust that opts to use this disclosure exemption is required by this SORP to state in the notes to the accounts that this exemption has been taken. This disclosure exemption does not apply to charities registered in Scotland, Northern Ireland, or the Republic of Ireland.

17. Retirement benefits

Introduction

17.1. The reporting tiers applied for module 17 are as specified in the table below.

Table 17.1A: Tiered reporting requirements for module 17

All tiers	The requirements for retirement benefits apply fully to all charities.

17.2. This module applies to all charities that provide retirement benefits to their former staff after they have left the employment of the charity. The most common form of retirement benefit is a pension plan or scheme. The accounting requirements and disclosures in the notes to the accounts for retirement benefit plans depend on whether the plan is classified as a defined contribution plan or defined benefit plan. Charities should refer to Section 28 of FRS 102 for more information on accounting for retirement benefits, as well as other post-employment benefits.

17.3. This module sets out:

- Accounting for defined contribution plans
- Accounting for defined benefit plans
- Fund accounting and allocation of defined benefit plan costs
- Fund accounting and the treatment of a defined benefit plan surplus or deficit
- Accounting for multi-employer defined benefit plans which have been treated as defined contribution plans
- Disclosures in the accounts relating to plans accounted for as defined contribution plans
- Disclosures in the accounts relating to defined benefit plans

Accounting for defined contribution plans

17.4. Defined contribution plans are retirement benefit plans under which the employer, for example the charity (or its subsidiary), pays fixed contributions into a separate entity (a fund). The employer has no legal or constructive obligation to pay further contributions, or to make direct benefit payments to employees, if the fund does not hold sufficient assets to pay all the employee benefits relating to employee service in the current and prior periods.

17.5. The most common form of defined contribution plan is where the charity employer pays a fixed contribution, usually expressed as a proportion of the

employee's salary, into a pension fund for the period that the employee is with the charity. The amount of the retirement benefit received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a retirement benefit plan or to an insurer, together with investment returns arising from the contributions. The charity is under no further obligation to make any extra payments, irrespective of how that pension fund performs.

17.6. Any liability and expenses should be allocated to unrestricted funds and restricted funds on the same basis as other employee-related costs, unless the terms of a restriction prohibit the allocation of such costs to a restricted fund.

Accounting for defined benefit plans

17.7. Defined benefit plans are any retirement benefit plans that are not defined contribution plans. A feature of defined benefit pension plans is that the employer has offered a guarantee as to the amount or level of pension or benefit ultimately payable. The employer is therefore liable to make additional contributions to provide that guaranteed level of benefit. Under defined benefit plans, a charity's (and/or its subsidiary's) obligation is to provide the agreed benefits to current and former employees. Actuarial risk and investment risk are effectively borne by the employer.

17.8. Charities must refer to paragraphs 28.14 to 28.28 of FRS 102 for detailed guidance on the methodology to be followed in calculating the components and cost of a defined benefit pension plan.

Fund accounting and allocation of defined benefit plan costs

17.9. Defined benefit plan component costs must be allocated between the expenses categories in the statement of financial activities (SoFA) on a fair and reasonable basis. The allocations are made on the basis of the charity's own computations. The basis of the allocation should be consistent from year to year. One common approach is to allocate the defined benefit plan components based on the staff costs of employees within the scheme, although other approaches (for example, allocation based on pension contributions payable) may also produce an equitable allocation.

17.10. In cases where a restricted fund may be of a short-term nature or staff may be frequently transferred between activities funded from restricted funds, there may be uncertainty as to the fund that will ultimately recover any surplus or meet future contributions resulting from any deficit. In these circumstances, the restricted funds should be charged only an appropriate portion of the current service cost component of the pension cost relating to the staff engaged in activities funded from restricted funds.

17.11. Past service costs and gains and losses on curtailments and settlements should be charged to restricted funds only when a charity can demonstrate that the costs relate to staff presently engaged in the activities funded by

the restricted funds.

Fund accounting and the treatment of a defined benefit plan surplus or deficit

17.12. A surplus in a defined benefit plan is the excess of the value of the assets in the plan over the present value of the plan's liabilities. A deficit in a defined benefit plan is the shortfall in the value of the assets in the plan below the present value of the plan's liabilities.

17.13. The plan surplus is a defined benefit plan asset and it is recognised to the extent that the charity is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

17.14. The plan deficit is a defined benefit plan liability that recognises a charity's obligations under defined benefit plans. The liability recognised is the net total of the following amounts:

- the present value of its obligations under defined benefit plans (its defined benefit obligation) at the reporting date; minus
- the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly

17.15. Charities must include the actuarial gain or loss arising in the reporting period within the 'other recognised gains and losses' heading in the SoFA under a separate sub-heading, 'actuarial gains or losses on defined benefit pension schemes'. Charities must refer to paragraphs 28.23 and 28.25 of FRS 102 for guidance on what this includes.

17.16. Where a surplus or deficit in a defined benefit plan gives rise to an asset or liability, the asset or liability must be shown on the balance sheet within the unrestricted funds of the charity. The only exception to this, where staff are specifically engaged on a long-term project funded from restricted funds and it is demonstrable that all or part of the asset or liability is properly attributable to those restricted funds.

17.17. It may be necessary for the charity to liaise with the provider of a particular restricted fund in order to establish the basis on which any pension asset or liability is allocated to that fund and the pension costs that may be properly charged to it. Charities allocating a pension asset or a liability to a restricted fund should review the basis of the allocation annually to assess whether the benefit or obligation continues to accrue to that fund.

17.18. Where staff changes, or the cessation of a particular project, indicate that the economic benefits or obligations will no longer accrue to a particular restricted fund, then the asset or liability should be allocated to the unrestricted funds by means of a transfer in the SoFA.

Accounting for multi-employer defined benefit plans which have been treated as defined contribution plans

17.19. A charity participating in a defined benefit plan should normally be able to ascertain its share of the underlying assets and liabilities of the plan and make the disclosures required by Section 28 of FRS 102. Therefore, a multi-employer defined benefit pension scheme must be accounted for as a defined benefit pension plan unless insufficient information is available. In such circumstances, a charity participating in a multi-employer defined benefit plan scheme must account for contributions to the plan as if they were made to a defined contribution plan.

17.20. A charity that is accounting for its obligations under a defined benefit multi-employer plan as though it were a defined contribution plan, must also recognise any liability to make payments to fund any deficit relating to past service where it has entered into an agreement to make those payments. A charity must recognise a liability for the present value of contributions payable that result from the terms of the agreement with the multi-employer plan. This expense should be allocated, where practicable, to the activities in the SoFA to which the past service cost relates and must be disclosed separately if it is material (refer to the SORP module '*Statement of financial activities*'). In all other cases, the charity must account for its obligations under a multi-employer defined benefit plan as a defined benefit plan and report its share of components of plan cost and its share of any remeasurement of the net defined benefit liability in accordance with FRS 102. The charity must also refer to paragraphs 17.9 to 17.18 of this SORP.

17.21. Charities operating group plans should refer to paragraph 28.38 of FRS 102. A group plan is a defined benefit plan that shares the risks between entities under common control.

Disclosures in the accounts relating to plans accounted for as defined contribution plans

17.22. A charity operating a defined contribution plan must disclose the amount of contributions recognised in the SoFA as an expense. This SORP requires the disclosure of the basis for allocating the liability and expense between activities and between restricted and unrestricted funds.

17.23. In the exceptional cases where information is not available to ascertain a charity's share of the underlying assets and liabilities in a defined benefit plan, and where the scheme is treated as a defined contribution plan in accordance with paragraph 17.19 of this SORP the charity must also disclose:

- the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan
- such information as is available about the plan's surplus or deficit and the implications, if any, for the reporting charity

17.24. A charity that participates in a multi-employer defined benefit plan that is accounted for as a defined contribution plan must also include in its disclosures:

- a description of the extent to which the charity can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan
- an explanation of how any liability arising from an agreement with a multi-employer plan to fund a deficit has been determined

Disclosures in the accounts relating to defined benefit plans

17.25. Charities reporting under FRS 102 must make the disclosures set out in paragraphs 28.41 to 28.41A of FRS 102.

Selection 2: Accounting for special types of assets held

18. Accounting for heritage assets

Introduction

18.1. The reporting tiers applied for module 18 are as specified in the table below.

Table 18.1A: Tiered reporting requirements for module 18

All tiers	The requirements in this module apply fully to all charities holding heritage assets.

18.2. This module sets out: Charities holding heritage assets should refer to Section 34 of FRS 102.

18.3. This module sets out:

- Definition of a heritage asset
- Presentation, recognition and measurement of heritage assets on the balance sheet
- How to measure heritage assets that have been purchased
- How to measure heritage assets that have been donated
- Depreciation and impairment of heritage assets
- Accounting treatment for heritage assets recognised on the balance sheet
- Disclosures required for all charities holding heritage assets
- Disclosure of heritage assets recognised on the balance sheet
- Disclosure of heritage assets not recognised on the balance sheet
- Disclosure of a five-year summary of transactions

Definition of a heritage asset

18.4. A heritage asset is a tangible or intangible asset with historic, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.

18.5. An asset may have the attributes of a heritage asset, for example it may be of historic or artistic importance, but unless it is also held and maintained principally for its contribution to knowledge and culture then it will not fall within the definition of a heritage asset.

18.6. Assets with heritage attributes may be used operationally for purposes unconnected with the promotion of knowledge and culture or even held as investments. In such instances, the asset is accounted for within tangible fixed

assets or investments/investment properties as appropriate. In determining whether an asset is a heritage asset, the charity must use its judgement to assess the characteristics of the asset and whether it is held and maintained principally for its contribution to knowledge and culture.

For example:

- A historic building used by an educational establishment for teaching would not be accounted for as a heritage asset because it is held to provide a facility for teaching rather than the building itself contributing to knowledge and culture.
- In the case of a museum or gallery, it is the collections held, and not the buildings or display cases that house them, that will be treated as heritage assets unless the structures themselves also have the attributes of a heritage asset and are held principally for their contribution to knowledge and culture.
- Works of art or historic buildings principally held for investment purposes are categorised as investments/investment properties, as they are held for investment gain, capital appreciation or for income generation rather than for their contribution to knowledge and culture.

18.7. Similarly, a requirement to hold and maintain an asset, for example as an endowment, does not mean that asset is held for its contribution to knowledge and culture. For example, an inalienable building or painting, which must be retained indefinitely by a charity due to the terms of a donation, is not a heritage asset unless it meets the definition of a heritage asset.

18.8. However, a heritage asset used incidentally for operational purposes unconnected with the promotion of knowledge and culture may still fall within the definition of a heritage asset. For example, a historic building incidentally used for service or administrative activities by a charity, but principally held and maintained for its contribution to knowledge and culture, is accounted for as a heritage asset.

18.9. Although a heritage asset is normally tangible, it is possible for it to be intangible. For example, a library of digital recordings or film rights can be a heritage asset if it is held for its contribution to knowledge and culture.

18.10. Heritage assets may include abbeys, monasteries, cathedrals and historic churches and monuments where a contribution to knowledge and culture is associated to faith or other purposes.

18.11. Similarly, the artefacts contained within, or associated with, such assets may also be heritage assets. For example, associated artefacts could include religious artefacts contained within a cathedral or historic church.

18.12. Charities that do not have preservation or conservation purposes must account for an asset as a heritage asset only if that asset:

- has historic, artistic, scientific, technological, geophysical or environmental qualities

- is held and maintained principally for its contribution to knowledge and culture
- is accessible to the public for viewing and/or research

Presentation, recognition and measurement of heritage assets on the balance sheet

18.13. Heritage assets must be presented as an asset on a charity's balance sheet separately from other assets. Heritage assets are presented as a separate class of fixed asset on the balance sheet and should be measured initially at either their cost or, if donated, at fair value.

18.14. A charity shall recognise and measure heritage assets in accordance with SORP modules 10 and 10B as appropriate, subject to the requirements set out in paragraph 18.17.

18.15. When, for whatever reason, a charity is measuring a heritage asset at fair value, the charity may adopt any reliable valuation method to estimate the asset's fair value. For example, for some heritage buildings, the use of market value may provide a reasonable approach; in other cases, the use of depreciated replacement cost may be appropriate. However, depreciated replacement cost may not be an appropriate method where a building cannot be replicated using modern building methods or where the value of the original asset lies in its unique historic or heritage qualities. The valuation method adopted must be applied to all assets within a particular class, or to a group of similar assets.

How to measure heritage assets that have been purchased

18.16. When a heritage asset is purchased, its cost of acquisition will be known and therefore the asset must be measured initially at this amount. Should the acquisition be by way of an exchange of assets, the cost of acquisition is represented by the carrying amount of the asset exchanged and any cash settlement made or payable at the date the charity assumed legal title or control of the acquired asset. A heritage asset that is measured initially at its cost may be subsequently carried at a valuation where a charity adopts a policy of carrying its heritage assets (or group of heritage assets) at valuation. There is no prescribed minimum period between valuations. However, if the valuation model is adopted, the carrying amount of the asset should be reviewed with sufficient frequency to ensure that the valuations remain current.

How to measure heritage assets that have been donated

18.17. Heritage assets which have been acquired by way of donation or other form of non-exchange transaction must be measured initially at their fair value. Fair value can often be estimated by reference to recent market transactions or binding sale

agreements, and in accordance with Section 2A of FRS 102. Fair value may be determined by the appraisal of market-based evidence by trustees or staff who have relevant skills, knowledge and experience, or by a professionally qualified valuer. Where no market-based evidence exists, depreciated replacement cost may be used to estimate the fair value of certain properties held as heritage assets.

18.18. If, in exceptional cases, the fair value of the heritage asset cannot be measured reliably at a cost which is commensurate with the benefits to users of the financial statements, the heritage asset shall not be recognised in the accounts, but must be disclosed in accordance with the requirements at paragraph 18.26 below.

Depreciation and impairment of heritage assets

18.19. A heritage asset must be depreciated over its useful economic life. However, certain heritage assets may have indefinite lives and are therefore not depreciated. In either case, a charity must consider SORP module 12 ‘*Impairment of assets*’, to determine whether a heritage asset is impaired and to account for any impairment loss identified. Impairment may be due to physical deterioration, breakage, new evidence giving rise to doubts as to its authenticity, or other factors.

Accounting treatment for heritage assets recognised on the balance sheet

18.20. When heritage assets are recognised on the balance sheet, a charity must:

- present heritage assets as a separate class of fixed asset on the balance sheet
- provide an analysis, in the notes to the accounts, of those classes or groups of heritage assets reported at cost and those reported at valuation
- include the value placed on any heritage asset gifted to the charity in the ‘income from donations and legacies’ heading in the statement of financial activities (SoFA) and allocate that income to a restricted fund when the use of the asset is restricted
- recognise any change in the valuation of a heritage asset as a ‘gain or loss on revaluation of fixed assets’ in the SoFA
- recognise any gain on the disposal of a heritage asset as ‘other income’ in the SoFA
- recognise any loss on disposal, depreciation or impairment of a heritage asset as a cost of charitable activities in the SoFA

Where heritage assets are held by the lessee as a right of use asset, these must be shown separately with the disclosures above.

Disclosures required for all charities holding heritage assets

18.21. All charities must disclose the following for all heritage assets held:

- an indication of the nature and scale of heritage assets held
- the policy for the acquisition, preservation, management and disposal of heritage assets (including a description of the records maintained by the charity of its collection of heritage assets, and information on the extent to which access to the assets is permitted)
- the accounting policies adopted for heritage assets, including details of the measurement bases used

18.22. The above notes should be brief but sufficiently informative. Charities providing further information on these matters in the trustees' annual report should include a cross reference to the annual report in the notes.

18.23. The disclosures relating to heritage assets can be aggregated for groups or classes of heritage assets provided that this does not obscure significant information.

Disclosure of heritage assets recognised on the balance sheet

18.24. When heritage assets are recognised on the balance sheet, all charities must disclose:

- the carrying amount of heritage assets by class or group both at the beginning of the reporting period and at the reporting date, distinguishing between classes or groups of heritage assets recognised at cost and those recognised at valuation at the reporting date
- where assets are recognised at valuation, sufficient information to assist in understanding the valuation being recognised (date of valuation, method used, whether carried out by external valuers and, if so, their qualifications, and any significant limitations on the valuation)

Where heritage assets are held by the lessee as a right of use asset these must be shown separately with the disclosures above. A right of use heritage asset is not expected to be common.

18.25. Charities must present a reconciliation of the movements between the opening and closing carrying amount(s) in the balance sheet for heritage assets. This information may be presented in a tabular format (see Table 17).

Table 17: Analysis of heritage assets

Basis of capitalisation	At valuation Group A	At cost Group B	Total
	£	£	£
Carrying amount at beginning of the reporting period	X	X	X
Additions	X	X	X
Disposals	(X)	(X)	(X)
Depreciation/impairment	(X)	(X)	(X)
Revaluation	X	-	X
Carrying amount at reporting date	X	X	X

Disclosure of heritage assets not recognised on the balance sheet

18.26. When heritage assets have not been recognised in the balance sheet, charities must:

- explain the reasons why
- describe the significance and nature of those assets
- disclose information that is helpful in assessing the value of those assets

18.27. If, in exceptional circumstances, a heritage asset acquired during the reporting period in a non-exchange transaction, e.g. by donation, has not been recognised because its fair value cannot be measured reliably, an entity shall state for what reason its fair value cannot be measured reliably. This disclosure can be aggregated for groups or classes of heritage assets, provided this does not obscure significant information.

Disclosure of a five-year summary of transactions

18.28. All charities must provide a summary of transactions relating to heritage assets for the reporting period, and for each of the previous four reporting periods, disclosing:

- the cost of acquisition of heritage assets
- the value of heritage assets acquired by donation
- the carrying amount of heritage assets disposed of in the period and the proceeds received
- any impairment recognised in the period
- any depreciation or amortisation recognised in the period

18.29. The summary must show separately those transactions that are included in the balance sheet and those that are not. Charities that have been operating for fewer than five years must provide information for such prior periods as are available. The required information may be presented in a tabular format (see Table 18).

18.30. When it is impracticable to do so, the disclosures required by paragraph 18.29 need not be given for more than one prior period, and a statement to the effect that it is impracticable shall be made.

Table 18: Summary analysis of heritage asset transactions

	2026	2025	2024	2023	2022
	£	£	£	£	£
Purchases					
Group A					
Group B					
Donations					
Group A					
Group B					
Total additions					
Charge for impairment					
Group A					
Group B					
Total charge for impairment					
Disposals					
Group A: carrying amount					
Group B: carrying amount					
Total disposals					
Proceeds from disposals					
Group A: sale proceeds					
Group B: sale proceeds					
Total sale proceeds					

19. Accounting for funds received as agent or as holding trustee

Introduction

19.1. The reporting tiers applied for module 19 are as specified in the table below.

Table 19.1A: Tiered reporting requirements for module 19

All tiers	The requirements in this module apply fully to all charities receiving funds as agents or as holding trustees

19.2. Charities may agree to administer the funds of another entity as its agent. As agent, a charity will act in line with the instructions of the entity that acts as the principal. For example, a charity may operate in an area of the world where the principal does not and so, by agreement with the principal, the charity administers the principal's funds in accordance with the instructions received. Within the charity sector, agency arrangements are sometimes referred to as conduit funding because the charity, in acting as agent, provides a conduit through which funds are passed in order to fund activities or assist the beneficiaries of the principal.

19.3. The agent is usually bound by an agency agreement and distributes the funds it holds as agent to specified third parties in line with the instructions given by the principal. The funds transferred to the agent remain under the control of the principal and the principal remains responsible for the charitable application of those funds. A charity acting as agent should ensure that the terms of the agency agreement and the use of the funds are consistent with its own purposes.

19.4. It is important to consider the substance of the arrangement over its legal form so as to distinguish between a charity acting as agent and a charity acting as principal:

- as agent, the trustees of a charity have no discretion about the use to which the funds received are put. The charity acts only in accordance with the instructions or directions of the principal
- as principal, the trustees of a charity have discretion (subject to the purposes or terms on which the funds are held) as to how the funds are used

19.5. A restricted donation is not an agency arrangement. A charity accounts for the receipt of a restricted donation as principal because the charity's trustees control how it is subsequently spent. For example, even if the purposes of the gift were narrowly defined by the donor, the trustees of a grant-making charity would still retain discretion as to the selection of grant recipients and the timing of the payment.

19.6. Charities may also act as holding trustee holding the title to property belonging

to another charity on its behalf. Property held as holding does not belong to the holding trustee and so is not a component of the holding trustee's assets, income or expenditure in the reporting period.

19.7. This module sets out:

- Accounting for funds held as agent
- Distinguishing consortia or similar arrangements involving a 'lead' charity
- The disclosure of funds received as agent or held as holding trustee

Accounting for funds held as agent

19.8. Funds received by a charity as agent are not recognised as an asset in its accounts because the funds are not within its control. Consequently, the receipt of funds as agent is not recognised as income nor is its distribution recognised as the agent's expenditure.

19.9. However, any fee receivable by a charity for acting as agent is recognised as its income (refer to the SORP module 5 '*Recognition of income, including legacies, grants and contract income*'). Similarly, any costs incurred by a charity in the administration of the agency arrangement are recognised as expenditure in its accounts (refer to the SORP module 7 '*Recognition of Expenditure*').

Distinguishing consortia or similar arrangements involving a 'lead' charity

19.10. Charities may also enter into a consortium or similar arrangement whereby two or more charities co-operate to achieve economies in the purchase or supply of goods or services for members of the arrangement or to a third party. The accounting for a consortium's transactions requires an understanding of the substance of any underlying contractual arrangements.

19.11. Consortium arrangements can be set up through:

- a formal joint venture arrangement (refer to the SORP module 25, '*Branches, linked or connected charities and joint arrangements*')
- a joint venture entity (refer to the SORP module 29 '*Accounting for joint ventures*')
- a charity acting as principal entering into contractual arrangements and then sub-contracting with other parties or charities to deliver components of the contract (refer to the SORP module 5 '*Recognition of income, including legacies, grants and contract income*')
- a lead charity acting as agent for the consortium's members administering the contractual arrangements on behalf of all the members of the consortium

19.12. When a lead charity acts as agent for members of a consortium, it may provide administrative support to the consortium arrangement, including:

invoicing and making payments on behalf of the consortium members. However, each charity participating in the consortium retains its own contractual obligations and rights despite the lead charity being the main point of contact with the customer or being the commissioning body for a service. The lead charity is not acting as agent if it is the principal under the contract and is then sub-contracting work to third parties, including other charities, in order to fulfil its contractual obligations

Disclosure of funds received as agent or held as holding trustee

19.13. This SORP requires that a charity that has acted as agent during the reporting period must disclose in the notes to the accounts:

- an analysis of funds received and paid by the charity as agent
- details of any balances held as agent at the reporting date
- details of any balances outstanding between any participating consortium members for which it is administratively responsible
- where funds have been held as agent for related parties the charity must make the required disclosures for related parties required by the SORP module 9 '*Disclosure of trustee and staff remuneration, related party and other transactions*'

19.14. This SORP requires that a charity that has acted as holding trustee during the reporting period must disclose in the trustees' annual report or as a note to the accounts:

- a description of the assets, classes of assets or categories of assets which they hold in this capacity
- the name and objects of the charity (or charities) on whose behalf the assets are held and how this activity falls within the holding charity's objects
- details of the arrangements for safe custody and segregation of such assets from the charity's own assets

Selection 3: Accounting for investments

20. Total return (investments) – (England and Wales only)

Introduction

20.1. The reporting tiers applied for module 20 are as specified in the table below:

Table 20.1A: Tiered reporting requirements for module 20

All tiers	The requirements in this module apply fully to all charities in England and Wales that adopt a total return approach to the investment of funds.

20.2. This module applies to charities established in England and Wales that hold investments as permanent endowment and adopt a total return approach to the investment of those funds. This module reflects the requirements of charity law and regulations in England and Wales where a statutory power exists that enables charities to adopt a total return policy for the investment of permanently endowed funds. FRS 102 does not deal with the specific issue of charities with permanent endowment funds invested on a total return basis.

20.3. Trust law requires the trustees of a permanently-endowed fund to be even-handed in the way that they allocate investment returns between current and future beneficiaries. Under standard trust rules, income generated from endowed investments must be spent on the purposes of the fund for current beneficiaries, and any capital gains or losses must be allocated to the capital of the endowment held to produce income for the benefit of future beneficiaries.

20.4. When a total return approach to investment is adopted, the permanently-endowed funds are invested to produce an investment return without regard to whether that return is in the form of income (for example, dividends or interest) or capital appreciation.

20.5. The investment return forms a component of the endowment fund known as the 'unapplied total return'. The trustees then periodically determine how much of the 'unapplied total return' is released to income for spending and how much is retained for investment as a component of the endowment. This allocation must be made equitably to balance the need for income to meet current requirements and to hold funds as part of the endowment to produce investment returns for the future.

20.6. Under a total return approach to investment, the endowment has two distinct components:

- the value of the original and any subsequent gifts made to the capital of the endowment (which cannot normally be spent), which is termed the 'value of the trust for investment'
- the 'unapplied total return' which represents the accumulated investment returns from the investment of the endowment, less any

amounts that have been allocated to income

20.7. A charity must have the relevant investment power to adopt a total return approach to investment. This power may be granted to endowed charities in England and Wales by an order of the Charity Commission made under section 105 of the Charities Act 2011, or exercised by trustees under section 104A of the Charities Act 2011 as amended by the Trusts (Capital and Income) Act 2013. Charities exercising the power to invest on a total return basis under section 104A of the Charities Act 2011 must also refer to the Charities (Total Return) Regulations 2013 and the further guidance available from the Charity Commission's website.

20.8. The Charities Act 2022 gives trustees a power, once they have made a section 104A(2) resolution, to then resolve (under section 104AA(2)) to use permanent endowment to invest the total return fund, or part of it, in social investments with a negative or uncertain financial return, provided that any losses are offset by gains made elsewhere in the relevant fund.

20.9. This module sets out:

- The accounting treatment
- Disclosures required in the notes to the accounts where permanent endowment is invested on a total return basis
- Disclosures required in the trustees' annual report

The accounting treatment

20.10. This SORP requires that the following accounting treatment must be used where a charity adopts a total return approach to the investment of endowment:

- income from the endowment's investments must be recognised as 'investment income' in the endowment column of the statement of financial activities (SoFA)
- investment gains and losses (both realised and unrealised gains and losses) must be recognised as 'investment gains and losses' in the endowment column of the SoFA
- any part of the unapplied total return that is allocated to income funds must be separately identified in the SoFA as an allocation between endowment funds and income funds, either within the 'transfer' line or within the 'other income' section of the SoFA
- the amount of any unapplied total return fund must be included as a part of the relevant endowment together with the value of the trust for investment on the balance sheet

20.11. Where investment losses exceed the amount of unapplied total return, the loss must be treated as a reduction in the value of the trust for the investment component of the permanent endowment until such time as these losses are reversed.

Disclosures required in the notes to the accounts where permanent endowment is invested on a total return basis

20.12. This SORP requires that the notes to the accounts must provide the following information for each endowment fund that is invested on a total return basis:

- the amount of the value of the trust for investment that comprises the gift component of the endowment at the start of the reporting period
- the amount of any additional gifts to the endowment fund during the reporting period added to the value of the trust for investment
- the amount of any unapplied total return at the start of the reporting period
- the amount of the investment return from the investment of the endowment for the reporting period
- the amount of any allocations of unapplied total return to income funds
- the amount of any recoupment to make good the value of the trust for investment
- the amount of any allocation from the trust for investment to the unapplied total return
- the amount of any unapplied total return at the end of the reporting period
- the total amount of the endowment fund at the end of the reporting period
- details of the power of investment or the order that permits the charity to adopt a total return approach to investment

20.13. Table 19 summarises how the disclosures required in the notes to the accounts may be set out.

Table 19: Example of the disclosure of a total return approach to investment of permanent endowment

	Trust for investment	Unapplied Total Return	Total Endowment
	£	**£**	**£**
At beginning of the reporting period:			
Gift component of the permanent endowment	X	-	X
Unapplied total return	-	X	X
Total	**X**	**X**	**X**
Movements in the reporting period:			
Gift of endowment funds	X	-	X
Recoupment of trust for investment	X	(X)	-
Allocation from trust for investment	(X)	X	-
Investment return: dividends and interest	-	X	X
Investment return: realised and unrealised gains and (losses)	-	X	X
Less: Investment management costs	-	(X)	(X)
Total	**X**	**X**	**X**
Unapplied total return allocated to income in the reporting period	-	(X)	(X)
Net movements in reporting period	**X**	**X**	**X**
At end of the reporting period:			
Gift component of the permanent endowment	X	-	X
Unapplied total return	-	X	X
Total	**X**	**X**	**X**

20.14. Where trustees have obtained a power to adopt a total return approach to use permanent endowment and have also obtained a power to invest the total return fund, or part of it, in social investments that make a negative or uncertain financial return, this SORP requires the following disclosures:

- the amount of total return invested in social investments that make a negative or uncertain financial return
- the amount of investment return (if any) on the social investments that make a negative or uncertain financial return in the total return fund in the reporting period
- the amount of any losses on the social investments that make a negative or uncertain financial return in the total return fund in the reporting period and how the losses have been offset

Disclosures required in the trustees' annual report

20.15. This SORP requires that a charity that has been granted the power to invest on a total return basis by a Charity Commission for England and Wales order, or where the trustees have exercised the power granted under section 104A(2) of the Charities Act 2011, must provide the following additional information in the trustees' annual report:

- the date that the initial value of the trust for investment and the initial value of the unapplied total return was established
- the policy used to identify the initial amounts of the trust for investment, any unapplied total return and the date this analysis was performed
- an explanation of the policies used by the charity's trustees and the factors considered in determining the amount of the unapplied total return allocated to income (termed the trust for application) as well as any amounts allocated to the trust for investment in the reporting period
- an explanation of the policies used by the charity's trustees and the factors considered in determining the amount, if any, of the trust for investment (permanent endowment) allocated to the unapplied total return, or any recoupment made from the unapplied total return into the trust for investment in the reporting period
- the name and professional qualifications of any person who has provided advice to the charity's trustees as to the amount that can be allocated to income and/or the trust for investment from the unapplied total return in the reporting period

21. Accounting for social investments

Types of social investment and income risk sharing arrangements

21.1 The reporting tiers applied for module 21 are as specified in the table below.

Table 21.1A: Tiered reporting requirements for module 21

All tiers	The requirements in this module apply fully to all charities who make social investments.
Tier 2 and tier 3	In addition to the requirements of this module charities in tier 2 and tier 3 must provide an explanation of the charity's social investment policies in the trustees' annual report and explain how the investments contributed to the achievement of the charity's purposes (these requirements are set out in paragraph 1.25, SORP module 1 '*Trustees' annual report*')

21.2 This module applies to all charities making social investments. FRS 102 does not provide specific accounting guidance on social investments and therefore this module explains what a social investment is and how such investments must be measured and disclosed when accounts are prepared using this SORP.

21.3 A charity making or in receipt of social investments or undertaking complex contractual arrangements needs to consider carefully the nature of the arrangement and account for the substance of the arrangement.

21.4 To account for the investment or contractual arrangement correctly, a charity needs to be able to identify:

- the nature of the asset or entitlement to income acquired
- the basis upon which any financial return is calculated
- the method(s) to be used to measure financial return
- the nature of any liabilities or obligations acquired
- the method(s) to be used to measure any liability or obligation
- the charity's motive(s) for acquiring the investment

21.5 Reference must be made to the SORP module 10 '*Balance sheet*', which sets out the classification and disclosures required for investments and liabilities, and to the SORP module 5 '*Recognition of income, including legacies, grants and contract income*', which sets out the basis for income recognition including profit-sharing arrangements.

21.6 Previously the SORP has divided social investments into programme related investments and mixed motive investments. This has been simplified in this SORP by only referring to social investments. Comparative information must be restated as far as practicable on a like-for-like basis.

How the SORP defines social investment

21.7 This SORP uses the term 'social investment' to describe a class of assets that comprises investments made for both a financial return and to further the investing charities' purpose.

21.8 Social investments may take a variety of forms such as making loans, taking on a commitment, for example by giving a guarantee, or buying shares in a private company. An example is a development charity making a loan to a small-scale farming business. This helps to achieve the charity's purposes directly through the investment by bringing benefits to the local population, as well as providing a financial return from interest on, and repayment of the loan.

21.9 When a social investment is held in a subsidiary entity, an associate or joint venture, reference must also be made to the SORP module 24 '*Accounting for groups and the preparation of consolidated accounts*', SORP module 28 '*Accounting for associates*' and SORP module 29 '*Accounting for joint ventures*'.

21.10 This module sets out:

- Social investment policies
- Social investments in property (land and buildings)
- Social investments loans
- Accounting for guarantees
- Accounting for ordinary or preference shares
- The presentation of social investments in the investing charity's accounts
- The reclassification of a social investment as a financial investment
- Impairment of social investments
- Accounting for impairment losses
- Accounting for gains on disposal
- Information to be provided in the investing charity's trustees' annual report
- Disclosures in the notes to the accounts

Social investment policies

21.11 When social investment forms a material part of the charity's charitable and investment activities, tier 2 and tier 3 charities must provide an explanation of the charity's social investment policies in the trustees' annual report and explain how the investments contributed to the achievement of the charity's purposes. Tier 1 charities are also encouraged to make these disclosures. See paragraph 1.25, SORP module 1 '*Trustees' annual report*'.

Social investments in property (land and buildings)

21.12 Property may be classified as a social investment when it is held to enable a third party to undertake activities using the property that contribute to the investing charity's charitable purposes.

21.13 Property used by a charity to provide goods or services, or used for its own administrative purposes, must be presented within tangible fixed assets (property, plant and equipment). Similarly, property that is let out to further the lessor charity's own purposes by providing a service to a charity's own beneficiaries must also be accounted for within tangible fixed assets.

21.14 A charity that decides to occupy a property partly to carry out its own activities and partly lets it to another charity or third party which undertakes activities that further the landlord charity's purposes, should apportion it between tangible fixed assets and social investments. However, if such an apportionment is impracticable, the whole property must be classed as a tangible fixed asset.

21.15 Property that is held to generate rental income and/or for its capital appreciation must be accounted for as investment property.

21.16 A mixed use property used in part by the charity to provide goods or services and for its own administrative purposes, and in part to generate rental income, must be apportioned between tangible fixed assets and investment property if the resulting portions could be sold separately or leased out separately under a finance lease. However, if the fair value of the investment property component cannot be measured reliably, the entire property shall be accounted for, in the case of property held by the owner, as property, plant and equipment in accordance with Section 17 of FRS 102 or, in the case of property held by the lessee, as a right-of-use asset in accordance with Section 20 of FRS 102.

Social investment loans

21.17 A social investment may be made in the form of a concessionary loan to a third party interest free, or at below prevailing market rates. Concessionary loans are not made solely to achieve a financial return but also to advance the charity's purposes. **Concessionary loans**, as defined in FRS 102, are not repayable on demand.

21.18 Other loans that are interest free or at below market rate but are repayable on demand do not meet the FRS 102 definition of a concessionary loan. These loans are Social Investments and must be accounted for in line with section 11 and 12 of FRS 102 as well as making the disclosures required in this module.

21.19 Charities making (or receiving) concessionary loans must opt to either:

- initially recognise and measure the loans at the amount received or paid, with the carrying amount adjusted in subsequent years to reflect repayments and any accrued interest and adjusted, if necessary, for any impairment (with any losses recognised in income and expenditure). For further information on accounting treatment please refer to PBE34.87 to PBE34.97 of FRS 102
- apply the charity's accounting policy for financial instruments (refer to SORP module 11 '*Accounting for financial assets and financial liabilities*')

21.20 The same accounting policy for the measurement of concessionary loans must be applied to concessionary loans both made and received.

Accounting for guarantees

21.21 A charity may, as part of its strategy for social investments, provide loan guarantees to facilitate the financing of activities undertaken by third parties. All

such guarantees must be recognised by the charity making a guarantee as either a provision or a contingent liability depending upon the circumstances that exist as at the reporting date. A charity receiving a guarantee must disclose the guarantee as a contingent asset when an inflow of economic benefits is probable. If it is virtually certain that the guarantee will be called upon it is no longer contingent and the income receivable is recognised.

Accounting for ordinary or preference shares

21.22 When a social investment takes the form of ordinary or preference shares, it must be measured at the reporting date:

- at its fair value, if this can be measured reliably
- if its fair value cannot be measured reliably, at its cost less impairment. If a reliable measure of fair value is no longer available for an asset measured at fair value, its carrying amount at the last date the asset was reliably measurable becomes its new cost. An entity shall measure the asset at this cost amount less impairment until a reliable measure of fair value becomes available

21.23 The bid price may be used to measure fair value for accounting purposes of shares that are traded in an active market. When quoted prices are unavailable, the price of recent transactions of identical (or similar) investments in an arm's length transaction between knowledgeable, willing parties may offer evidence of their fair value, provided that there has not been a significant change in economic circumstances since those transactions. Prices may need to be adjusted if the last transaction price is not a good estimate of fair value (for example, if the transaction was as a result of a forced sale).

21.24 If neither the market price nor recent transaction prices provide a reliable estimate of fair value, then the fair value shall be estimated using another valuation technique. The objective of using another valuation technique is to estimate the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date. Refer to Section 2A.16 of FRS 102.

21.25 If a reliable measurement of fair value is no longer available for an asset measured at fair value, its carrying amount at the last date the asset was reliably measurable becomes its new cost. An entity shall measure the asset at this cost amount less impairment until a reliable measure of fair value becomes available.

The reclassification of a social investment as a financial investment

21.26 If a social investment ceases to be held to further the charity's purposes of the investing charity, it must be reclassified as a financial investment, or investment property, as appropriate.

21.27 However, if the failure of the investment to contribute to the charity's purposes of the investing charity is only temporary, a social investment should not be reclassified; instead, it should be subject to a review for impairment.

21.28 If the contribution made by a social investment to the investor's charitable purposes is reduced significantly, for example, due to a change in the activities financed by

the investment), then the classification of the asset must be reviewed. When necessary, the asset must be reclassified appropriately in the balance sheet and/or the notes to the accounts to reflect the purpose of the investment.

21.29 A financial investment acquired to generate a financial return must not be subsequently reclassified as a social investment as the initial decision to make the investment was based wholly on commercial considerations. Similarly, where financial investments are selected on other criteria, for example environmental, social or governance reasons, the investments must not be classified as social investments as they are held for financial return. However, the notes to the accounts may be used to identify the amounts of investments held that were selected using these other criteria.

Impairment of social investments

21.30 Social investments that are measured at cost or amortised cost must be assessed for objective evidence of impairment at the end of each reporting period.

21.31 If there is objective evidence of impairment, for example, a default on repayments due or evidence of significant financial difficulty in the entity in which the investment has been made, then an immediate impairment loss must be recognised in the statement of financial activities (SoFA). The impairment is measured on the same basis as other investments or financial assets. See paragraph 11.21 of FRS 102 for further information.

Accounting for impairment losses

21.32 An impairment loss arising on a social investment should be recognised as an investment impairment in the ‘gains/(losses) on investments’ line in the SoFA.

21.33 Any reversal of a previous impairment must be credited to ‘gains/(losses) on investments’ . The reversal of an impairment charge must not result in an asset’s carrying amount exceeding its carrying amount prior to its initial impairment.

Accounting for gains on disposal

21.34 Any gain on the disposal of a social investment must be recognised in the ‘gains/(losses) on investments’ line in the SoFA after offsetting any prior impairment loss.

Information to be provided in the investing charity’s trustees’ annual report

21.35 This SORP requires that tier 2 and tier 3 must include an explanation of the charity’s policy for the use of social investments in the trustees’ annual report when such holdings are material. The report must also explain the investment’s performance in relation to the objectives set by the trustees. Further guidance is provided in the SORP module 1 ‘*Trustees’ annual report*’.

Disclosures in the notes to the accounts

21.36 This SORP requires that the accounting policy note must disclose:

- the measurement bases used for social investments
- any other accounting policies that are relevant to understanding these transactions in the accounts

21.37 This SORP also requires that the notes to the accounts must present social investments as a separate class of investment in the relevant note, if not separately disclosed on the balance sheet, and disclose:

- details required by the SORP module 10 '*Balance sheet*' for the relevant classes of fixed asset into which the investment falls
- details and amount of any guarantee made to, or on behalf of, a third party
- the name of the entity or entities benefiting from those guarantees
- an explanation as to how the guarantee furthers the charity's purposes

21.38 The applicable disclosures set out in the SORP module 11 '*Accounting for financial assets and financial liabilities*' must also be made.

21.39 Section 34 of FRS 102 sets out the accounting treatment and disclosures relating to concessionary loans. Charities must disclose:

- the carrying amount of concessionary loans made or received (multiple loans made or received may be disclosed in aggregate, provided that such aggregation does not obscure significant information)
- the terms and conditions of concessionary loan arrangements (for example, the interest rate, any security provided and the terms of repayment)
- the value of any concessionary loans that have been committed but not taken up at the reporting date
- Separately, amounts payable or receivable within one year and amounts payable or receivable after more than one year

22. Accounting for charities pooling funds for investment

Introduction

22.1. The reporting tiers applied for module 22 are as specified in the table below.

Table 22.1A: Tiered reporting requirements for module 22

All tiers	The requirements of this module apply to all charities that need to account for pooled investment funds

22.2. FRS 102 does not address how charities account for pooled investment funds. This module sets out the accounting requirements, reflecting charity law, for:

- Common investment funds and common deposit funds
- Charitable authorised investment funds (England and Wales only)
- Accounting for pooling schemes and arrangements with common trustees
- Disclosure for pooling schemes and arrangements with common trustees

Common investment funds and common deposit funds

22.3. Common investment funds (CIFs) and common deposit funds (CDFs) are charities which accept contributions or deposits from any charity and invest these contributions or deposits to earn a return for the investing charities.

22.4. The fund managers and any corporate trustees of CIFs and CDFs are usually regulated by the financial markets' regulator in the jurisdiction(s) in which they are established.

22.5. CIFs and CDFs must not adopt the charities SORP when preparing their trustees' annual report and accounts. Instead, as collective investment schemes, CIFs and CDFs must follow any charity-specific reporting requirements set out in the regulations applying in the jurisdiction in which they are established. Charities in England and Wales must follow the Charities (Accounts and Reports) Regulations 2008 and charities in Northern Ireland must follow the Charities (Accounts and Reports) Regulations (Northern Ireland) 2015. The regulations currently require charities to also consider the Investment Association (previously the IMA) Statement of Recommended Practice.

22.6. Certain CIFs restrict participation in the fund to particular charities that are connected in some way, for example by having similar purposes but without necessarily sharing a common body of trustees. Restricted participation CIFs must not adopt the Charities SORP when preparing their trustees' annual report and accounts but instead must follow the particular reporting requirements in the jurisdiction in which they are established. Charities in England and Wales must follow the Charities (Accounts and Reports) Regulations 2008 and charities in Northern Ireland must follow the Charities (Accounts and Reports) Regulations (Northern Ireland) 2015.

Charitable authorised investment funds (England and Wales only)

22.7. Charitable authorised investment funds (CAIF) are collective investment schemes authorised by the Financial Conduct Authority (FCA) and registered as charities. A CAIF is a type of CIF but is subject to the FCA rules and supervision because it is an authorised fund.

22.8. A CAIF must not adopt the Charities SORP but must follow the Financial Statements of UK Authorised Funds SORP (also known as the Investment Association SORP).

Accounting for pooling schemes and arrangements with common trustees

22.9. Charities with the same body of trustees may pool their investments to form a single investment fund, resulting in greater efficiency in the management of the investment. A pooling scheme or arrangement with common trustees may include linked charities or special trusts (England and Wales and Northern Ireland) or connected charities (Scotland). Separate charity accounts are not generally published for the pooling scheme or arrangement. Instead, the pooling scheme or arrangement must be presented as a restricted fund of the reporting charity responsible for operating the pooling scheme or arrangement.

22.10. The assets of the pooling scheme or arrangement are the investments held. Its liabilities are the share of these investments due to those charities or funds which have invested through the pooling scheme or arrangement. The income and costs of managing investments will accrue to the charities or funds investing in the pool. Much of this information will already be presented in the reporting charity's accounts but charities may choose to summarise this information as a note to the accounts, as set out in Table 20.

Table 20: Analysis of fund movements for a pooling scheme

	Fund/Charity A	Fund/Charity B	Fund/Charity C	Fund/Charity D	Fund/Charity E	Total
	£	£	£	£	£	£
Net assets brought forward						
Additions to investment pool						
Investment income						
Investment management expenses						
Realised investment gains/(losses)						
Unrealised investment gains/(losses)						
Less distributions (for charitable expenditure)						
Net assets carried forward						

22.11. A pooling scheme or arrangement that is registered or established as a separate charity must prepare its own accounts in accordance with this SORP and must make the additional disclosures set out in the section below.

Disclosure for pooling schemes and arrangements with common trustees

22.12. This SORP requires that a charity which is a pooling scheme or arrangement preparing separate accounts must disclose:

- that the accounts presented are for a pooling scheme or arrangement
- the date and authority, if any, for the pooling scheme or arrangement (for example, a scheme registered with a charity regulator)
- the names of the charities participating in the pooling scheme or arrangement
- an analysis of the investments held within the pooling scheme or arrangement in accordance with the SORP module 10 '*Balance sheet*'
- an analysis of the investment income, gains and investment management costs in accordance with the SORP module 4 '*Statement of financial activities*'

22.13. The notes to the accounts should also provide:

- an analysis of the proportions of the funds of the pooling scheme or arrangement attributable to each participating charity or fund at the end of the reporting period
- an analysis of the fund movements attributable to each participating charity or fund, reconciling the value of funds brought forward and carried forward

22.14. An example of how the analysis of fund movements for a pooling scheme or arrangement may be presented is set out in Table 20.

Selection 4: Accounting for branches, charity groups and combinations

23. Overview of charity combinations or interests in other entities

23.1. The reporting tiers applied for module 23 are as specified in the table below.

Table 23.1A: Tiered reporting requirements for module 23

All tiers	The requirements for charity combinations or interests in other entities apply to all charities

23.2. Charities may operate through branches or group structures or share resources, knowledge or service arrangements by working with other charities or non-charity entities to further shared objectives by establishing joint arrangements, activities and operations.

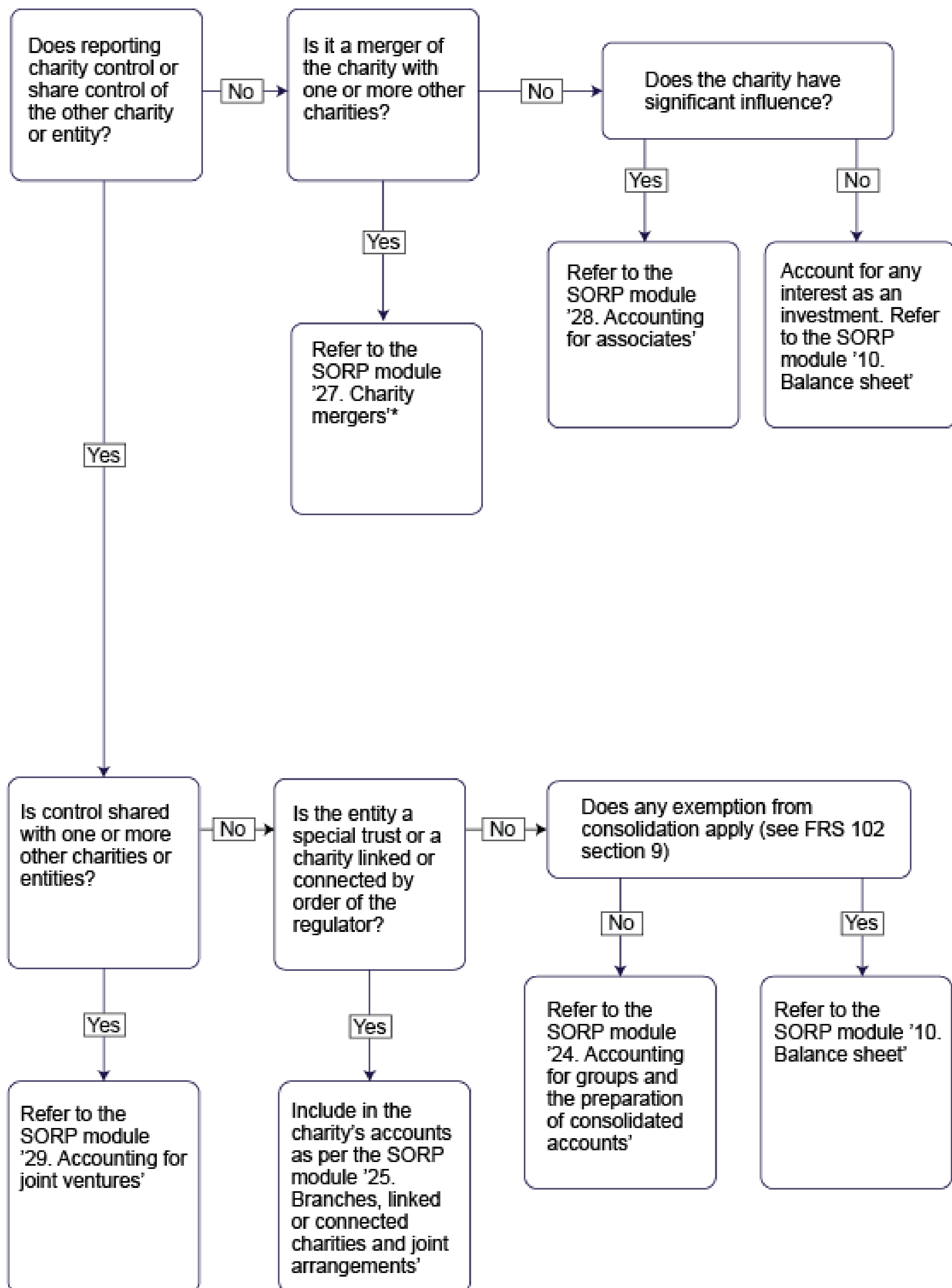
23.3. The accounting to be followed for the combination or joint venture depends on the substance of the arrangement and what form it takes, the nature and level of control exercised and whether that control is exercised over the other entity. Figure 2 provides a guide to which module to refer to when deciding on the accounting for a charity combination or interests in other entities. Depending on the nature of the arrangement, the charity must refer to:

- the SORP module 27 ‘*Charity mergers*’
- the SORP module 28 ‘*Accounting for associates*’
- the SORP module 10 ‘*Balance sheet*’
- the SORP module 29 ‘*Accounting for joint ventures*’
- the SORP module 25 ‘*Branches, linked or connected charities and joint arrangements*’
- the SORP module 24 ‘*Accounting for groups and the preparation of consolidated accounts*’

23.4. If the reporting charity is itself a subsidiary, it must refer to the SORP module 26 ‘*Charities as subsidiaries*’.

23.5. This SORP requires that related party transactions between a parent charity and its subsidiaries, associates and joint ventures must be disclosed. Similarly, in those circumstances where charities have trustees in common, consideration should be given as to whether the circumstances are such that related party disclosures are required. Refer to the SORP module 9 ‘*Disclosure of trustee and staff remuneration, related party and other transactions*’.

Figure 2: Guide to accounting for charity combinations or interests in other entities



*Charitable companies should refer to paragraph 27.5 of SORP module 27 '*Charity mergers*' and section A3.30A of FRS 102 to determine if they are permitted to use merger accounting

24. Accounting for groups and the preparation of consolidated accounts

Introduction

24.1. The reporting tiers applied for module 24 are as specified in the table below.

Table 24.1A: Tiered reporting requirements for module 24

All tiers	The requirements for group accounting and the preparation of consolidated accounts set out in this module apply fully to all charities preparing consolidated accounts.

24.2. All charities preparing consolidated accounts, whether as a requirement of company or charity law or on a voluntary basis, must follow this module and should refer to Section 9 of FRS 102 for more information. Details of the thresholds at which the preparation of consolidated accounts by charities is mandatory are set out in Appendix 3, 'Company law thresholds for the UK and the Republic of Ireland'.

24.3. Consolidated accounts are prepared by a parent charity and include all of the resources controlled by the parent charity. A parent charity is a charity that has one or more charitable or non-charitable subsidiaries (subsidiary entities).

24.4. Where consolidated accounts are prepared, the accounting disclosures required of the charity by other applicable modules are extended to the group accounts (unless otherwise stated).

24.5. This module sets out:

- The legal requirements to prepare consolidated accounts
- What are consolidated accounts?
- How control is identified
- The consolidation procedures and accounting for non-controlling (minority) interests
- Accounting for charity combinations
- Accounting for the acquisition and disposal of non-charitable subsidiaries
- Disclosures required where consolidated accounts are prepared

The legal requirements to prepare consolidated accounts

24.6. A parent charity must prepare consolidated accounts, in accordance with section 9 of FRS 102, to include all of its subsidiary entities where the accounts' preparation is a requirement of:

- company law
- charity law in the relevant legal jurisdiction(s)
- any other statutory or mandatory framework applicable to the charity

What are consolidated accounts?

24.7. Consolidated accounts, which are also known as group accounts, combine the activities, assets and liabilities of the reporting charity with those of the subsidiaries it controls. Consolidated accounts include the activities and funds of any subsidiary charity that is controlled by a parent charity as its trustee.

24.8. Consolidated accounts present the financial performance and financial position of the accounting group as though it were a single reporting entity with unity of trusteeship.

24.9. Consolidated accounts must disclose relevant information relating to any associates or joint ventures in which the parent charity has an interest. Refer to the separate SORP modules 28 '*Accounting for associates*' and 29 '*Accounting for joint ventures*' for more information.

24.10. The headings used in the accounts must state that they present the 'consolidated statement of financial activities' and 'consolidated balance sheet' of the parent charity and its subsidiaries, and the 'consolidated statement of cash flows'.

24.11. Consolidated accounts must also include any special purpose entity that is controlled by a parent charity and created to undertake an activity for the benefit of the parent charity. For more information about what constitutes a special purpose entity and the criteria for its consolidation, refer to section 9 of FRS 102, paragraphs 9.10 to 9.12.

24.12. A subsidiary must be excluded from consolidation where:

- severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary; or
- the subsidiary is held exclusively with a view to its subsequent resale and the subsidiary has not been previously consolidated by the charity

24.13. A subsidiary may be excluded from consolidation when its inclusion is not material for the purpose of giving a true and fair view (but two or more subsidiaries must only be excluded if they are not material when taken together). If immaterial subsidiaries, associates or joint ventures are excluded from the consolidated accounts, these are treated as investments and are reported at cost or fair value as appropriate. For more information, refer to the SORP modules 10 '*Balance sheet*', 28 '*Accounting for associates*' or 29 '*Accounting for joint ventures*'.

24.14. A subsidiary is not excluded from consolidation because:

- its activities are dissimilar to the parent charity or other entities within the consolidation
- it operates in a jurisdiction that imposes restrictions on transferring cash or other assets out of that jurisdiction provided it is able to control and manage those assets within that jurisdiction to further its charitable purposes

How control is identified

24.15. A parent charity consolidates the subsidiaries it controls. 'Control' is the power to govern the financial and operating policies of an entity in order to obtain benefits from its activities.

24.16. A parent charity consolidates the subsidiaries it controls. Control is made up of two elements: power and benefit. The underlying principle is that the parent charity exercises control to obtain benefit from its interest in the subsidiary. The parent charity is deemed to exercise control over a subsidiary if it has both the power to govern the financial and operating policies and the ability to benefit from the subsidiary's activities.

24.17. Control is presumed to exist when the parent charity owns, directly or indirectly through its subsidiaries, more than half the voting power of an entity. However, control can also exist when the parent charity directly or indirectly controls half or less than half of the voting power of an entity, if it has:

- power over more than half of the voting rights by virtue of agreement with other investors
- the power to govern the financial and operating policies of the entity under a statute or an agreement
- the power to appoint or remove the majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body
- the power to cast the majority of votes at the meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body

24.18. The nature of the control a parent charity exercises differs in its character between non-charitable subsidiaries and controlled charities. Where a charity exercises control as an owner or investor in a non-charitable subsidiary, it does so to benefit from the cash flows and the financial return from that investment.

24.19. The parent charity can exercise control through trusteeship, which gives a parent charity the ability to govern the financial and operating policies of the subsidiary charity. The consolidated accounts show the total funds under the trusteeship of the parent charity.

24.20. The power element of control of one charity by another can be identified through:

- sole trusteeship
- powers to appoint and/or remove a majority of the trustees

- the terms of a formal agreement or arrangement
- the provisions of a clause in the governing document or a legislative provision

24.21. Having trustees in common does not in itself demonstrate that the power element is present. Also, simply being the sole or main funder of another charity or entity is insufficient to demonstrate that the power element is present. While the funding of one charity by another indicates a degree of concurrence of purposes, for control to exist the power element must be present.

24.22. The benefit element of control is met where the purposes of the parent charity and its subsidiary charity are concurrent. The purposes of the parent charity do not have to be identical to those of its charitable subsidiary, nor do they need to encompass all the purposes of the charitable subsidiary. When considering whether the purposes are concurrent, judgement is required. The purposes of the parent charity have to be similar enough to those of the subsidiary that the activities of the subsidiary can be seen to contribute to the purposes and aims of the parent charity and to benefit the parent charity's beneficiaries. On rare occasions, it may not be clear that the benefit element of control is met. In these cases the parent charity will need to fully consider the elements of control noted at paragraph 24.17 above.

24.23. The parent charity might benefit where the services and benefits provided by the subsidiary charity to its own beneficiaries also contribute to the purposes of the parent charity. The funds of the subsidiary charity are restricted to its own purposes and, unless the parent and subsidiary charity have identical purposes, the subsidiary will be a separate component of the group's reported restricted funds. The reporting of a restriction over the use of a subsidiary charity's funds is important for the understanding of the consolidated accounts and of how funds held by charitable subsidiaries may be used. For example, the funds of a subsidiary charity are not normally available to the creditors of the parent charity in the event of the latter's insolvency.

Consolidation procedures and accounting for non-controlling (minority) interests

24.24. For guidance on how to apply the consolidation procedures, charities should refer to Section 9 of FRS 102 (see paragraphs 9.13 to 9.17). In particular, a parent charity must ensure that:

- the consolidation is undertaken on a line-by-line basis
- balances and transactions between the parent and the subsidiary are eliminated
- the accounts of the parent and its subsidiaries have, unless impracticable, the same reporting date
- uniform group accounting policies are adopted for transactions and other events or conditions in similar circumstances

24.25. Transactions between a parent and subsidiary charity are eliminated on

consolidation. In the consolidated balance sheet, the charitable funds of the parent charity and the subsidiary charity must not be consolidated on a line-by-line basis; instead, the subsidiary charity's funds should be shown as a component of restricted funds – unless the subsidiary and parent have identical purposes. Where the purposes are identical, the unrestricted funds of the subsidiary are a component of the unrestricted funds of the group.

24.26. In some cases, a parent charity may not own the entire equity of a subsidiary. In this case, a non-controlling interest (minority) interest must be recognised. A non-controlling interest exists where a third party has a right to dividends or the distribution of resources, a claim on the net assets of the subsidiary through the holding of equity or significant influence through its voting power.

24.27. Where a non-controlling interest exists, it is important to consider the substance of the interest as well as legal form. For example, a subsidiary may be established to assist a parent charity to further its aims with supporters of the charity subscribing to the share capital. If the non-controlling interest enters into an agreement to waive their right to a share of the net assets in the event of the subsidiary being wound up and to receiving any dividends, then the parent charity enjoys all the economic benefits of the subsidiary and the non-controlling interest should not be recognised.

24.28. Where a non-controlling interest in a non-charitable subsidiary is recognised, the parent charity must:

- present in its consolidated balance sheet the non-controlling interest in the net assets of the consolidated subsidiaries separately from the parent charity's interest in them
- separately present the non-controlling interest share of net income (or net expenditure) in the income or expenditure section of the consolidated statement of financial activities (SoFA)
- present separately the non-controlling interest's share of any net gain or loss reported within the 'other recognised gains and losses' section of the consolidated SoFA

24.29. In the case of a non-controlling interest in a subsidiary charity, the measurement of the non-controlling interest should consider the substance of the arrangement and the extent to which, if at all, the non-controlling interest benefits from its interest.

24.30. The carrying amount of the non-controlling interest will need to be adjusted if there are changes in a parent charity's controlling interest in a subsidiary that do not result in a loss of control. FRS 102 considers these changes to reflect transactions with equity holders in their capacity as equity holders. The carrying amount of the non-controlling interest must be adjusted to reflect the change in the parent charity's interest in the subsidiary's net assets in accordance with paragraph 9.20A of FRS 102.

Accounting for charity combinations

24.31. Charities may on occasion combine into one reporting entity or operate through

a restructured group. To establish whether the combination meets the definition and criteria of a merger, reference must be made to the SORP module '27. *Charity mergers*'. Combinations that are not mergers may also take place between charities whereby assets and liabilities of one charity are transferred into the control of another charity at nil or nominal consideration and are in substance a donation/gift . If the fair value of the assets received exceeds the fair value of the liabilities assumed, a gain is recognised and shown separately within income – normally as a donation/gift. Conversely, if the fair value of liabilities assumed exceed the fair value of the assets acquired then a net loss is recognised and shown separately in charitable expenditure. If the combination is neither in substance a donation/gift nor a merger, it must be accounted for as an acquisition with any negative goodwill accounted for in line with paragraph 24.35 below. Charities should refer to paragraph 19.24 of FRS 102 for more information on accounting for negative goodwill.

24.32. A combination that is in substance a donation shall be accounted for in accordance with Section 19 of FRS 102, except for the matters addressed in paragraphs PBE34.78 and PBE34.79 of FRS 102.

Accounting for the acquisition and disposal of non-charitable subsidiaries

24.33. The income and expenditure of a subsidiary are included in the consolidated accounts from the date of the acquisition. The income and expenditure of a subsidiary are similarly included in the consolidated accounts until the date on which the parent charity ceases to control the subsidiary. Charities should refer to Section 9 of FRS 102 paragraphs 9.18 to 9.19D for more information on the acquisition and disposal of subsidiaries.

24.34. Where the parent charity acquires a non-charitable subsidiary and the consideration paid exceeds the fair value of the net assets acquired, goodwill arises on acquisition and is disclosed in the consolidated balance sheet. 'Goodwill' is an intangible asset arising on the acquisition of a subsidiary purchased by the reporting charity. If, in exceptional cases, the useful life for goodwill cannot be estimated reliably, the life shall not exceed 10 years. Goodwill must be amortised across its useful economic life. A charity must also assess goodwill, at each balance sheet date, for any indication of impairment, as set out in SORP module 12 '*Impairment of assets*'.

24.35. However, in the case of a combination which is in substance a donation to the parent charity (where the consideration paid is nil or a nominal amount and is less than the net assets acquired) the parent charity has made a gain. The parent charity should recognise that gain as 'other income' in the consolidated SoFA, rather than treat it as negative goodwill on consolidation. In all other cases, where a parent charity acquires a subsidiary for consideration that is less than the fair value of the assets acquired, negative goodwill arises on the acquisition. Negative goodwill is disclosed separately in the consolidated balance sheet and released to income

as the acquired non-monetary assets are depreciated or recovered through sale. Any negative goodwill in excess of the fair values of the non-monetary assets acquired is recognised as income in the periods expected to benefit (for more on goodwill arising on acquisition see paragraphs 19.22 to 19.24 of FRS 102).

24.36. On the disposal of a controlling interest in a subsidiary, the reporting charity recognises a gain or loss on disposal in the appropriate line of the consolidated SoFA. If the reporting charity retains an equity interest in the former subsidiary, it must determine whether the retained interest represents an investment, an associate or a joint venture and account for it accordingly.

Intangible assets acquired in the acquisition of non-charitable subsidiaries

24.37. An intangible asset is recognised as an asset if, and only if:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the charity
- the cost or value of the asset can be measured reliably

24.38. Where a parent charity acquires a non-charitable subsidiary and acquires intangible assets, these assets must be recognised separately from goodwill when:

- the recognition criteria set out in paragraph 24.37 are met
- the intangible asset arises from contractual or other legal rights
- the intangible asset is separable (i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability)

24.39. A charity may additionally choose to recognise any or all intangible assets separately from goodwill when the recognition criteria set out in paragraph 24.37 are met, and when either of the following conditions are satisfied:

- the intangible asset arises from contractual or other legal rights
- the intangible asset is separable

24.40. Where a charity chooses to recognise such additional intangible assets, this policy must be applied to all intangible assets in the same class (i.e. having a similar nature, function or use in the charity), and must be applied consistently to all non-charitable subsidiaries acquired. The charity must also disclose the nature of those intangible assets and the reason why they have been separated from goodwill. For more information refer to paragraph 18.8 of FRS 102.

Disclosures required where consolidated accounts are prepared

24.41. The following disclosures must be made in the group's accounting policies

note when consolidated accounts are prepared (see paragraph 9.23 of FRS 102):

- a statement that the accounts are consolidated
- the basis for concluding that control exists when the parent charity does not own, directly or indirectly through subsidiaries, more than half of the voting power
- any difference in the reporting date of the accounts of the reporting charity parent and its subsidiaries in the preparation of the consolidated accounts
- the nature and extent of any significant restrictions on the ability of subsidiaries to transfer funds to the parent charity in the form of cash dividends or to repay loans
- the name of any subsidiary excluded from consolidation, and the reason for its exclusion
- the nature and extent of any interests in unconsolidated special purpose entities, and the risks associated with those interests

This SORP requires that the fair value of any non-controlling interest is disclosed as a separate item, after the 'Funds of the charity' heading, in the balance sheet.

24.42. This SORP requires that consolidated accounts must disclose, in relation to each material subsidiary:

- its name(s), company number and, where applicable, its charity registration number
- particulars including the percentage of the parent charity's equity shareholding or other means of control
- the aggregate amount of its assets, liabilities and funds at the end of the reporting period
- a summary of its turnover (or gross income) and expenditure and its profit or loss (or surplus or deficit) for the reporting period

24.43. If a charity has a large number of subsidiary undertakings, the SORP allows a charity to limit the information to those subsidiary undertakings the results or financial position of which have a material effect on the amounts shown in the consolidated accounts.

In relation to business combinations, charities should refer to disclosures noted in FRS 102, paragraphs 19.25 to 19.26B.

25. Branches, linked or connected charities and joint arrangements

Introduction

25.1. The reporting tiers applied for module 25 are as specified in the table below.

Table 25.1A: Tiered reporting requirements for module 25

All tiers	The requirements for branches, linked or connected charities and joint arrangements in this module apply fully to all charities.

25.2. All charities that operate through branches must apply this module. This module also applies to charities when accounting for:

- special trusts and any other non-corporate entities which are administered by, or on behalf of, the reporting charity and whose funds are held for specific purposes which are within the general purposes of the reporting charity
- charities linked by the Charity Commission (England and Wales)
- charities that are connected (Scotland)
- joint venture activities through jointly controlled operations or through using jointly controlled assets that do not involve the establishment of a separate jointly controlled entity. Where a separate jointly controlled entity is established, charities should refer to the SORP Module 29 '*Accounting for Joint Ventures*' and Section 15 of FRS 102 '*Investments in Joint Ventures*' for further guidance

25.3. FRS 102 provides general accounting guidance on jointly controlled assets and jointly controlled operations in Section 15, but it does not specifically address the unique circumstances of charities, such as branches, special trusts, linked or connected charities, or shared operations or assets in a sector-specific context. This module supplements FRS 102 by reflecting current accounting practice and the requirements of charity law.

25.4. This module sets out:

- What is meant by the term 'branch'?
- Accounting for branches
- When to apply branch accounting to other arrangements
- Branch accounting for special trusts (England and Wales) and similar arrangements
- Branch accounting for linked charities (England and Wales)
- Branch accounting for connected charities (Scotland)

- Accounting for joint arrangements involving other charities

What is meant by the term ‘branch’?

25.5. The term ‘branch’ is used in this SORP to describe a charity’s administrative arrangements whereby its internal operating structure is arranged according to function, location or other factor designed to facilitate its administration.

25.6. Branches may include supporters’ groups, members’ groups, and offices in different countries, communities or parishes that are part of a charity. Branches are commonly used to organise fundraising, to represent the charity in a locality or to carry out the charity’s work in a locality.

25.7. The indicators of a branch include the following:

- it uses the name of the reporting charity in its title
- it raises funds exclusively for the reporting charity and/or its local activities
- it uses the reporting charity’s registration number on its letterheads, publicity and website
- it uses the reporting charity’s registration number to receive tax relief on its activities
- it represents itself to the public as the reporting charity’s local representative or its representative for a particular purpose
- it receives support from the reporting charity through advice, publicity materials, fundraising, etc.

25.8. Excluded from the SORP definition of branches are:

- charities that are incorporated and have a legal personality separate from their directors/trustees and members, for example charities incorporated under the Companies Act, Co-operative and Community Benefit Societies (formerly known as Industrial and Provident Societies), Charitable Incorporated Organisations or companies established by statute or Royal Charter
- groups of people who gather together to raise funds for a charity or a number of different charities
- special-interest groups that are affiliated to a particular charity but do not themselves undertake charitable or fundraising activities for the charity

25.9. All the funds held by the branch will be the legal property of the reporting charity or under the direct control and management of the trustees of the reporting charity. This is the case whether or not a branch has a separate bank account.

Accounting for branches

25.10. A branch is an internal structure adopted by a charity to undertake its activities. All transactions undertaken through a branch must be accounted for gross in the reporting charity's own accounts. Similarly, the reporting charity's balance sheet must include all assets and liabilities of the branch when in aggregate these amounts are material. For example, the branch may hold funds at the reporting date that have been raised but not yet remitted to the head office of the reporting charity. When material, these funds must be included in the accounts of the reporting charity.

25.11. Funds raised by a branch for the general purposes of the charity will be accounted for by the reporting charity as unrestricted funds. Funds raised by a branch for specific purposes are accounted for as restricted funds of the charity.

25.12. Any branch accounts form part of the results reported in the accounts of the reporting charity. Individual memorandum branch accounts may be prepared covering only each branch in order to provide information for the benefit of local supporters and beneficiaries.

When to apply branch accounting to other arrangements

25.13. Branch accounting should also be adopted for certain other arrangements that are not subsidiaries, associates or jointly controlled entities, including:

- special trusts (in England and Wales) and similar arrangements
- charities linked by the Charity Commission (England and Wales)
- charities that are connected (Scotland)
- joint venture activities that do not involve a jointly controlled entity being established

Branch accounting for special trusts (England and Wales) and similar arrangements

25.14. If a separate legal entity, which is not an incorporated charity, is administered by, or on behalf of, the reporting charity and its funds are held for specific purposes which are within the general purposes of the reporting charity, that entity may form part of the reporting charity for accounting purposes.

25.15. In England and Wales such arrangements will usually fall within the definition of a special trust set out in section 353(4) of the Charities Act 2011: 'property which is held and administered by or on behalf of a charity for any special purposes of the charity, and is so held and administered on separate trusts relating only to that property'.

25.16. A special trust may be a separate endowment fund, a restricted fund, for example a prize fund, or a specific piece of land or an item of property. A

special trust can be a separate non-company charity, but where this is the case it is usually listed as a component of the register entry for the reporting charity itself.

25.17. A special trust is not a separate reporting entity in charity law for the purposes of preparing and filing of a trustees' annual report and accounts. Instead, it is accounted for as a restricted fund in the accounts of the charity that is acting as trustee of the special trust.

25.18. A special trust is accounted for in a similar manner to a branch, but the accounts should separately identify the special trust(s) as a component of restricted funds.

Branch accounting for linked charities (England and Wales)

25.19. In England and Wales, the Charity Commission can link two or more charities using a direction made under section 12 of the Charities Act 2011. The effect is to link two or more charities for registration and accounting purposes, with the aim of simplifying the reporting arrangements. Linking can apply where the charities either have trustees in common or the charities have common purposes and are interdependent.

25.20. Branch accounting should be adopted for all linked charities that are not companies established under company law. If one or more of the linked charities is a company, company law requires that each prepares its own entity accounts. Consolidated accounts must be prepared by the parent charity if the combined income of the reporting charity and linked subsidiary-company charities exceeds the applicable threshold (see Appendix 3, 'Company law thresholds for the UK and the Republic of Ireland') or they have been linked for reporting purposes (section 12 of the Charities Act 2011) in which case a linked charitable company is treated as a subsidiary. Refer to the SORP module 24 '*Accounting for groups and the preparation of consolidated accounts*'.

25.21. Accounts prepared for linked charities on a branch basis combine (or aggregate) the funds held by each linked charity. However, the funds of each linked charity must be separately identifiable as they are not merged together. Each charity retains its own charitable purpose. The separate charities are reported in a manner that is similar to the presentation of restricted funds (refer to the SORP module 2 '*Fund accounting*' for the disclosures required for restricted funds).

25.22. Linked charities should be presented in the combined accounts by:

- including a separate column or columns in the statement of financial activities (SoFA) and the balance sheet for each linked charity
- providing an analysis in the notes to the accounts differentiating the activities and funds held by each linked charity, including any restricted funds

Branch accounting for connected charities (Scotland)

25.23. In Scotland, two or more charities can be connected under Regulation 7 of the Charities Accounts (Scotland) Regulations 2006 (as amended). Connected charities are those charities that have common or related charitable purposes or those that have common control or unity of administration. The connected charities may prepare a single set of accounts.

25.24. Where connected charities prepare a single set of accounts, they must include all of the information for each charity that would be required if each charity produced individual accounts. This may be achieved, for example, by including a separate column or columns in the SoFA and balance sheet.

Accounting for joint arrangements involving other charities

25.25. Joint arrangements can take many forms, and charities must consider the substance of the arrangement. Charities should make reference to any agreements to identify the charity's share of the income and expenditure, and assets and liabilities relating to the joint arrangement. Where a joint arrangement meets the definition of joint venture, charities should refer to Section 15 of FRS 102 'Investments in Joint Ventures'.

25.26. A joint venture is a specific form of joint arrangement. A joint venture is established by contractual agreement whereby two or more parties (the venturers) undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control over an economic activity. It exists only where the strategic financial and operating decisions relating to the activity require the unanimous consent of all of the parties sharing control.

25.27. A joint venturer of either a jointly controlled operation or jointly controlled assets, must include in its accounts its own charity's share of the income and expenditure relating to the joint venture activity. For jointly controlled assets, the charity must also include its share of the assets and liabilities in its accounts. For jointly controlled operations, each venturer accounts for the assets it directly controls and the liabilities it incurs. Where appropriate, the joint venture should be reported as a separate activity in the SoFA and notes to the accounts. However, if a jointly controlled entity is established, refer to the SORP module 29 '*Accounting for joint ventures*' for the accounting treatment to follow. Preparers should also refer to paragraphs 15.4 to 15.7 of FRS 102 for detailed requirements on jointly controlled operations and jointly controlled assets.

26. Charities as subsidiaries

Introduction

26.1. The reporting tiers applied for module 26 are as specified in the table below.

Table 26.1A: Tiered reporting requirements for module 26

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

26.2. On occasion, a company or other incorporated body may act as a charity's corporate trustee, or a charity's trustees may be appointed by another entity. In these circumstances, the charity can be viewed for accounting purposes as a subsidiary because it is being 'controlled' by another entity through the trusteeship arrangements. This module applies to charities that are treated as a subsidiary in the accounts of another entity.

26.3. A subsidiary is an entity that is controlled by a parent entity. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Although a charity is controlled and managed by its trustees, it can be a subsidiary for accounting purposes when the criteria for control are met.

26.4. A charity that is a subsidiary, for accounting purposes, of another charity or other entity, must make the disclosures required by this module in its own accounts.

26.5. Charities should refer to Section 33 of FRS 102 Related Party Disclosures for more information.

Disclosure requirements

26.6. A charity that is a subsidiary must disclose in a note to its own accounts the name of its parent entity and, if different, the ultimate controlling party. If neither the charity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) must also be disclosed.

26.7. Relationships between a parent and its subsidiaries must be disclosed irrespective of whether there have been related party transactions.

26.8. This SORP also requires that a subsidiary must also disclose:

- the country of incorporation of its parent entity, if it is outside the UK or the Republic of Ireland
- the address of its parent's place of business, if the parent is unincorporated
- if the parent is a charity, its charity registration number and, if applicable, its company registration number in the jurisdiction of its registration

- the parent's principal purposes and activities
- how control can be exercised by the parent, for example through corporate trusteeship or through a power to appoint or remove the majority of trustees
- the address from which the public can obtain the consolidated accounts that include the subsidiary charity's accounts

26.9. Where for accounting purposes the parent entity is itself a subsidiary of another entity, this SORP requires that the notes to the accounts must disclose the same information about the subsidiary charity's ultimate parent entity.

26.10. Charities must also make the applicable disclosures set out in the SORP module 9 '*Disclosure of trustee and staff remuneration, related party, and other transactions*'.

27. Charity mergers

Introduction

27.1. The reporting tiers applied for module 27 are as specified in the table below.

Table 27.1A: Tiered reporting requirements for module 27

All tiers	The requirements for charity mergers in this module apply fully to all charities.

27.2. This module applies to charities that have combined and meet the criteria for merger accounting. Charities should refer to FRS 102, section 19 Business Combinations and Goodwill and Section 34 Public Benefit Entity Combinations paragraphs 34.75 to 34.86.

27.3. A charity merger involves two or more charities coming together in a partnership for the mutual sharing of risks and benefits, with no party obtaining control over any other. A merger often involves the formation of a new charity to further the purposes of the combining charities and to control the activities, assets, and liabilities of the combining charities. The module sets out:

- Criteria for merger accounting
- Accounting for mergers
- Accounting for charity reconstructions as mergers
- Disclosures relating to mergers

Criteria for merger accounting

27.4. A charity combination must be accounted for as a merger if all of the following criteria are met:

- it is permitted by the statutory framework
- no party to the combination is portrayed as either acquirer or acquiree, either by its governing body or management or by that of another party to the combination
- all parties to the combination, as represented by the members of the governing body, participate in establishing the management structure of the combined charity and in selecting the management personnel. Such decisions are made on the basis of a consensus between the parties to the combination, rather than purely by exercising voting rights
- there is no significant change to the class of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination

27.5. Charities that are UK registered companies and enter into a business combination with a third party cannot apply merger accounting to that combination. However, in exceptional circumstances where acquisition accounting does not provide a true and fair view, a charitable company may consider applying the true and fair override as outlined in Appendix III: Note on Legal Requirements of FRS 102. If adopting merger accounting, the charity must provide the corresponding disclosures. Unincorporated charities, charitable incorporated organisations and non-UK registered companies can continue to apply merger accounting if they meet the criteria set out in FRS 102 and this SORP, provided merger accounting is not prohibited by other relevant legislation.

27.6. When charities merge, their purposes must be the same or substantially the same. The purposes of the new reporting entity must encompass those of the combining charities. While a merger may result in some changes to how activities are carried out, and/or some minor changes to purposes, a significant change in purposes or the beneficiary class would rule out accounting for the combination using merger accounting.

27.7. For merger accounting to apply, no major change to the classes of beneficiaries or the purposes of the benefits provided should occur. Minor adjustments, such as slightly broadening the beneficiary class or purposes, do not preclude the use of merger accounting.

27.8. If the combination does not meet all of the above criteria, then it must be treated as an acquisition (see the SORP module 24 '*Accounting for groups and the preparation of consolidated accounts*').

Accounting for mergers

27.9. Merger accounting involves aggregating the assets, liabilities and funds of the combining charities and presenting them as though they had always been part of the same reporting charity. Although the merger may have taken place part way through a reporting period, the accounts must be drawn up to include the results of the combining charities for the whole of the reporting period in which the merger occurred.

27.10. Any funds of the combining charities that are restricted to the particular purposes of the new charity must continue to be presented as 'restricted' in the accounts of the merged charity. The unrestricted funds of the constituent charities to the merger will be aggregated provided that their purposes are identical to the new charity. Refer to the SORP module 2 '*Fund accounting*' for more information on the classification of funds.

27.11. The accounts must present comparative amounts on the same basis to show the aggregated results for the combining charities for the previous reporting period. The comparative amounts should be identified as being 'combined' figures.

27.12. The carrying amount of assets and liabilities of the combining charities is not restated to fair value, although adjustments must be made to ensure

uniformity of accounting policies.

Accounting for charity reconstructions as mergers

27.13. In some cases, a charity may change its legal form but there is no significant change to its purposes and beneficiary class. The most common examples are the decision by trustees of an unincorporated charity to establish a charitable company or charitable incorporated organisation to take forward the charity's work and the conversion of a charitable company to a charitable incorporated organisation. Another common example is the transfer of activities to a wholly-owned subsidiary undertaking. A subsidiary entity may be established to undertake non-charitable trading activities previously undertaken by the parent charity.

27.14. These reconstructions should be treated as mergers and not acquisitions, provided that:

- the use of the merger accounting method is not prohibited by company law or other relevant legislation
- the beneficiary class is not significantly changed
- the purposes for which funds are held are not significantly changed
- the persons who constitute the trustee body are not significantly changed
- no non-controlling interest in the net assets of the charity is altered by the transfer

Disclosures relating to mergers

27.15. In the reporting period in which the merger takes place, the accounts for the merged charities must disclose:

- the names and descriptions of the combining charities
- the date of the merger
- an analysis of the principal components of the current reporting period's statement of financial activities (SoFA), to indicate
- the amounts relating to the merged charity for the period after the date of the merger
- the amounts relating to each party to the merger up to the date of the merger
- an analysis of the principal components of the previous period's SoFA between each party to the merger
- the aggregate carrying amount of the net assets of each party to the merger, differentiating between restricted and unrestricted funds at the date of the merger
- the nature and amount of any significant adjustments they have made in order to align accounting policies, and an explanation of any further

adjustments to net assets as a result of the merger (for example any restatement of unrestricted funds)

27.16. This SORP requires that the accounts of a charity created by a merger must disclose in reporting periods subsequent to the merger:

- the names and descriptions of the combining charities
- the date of the merger

27.17. Tables 21 to 23 illustrate how these disclosures may be shown. On a merger taking place, the unrestricted funds of the participating charities may become restricted in whole or in part due to their objects being narrower than those of the merged charity. In such cases, Table 23 should be adapted accordingly.

Table 21: Analysis of principal SoFA components for the current reporting period

	Charity A (pre-merger)	Charity B (pre-merger)	Charity (post-merger)	Combined total
	£	£	£	£
Total income				
Total expenditure				
Net income/(expenditure)				
Other gains/(losses)				
Net movement in funds				

Table 22: Analysis of principal SoFA components for the previous reporting period

	Charity A	Charity B	Combined total
	£	£	£
Total income			
Total expenditure			
Net income/(expenditure)			
Other gains/(losses)			
Net movement in funds			
Total funds brought forward			
Total funds carried forward			

Table 23: Analysis of net assets at the date of merger

	Charity A	Charity B	Combined total
	£	£	£
Net assets			
Represented by:			
Unrestricted funds			
Restricted income funds			
Endowment funds			
Total funds			

28. Accounting for associates

Introduction

28.1. The reporting tiers applied for module 28 are as specified in the table below.

Table 28.1A: Tiered reporting requirements for module 28

All tiers	The requirements for accounting for associates in this module apply fully to all charities with an interest in an associate.

28.2. If a charity has a long-term participating interest in another entity and exercises significant influence over its operating and financial policies, then it must account for its interest in the entity as an associate. Charities should refer to Section 14 Investments in Associates of FRS 102.

28.3. This module sets out:

- How to identify an associate
- Accounting for an interest in an associate
- Presentation of associates in the accounts
- Disclosures of interests in associates

How to identify an associate

28.4. An associate is an entity over which the investing charity has significant influence, but it is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not control or joint control over those policies.

28.5. A charity is presumed to have significant influence if, as the investing charity, it holds directly or indirectly 20 per cent or more of the voting power of the associate – unless it can be clearly demonstrated that significant influence does not exist (see also paragraph 14.3 of FRS 102).

28.6. Where the charity has an interest in an entity but holds, directly or indirectly, less than 20 per cent of the voting power of that entity, it is presumed that no significant influence exists, unless such influence can be clearly demonstrated.

28.7. The existence of significant influence by an investing charity is usually evidenced in one or more of the following ways:

- representation on the board of trustees (see 28.9 and 28.10, below)
- participation in policy-making processes, including participation in decisions about dividends or other distributions, if applicable
- material transactions between investing charity and its associate
- interchange of managerial personnel

- provision of essential technical information

(see paragraph 14.3A of FRS 102)

28.8. An investing charity exercises significant influence over an associate if it actively influences the associate's policy decisions so as to benefit. For example, when the associate is a commercial investment, the investing charity might exercise influence over the associate's dividend and reinvestment policies. When the associate is another charity or a social investment, the investing charity might exercise influence over the associate to ensure that its activities or objectives contribute to its own.

28.9. Charities may nominate a trustee or trustees or make them available to another charity in order to provide that charity with expertise or to give it access to particular skills. Some funders and grant-making charities combine financial assistance with the provision of advice, or they may be invited by the recipient of the funding to provide or nominate a trustee or trustees with particular skills. Where the recipient charity operates with a small trustee body, this might qualify as creating an associate provided that the charity is able to exert significant influence over the operating and financial policies of the other charities.

28.10. An associate is created if the nomination or appointment power is used in conjunction with a formal or informal agreement to exercise significant influence through direct involvement in setting the funding recipient charity's financial and operating policies. However, the power to make a trustee appointment that is simply used to provide advice or expertise to the recipient charity, while allowing the recipient charity to adopt its own policies and strategies, does not create an associate relationship.

Accounting for an interest in an associate

28.11. A charity that does not prepare consolidated accounts must in its individual financial statements account for its investments in associates using either:

- the cost model to measure investments at cost less accumulated impairment losses
- at fair value in accordance with paragraphs 14.9 to 14.10A of FRS 102
- at fair value with any gain or loss taken through the statement of financial activities (SoFA). FRS 102 Section 2A Fair Value Measurement provides guidance on determining fair value (see paragraph 14.4 of FRS 102 for more information)

28.12. When consolidated accounts are prepared, the charity must use the equity method of accounting to measure its interest in the associate.

28.13. The equity method of accounting requires the associate to be initially recognised at its cost (the transaction price paid), including any cost incurred making the investment (transaction costs). The initial cost equates to the fair value of net assets acquired, plus any goodwill. The carrying amount of an investment in an associate is subsequently adjusted through the SoFA to

reflect the investing charity's share of the associate's profit and loss, other comprehensive income and equity. For full details on the equity method, refer to Section 14.8 of FRS 102.

28.14. If significant interest is achieved through the power to appoint trustees to a charity, the interest in the associate should be initially recognised at the fair value of the investing charity's share of the associate's net assets on appointment of the trustees. Where an interest in an associate is acquired and no consideration is involved, the interest in the associate established through trusteeship is accounted for as though it were a donation, and recognised as a gain under the 'Income from donations and legacies' heading in the statement of financial activities (SoFA).

28.15. The investing charity's share of the associate's net assets is determined by its ownership interest in the associate. If the associate is a charity, then reference should be made to any formal agreement to identify a basis for measuring the interest or share in the associate. The rebuttable presumption, in the absence of any information to the contrary, is that the interest in the associate is measured by reference to the proportion of the voting rights held by the parent based on voting rights attaching to that interest as set out in the associate charity's governing document.

Presentation of associates in the accounts

28.16. In non-consolidated (individual or separate) accounts, an investment in an associate must be classified as a fixed asset investment in the accounts of the investing charity. This must be separately identified either in the investing charity's balance sheet or in its notes to the accounts analysing the classes of fixed asset investments it holds.

28.17. If the associate is a charity, this SORP requires that the investment should be presented within restricted funds, as the purposes of the associate are likely to be distinct from those of the investing charity. The investment should be shown as a social investment, see Module 21, '*Accounting for social investments*'.

28.18. When consolidated accounts are prepared, the investing charity's share of the associate's results should be presented on the 'net gains/(losses) on investments in 'Joint controlled entities (JCEs) and Associates' line in the consolidated SoFA.

Disclosures of interests in associates

28.19. All charities with an investment in an associate must disclose (paragraphs 14.12 and 14.15A, FRS 102):

- the accounting policy adopted for investments in associates
- the carrying amount of investments in associates
- the fair value of each investment in an associate, if a market price for the investment is quoted and the charity accounts for the associate using the equity method

- in the individual accounts of an investor that is not a parent, summarised financial information about the investments in the associates, along with the effect of, including those investments as if they had been accounted for using the equity method

This SORP also requires:

- for each material associate that is a charity, an analysis of the investing charity's share of the income and expenditure of the associate, analysed across the main areas of the associate's activities;
- the disclosure of the name of the associate(s).

28.20. Charities must also disclose the following:

- for investments in associates accounted for using the cost model, the trustees must also disclose the amount of dividends and other distributions recognised as income
- for investments in associates accounted for by the equity method, an investor must disclose separately its share of the profit and loss (income/expenditure) of such associates on the 'net gains/(losses) on investments in JCEs and Associates' line in the SoFA and its share of any discontinued operations of such associates
- for investments in associates accounted for by the fair value method as defined by FRS 102 paragraph 14.4(c), an investor must make the following disclosures:
    - the basis for determining fair value, for example the quoted market price in an active market or a valuation technique
    - when a valuation technique is used, the assumptions applied in determining fair value for each associate
    - if a reliable measure of fair value is no longer available for an associate, the charity must disclose that fact and the carrying amount of those financial instruments

29. Accounting for joint ventures

Introduction

29.1. The reporting tiers applied for module 29 are as specified in the table below.

Table 29.1A: Tiered reporting requirements for module 29

All tiers	The requirements for accounting for joint ventures in this module apply fully to all charities that enter into a contractual arrangement which meet the definition of a joint venture.

29.2. Charities may collaborate with other charities or entities in a number of ways. This module applies to circumstances where charities enter into a contractual arrangement which meets the definition of a joint venture . Charities should refer to section 15 of FRS 102.

29.3. A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. The other venturers may be charities, social enterprises or for-profit companies or other entities.

29.4. Joint control is the contractually agreed sharing of control over an economic activity and exists only when the strategic, financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

29.5. This module sets out:

- The different forms of joint venture
- Method for the identification of respective interests in jointly controlled entities
- Accounting for jointly controlled entities that are charities
- Accounting for jointly controlled entities involving non-charitable entities
- Presentation of jointly controlled entities in consolidated accounts
- Disclosures

The different forms of joint venture

29.6. There are three forms of joint venture:

- jointly controlled operations where each venturer uses its own assets, incurs its own expenses and liabilities, raises its own finance and shares the revenue from the joint venture in a way that is agreed with the other venturers (see also paragraphs 15.4 and 15.5 of FRS 102)
- jointly controlled assets are joint ventures that involve joint control and often joint ownership by the venturers of one or more assets

contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. These are recognised in the financial statements with the assets, liabilities, income and expenses of the joint venture shared between the venturers (see also paragraphs 15.6 and 15.7 of FRS 102)

- jointly controlled entities are joint ventures that involve the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity

29.7. Where charities undertake joint venture activities through jointly controlled operations or through using jointly controlled assets, each charity's gross share of the incoming resources and resources expended and the assets and liabilities should be included in the participating charities' own accounts in accordance with the SORP module 25 '*Branches, linked or connected charities and joint arrangements*'.

29.8. Paragraphs 29.9 to 29.18 of this module deal with joint venture activities that are carried out through a separate jointly controlled entity. The disclosures in paragraphs 29.19 and 29.20 relate to jointly controlled entities and joint ventures.

Method for the identification of respective interests in jointly controlled entities

29.9. Each venturer exercises its right to shared control through an agreement with the other parties to the jointly controlled entity. On occasion, the jointly controlled entity will be established to undertake an activity that furthers the charitable purposes of the investing charities, for example to carry out a joint project. When the jointly controlled entity is itself a charity, control may be exercised through the appointment of trustees rather than through an equity share. In the absence of equity, judgement is required in order to identify the respective interests of each charity in the joint venture entity.

29.10. In order to identify the respective interests of each venturer, reference should be made to the evidence provided by:

- the joint venture agreement or contract
- the governing document or any legislative provision, including the provisions that apply upon winding up or ceasing the joint venture
- the respective voting power of the venturers
- the pattern of distribution of benefits from the jointly controlled entity charity between the venturers
- the value of the funding provided by each venturer in support of the activities undertaken by the joint venture

In the absence of any evidence to the contrary, the net assets and results

should be attributed equally between the venturers.

Accounting for jointly controlled entities that are charities

29.11. An interest in a jointly controlled entity that is a charity is normally treated as a restricted fund in the accounts of the reporting charity.

29.12. In a charity's own entity accounts, a joint venture charity should be included in its individual financial statements as a social investment using either:

- the cost model with investments in jointly controlled entities at cost less any accumulated impairment losses
- at fair value in accordance with paragraphs 15.14 to 15.15A of FRS 102
- at fair value with any gain or loss taken through SoFA, see Section 2A Fair Value Measurement of FRS102

The policy adopted must be applied to all joint venture charities accounted for in the charity's own entity accounts.

29.13. If consolidated accounts are prepared, the equity method of accounting must be used. The venturer's share of the net income or net expenditure in a joint venture charity is recognised on the 'net gains/(losses) on investments in JCEs and Associates' line in the SoFA. On the balance sheet, the net carrying amount should be shown with 'Social Investments' under 'Investments', where the interest is held to make a financial return and to further the purposes of the investing charity, and is normally treated as a component of restricted funds (see also paragraph 15.13 of FRS 102).

Accounting for jointly controlled entities involving non-charitable entities

29.14. Charities may also enter into a joint venture as a commercial activity to raise funds. The accounting treatment of a non-charitable joint venture entity depends on whether the investing charity prepares consolidated accounts or own entity accounts.

29.15. In a charity's own entity accounts, a jointly controlled entity must be included in its accounts at either cost less impairment (the cost model) or fair value. If the fair value of the charity's interest can be measured reliably, the charity may opt to measure its interest at fair value with any gain or loss taken through the SoFA (see paragraph 29.12 above).

29.16. When consolidated accounts are prepared, the charity must use the equity method of accounting in its consolidated accounts to measure its interest in the joint venture (see also paragraph 15.13 of FRS 102).

Presentation of jointly controlled entities in consolidated accounts

29.17. The equity method requires the interest in a joint venture to be initially recognised at its cost (the transaction price including any transaction costs).

The initial cost recognised therefore equates to the value of net assets acquired, plus any goodwill. The carrying amount is then adjusted for the post-acquisition change in the investor's share of net assets in the joint venture entity. The carrying amount of an investment in the joint venture is subsequently adjusted through the SoFA to reflect the investing charity's share of the joint venture's results.

29.18. The equity method requires the net share of profit or loss to be shown on the 'net gains/(losses) on investments in Jointly controlled entities (JCEs) and Associates' line in the SoFA. The share of net assets in the joint venture is shown as a separate line in 'Fixed assets' on the balance sheet as a sub-class of investments, with any distributions or dividends received reflected in a reduction to the carrying amount of the joint venture.

Disclosures

29.19. Where a charity is the venturer, its accounts must disclose:

- the accounting policy adopted for investments in jointly controlled entities
- the carrying amount of investments in jointly controlled entities;
- the aggregate amount of its commitments relating to each joint venture, including its share in the commitments that have been incurred jointly with other venturers
- the fair value of each investment in a jointly controlled entity if a market price for the investment is quoted and the entity accounts for the jointly controlled entity using the equity method
- where the charity is not a parent, the accounts must disclose summarised financial information about the investments in the jointly controlled entities, along with the effect of including those investments as if they had been accounted for using the equity method. Investing charities that are exempt from preparing consolidated financial statements, or would be exempt if they had subsidiaries, are exempt from this requirement

This SORP requires:

- for each material jointly controlled entity, the investing charity's share of the income and expenditure of the jointly controlled entity analysed across the main areas of the jointly controlled entity's activities
- for each material jointly controlled entity, the investing charity's share of the assets and liabilities and funds of the jointly controlled entity at the reporting date
- disclosure of the name of each jointly controlled entity

29.20. Charities must also disclose the following:

- For investments in joint venture entities accounted for by the equity method, an investor must disclose separately its share of the profit and loss (income/expenditure) of such joint venture entities and its

share of any discontinued operations.

- For investments in joint venture entities accounted for by the fair value method in 15.9(c) of FRS 102, an investor must make the following disclosures:
    - the basis for determining fair value, e.g. the quoted market price in an active market or a valuation technique (when a valuation technique is used, the charity must disclose the assumptions applied in determining fair value for each joint venturer); and
    - if a reliable measure of fair value is no longer available for a joint venture, the charity shall disclose that fact

29.21. In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements the assets that it controls and the liabilities that it incurs and the expenses that it incurs and its share of the revenue that it earns from the sale of goods or services by the joint venture.

29.22. In respect of its interest in a jointly controlled asset, a venturer shall recognise in its financial statements:

- its share of the jointly controlled assets, classified according to the nature of the assets
- any liabilities that it has incurred
- its share of any liabilities incurred jointly with the other venturers in relation to the joint venture
- any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
- any expenses that it has incurred in respect of its interest in the joint venture

Appendices

Appendix 1: Glossary of terms

This glossary provides information on terms used in this SORP and also includes terms that originate from, and are set out in FRS 102. If a term is not specifically set out in this glossary, users should refer to FRS 102.

Accounting estimates are monetary amounts in the accounts that are subject to measurement uncertainty.

Accounts is a term used in the SORP to refer to the statement of financial activities (SoFA),income and expenditure account (where produced or required by company law), balance sheet and statement of cash flows and notes.

Accruals accounts record the income and expenditure of the charity and the increase or reduction in its assets and liabilities. All income and charges relating to the reporting period to which the accounts relate must be taken into account without regard to the date of payment or receipt. Accruals accounts are compiled on a 'true and fair' basis in accordance with accounting standards and the SORP.

Activity classification of costs is the method of identifying the total cost of an activity, including both direct and indirect costs. An activity is a project, programme of work or activity that furthers one or more of a charity's purposes, or an activity undertaken to raise funds for the charity.

The SORP identifies three high-level activities for charities preparing accruals accounts: expenditure on raising funds, expenditure on charitable activities and other expenditure.

Amortisation is an accounting term referring to the systematic allocation of the depreciable amount of an asset over its useful life. An example would be a right to patent royalties for a set period of time; the value of this right declines in accordance with the fall in future benefits receivable.

Asset is a present economic resource controlled by the entity as a result of past events.

Associate is an entity over which the investing charity has significant influence, but it is neither a subsidiary nor an interest in a joint venture.

Audit when referred to in the SORP is the statutory requirement under charity law for an audit of the charity or the group where the charity's or group's gross income and/or assets exceed the relevant threshold. The audit threshold is set by charity law on the basis of the income received in the reporting period and the total assets held

at the end of the year.

Balance sheet (also known as a statement of financial position) is a statement of the assets, liabilities, funds and equity (where relevant) of the charity (the funds of the charity may also be known as the residual interest) at the end of the reporting period (financial year).

Branch is used in this SORP to describe a charity's administrative arrangements whereby its internal operating structure is arranged according to function, location or other factor designed to facilitate its administration. SORP module 25 'Branches, linked or connected charities and joint arrangements' provides further information on what constitutes a branch.

Capital is the charity law term used by the SORP for resources received by the charity which the trustees are either legally required to invest or retain and use for the charity's purposes. Capital is the term applied to permanent endowment where the trustees have no power to convert it into income and apply or spend it; the term also applies to expendable endowment where the trustees do have this power.

Charitable companies (company charities) are those charities established under company law for exclusively charitable purposes. The reference to company law is the law as it applies in England and Wales, Scotland, Northern Ireland and the Republic of Ireland. A feature of charitable companies is that of dual registration with the regulator for companies and the charity regulator. Both company law and charity law apply to the annual reporting requirements of a charitable company.

Charity is any institution established for purposes which are exclusively charitable in the law applying in England and Wales, Scotland, Northern Ireland or the Republic of Ireland. A charity includes all those activities, administrative branches and funds falling within the scope of a single governing instrument or for which the trustees are otherwise legally liable to account. The reference to a single governing instrument includes a situation where instruments are supplemental to the main instrument apply.

Charity trustees are the people who under the governing document are responsible for the general control and management and administration of the reporting charity. Charity trustees are those defined in section 177 of the Charities Act 2011, section 106 of the Charities and Trustee Investment (Scotland) Act 2005, section 180 of the Charities Act (Northern Ireland) 2008 or Part 1 of the Charities Act 2009 (Republic of Ireland). In the charity's governing document trustees may be called trustees, committee members, governors or directors, or they may be referred to by some other title. In the case of a company charity it is the directors who are the charity trustees. Trustees may be individuals or a corporate body.

Combined financial statements (aggregated accounts) are accounts prepared by the reporting charity which aggregate the assets and liabilities and income and expenses of one or more connected charities with the financial performance of the

reporting entity itself. The combined accounts provide a ‘true and fair’ view of all of the charities controlled and administered by the trustees of the reporting charity.

Commencement date (of a lease) is the date on which a lessor makes an underlying asset available for use by a lessee.

Common deposit funds (CDFs) are collective investment schemes that are authorised to accept deposits and are for charity investors only. They are investment vehicles that pool deposits and provide diversification to reduce risk, and are tax efficient, cost effective and administratively simple. They are deemed by law to be charities themselves, and enjoy the same tax status as other charities.

Common investment funds (CIFs) are collective investment schemes that are similar to authorised unit trusts and are for charity investors only. They are investment vehicles that provide diversification to reduce risk, and are tax efficient, cost effective and administratively simple. They are deemed by law to be charities themselves, and enjoy the same tax status as other charities.

Consideration is the term for the resources used to settle a transaction or the making of a payment in cash or kind.

Consolidated accounts is an accounting term for the accounts (financial statements) of a parent and its subsidiaries presented as those of a single reporting entity.

Contract asset is a charity’s right to consideration in exchange for goods or services that the charity has transferred to a customer when that right is conditional on something other than the passage of time (eg the charity’s future performance).

Constructive obligations is an accounting term for obligations that derive from actions where:

- through an established pattern of past practice, published policies or a sufficiently specific current statement, the reporting charity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the charity has created a valid expectation on the part of those other parties that it will discharge those responsibilities

Contingent asset is an accounting term for a possible asset that arises from past events. Its existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity’s control.

Contingent liability is an accounting term for either:

- a possible obligation that arises from past events where its existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity’s control; or

- a present obligation that arises from past events but is not recognised in the accounts – either because it is not probable that a transfer of economic benefits will be required to settle the obligation, or because the amount of the obligation cannot be measured with sufficient reliability

Contract is an agreement between two or more parties that creates enforceable rights and obligations.

Contract income is income received by a charity for the purpose of providing the goods or services under the terms of a legal contract. It is important that trustees establish from the outset whether the receipt of income is subject to a legally binding contract for the supply of goods or services.

Indicators of a contract for the supply of services are:

- the payer, rather than the recipient charity, has taken the lead in identifying the services to be provided; and/or
- the arrangement provides for damages to be paid in the case of a breach of its terms, rather than, for example, for total or partial refund of the payment made

If there is no contract, the rights and obligations of the parties will depend primarily on the law of trusts and conditional gifts, rather than on the law of contract.. A contractual payment to the charity will normally be unrestricted income of the charity.

Control (of an entity) is the power to govern the financial and operating policies of an entity in order to obtain benefits from its activities. For example, a charity may exercise control over a subsidiary in order to raise funds for the charity through trading activities or as a vehicle to carry out certain of the charity's purposes.

De facto trustee is a person who has not been validly appointed as a trustee but is acting as the trustee of the charity and is exercising the functions that could only be properly discharged by a trustee. This may have come about due to an error, omission or oversight in the appointment process of that trustee. A trustee who is a de facto trustee of a company charity may alternatively be known as a de facto director.

Deferred income consists of resources received by a charity that do not meet the criteria for recognition as income in the statement of financial activities (SoFA) because entitlement to the income does not exist at the balance sheet date. Deferred income is not recognised in the SoFA until the charity is entitled to the income. Instead, deferred income is disclosed as a liability in the balance sheet.

Defined benefit pension scheme (sometimes known as a final salary pension scheme) is a pension or other retirement benefit scheme other than a defined contribution scheme. Usually, the scheme rules define the benefits independently of the contributions payable, and the benefits paid are not directly related to the investments of the scheme.

Defined contribution pension scheme is a retirement benefit plan under which an entity pays fixed contributions into a separate entity (a fund), and has no legal or constructive obligations to pay further contributions or to make direct benefit payments to employees if the fund does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Derivatives are defined in FRS 102 as a financial instrument which in summary has all three of the following characteristics: its value changes in response to a change in the underlying variable, it requires no initial net investment or an initial net investment smaller than would otherwise be expected, and it is settled at a future date. In their simplest form, derivatives can be used to reduce the cost and/or risk associated with holding or acquiring assets. Examples include 'fixing' an interest rate on a loan for an agreed rate over a fixed time period, or agreeing a future value of foreign exchange for settlement at an agreed date at an agreed exchange rate.

Designated fund is a portion of the unrestricted funds of the reporting charity that has been set aside for a particular purpose by the trustees. For example, the value of functional fixed assets used to further the charity's purposes may be identified as a separate designated fund. Designated funds continue to count as part of the unrestricted funds of the charity, but the trustees may choose to exclude designated funds from the calculation of the charity's reserves.

Donations comprise gifts that will not provide any economic return to the donor other than the knowledge that someone will benefit from the donation. Income from donations includes gifts that must be spent on specific charitable purposes (i.e. restricted income funds) or given to be held as endowment funds. Donations will include gifts in kind and donated services.

Donations, for accounting presentation purposes, exclude any gifts such as performance-related grants where entitlement is dependent on the performance of a particular level of service or units of output being delivered.

Economic benefits refers to the value derived from an asset in terms of cash flows generated, its cash flow generating capacity, or the service potential created, or costs saved or avoided by having control over the asset.

Economic resource is a right that has the potential to produce economic benefits.

Employee benefits are all forms of consideration paid by a charity in exchange for the service rendered by employees, including trustees (who are also employees), and include all remuneration, salary, benefits, profit- sharing and bonuses, employer's pension contributions and any termination payments made. For employers with employee members of a defined benefit pension scheme, employee benefits include the change in the net defined benefit liability arising from employee service rendered during the reporting period and the cost of plan introductions, benefit changes, curtailments and settlements.

Endowment funds are resources received by the charity that represent capital. A feature of endowment funds is that charity law requires the trustees to invest it or to retain and use it for the charity's purposes. The term endowment applies to permanent endowment, where the trustees have no power to convert it into income and apply it, and to expendable endowment where the trustees do have this power.

Ex gratia payments are payments made at the discretion of trustees and not as a result of a contract or other legal obligation.

Ex gratia is where the trustees:

- believe that they are under a moral obligation to make the payment; but
- do not have the power to make the payment

In addition, the trustees must not:

- be able to justify the payment as being in the interests of the charity; or
- be under any legal obligation to make the payment

Fair value is an accounting term for the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

For the purposes of applying the lessor accounting requirements in Module 10B and Section 20 of FRS 102, fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

For traded securities in which there is an established market, the fair value is the value of the security quoted in the London Stock Exchange's *Daily Official List* or equivalent. For other assets where there is no market price on a traded market, it is the trustees' or valuer's best estimate of fair value. In these circumstances, fair value measurement aims to estimate an exchange price for the asset or liability being measured in the absence of an actual transaction for that asset or liability.

In the absence of any specific guidance in this SORP or in the relevant section of FRS 102, the guidance in Section 2A Fari Value Measurement shall be used in determining fair value.

Finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. A lease that is not a finance lease is an operating lease.

Financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial statement is a term used in FRS 102 to describe the accounts.

Fundraising costs consist of three categories:

- costs of generating donations
- fundraising trading costs, which are the costs of trading to raise funds and include the cost of goods sold and any other costs associated with a trading operation
- investment management costs

Funds is a term for the money and other assets held on trust or as corporate property.

General volunteer is a term used in the SORP for a person who is giving unremunerated assistance to the charity of any kind other than assistance which is related to their trade or profession.

Governance costs are the costs associated with the governance arrangements of the charity. These costs will normally include internal and external audit, legal advice for trustees and costs associated with constitutional and statutory requirements, for example the cost of trustee meetings and preparing statutory accounts.

Governing document means any document that sets out the charity's purposes for the public benefit and how it is to operate. It may be a trust deed, constitution, memorandum and articles of association, scheme of the Commission, Act of Parliament, Royal Charter, conveyance or will.

Government means government, government agencies and similar bodies whether local, national or international.

Government grants represent the assistance by government in the form of a transfer of resources to a charity in return for past or future compliance with specified conditions relating to the operating activities of the charity (or its subsidiary).

Grant income is any voluntary income received by the charity (or other transfer of property) from a person or institution. The income or transfer may be for the general purposes of the charity, or for a specific purpose. It may be unconditional or be subject to conditions which, if not satisfied by the recipient charity, may lead to the property acquired with the aid of the grant or part of it, being reclaimed by the grant-maker.

Entitlement to grant income may be subject to performance conditions and is recognised as the performance conditions are met.

Grant payments are any voluntary payments (or other transfer of property) in favour of a person or institution made by a charity in furtherance of its charitable purposes. The payment or transfer may be for the general purposes of the recipient, or for some specific purpose such as the supply of a particular service. It may be unconditional, or

be subject to conditions which, if not satisfied by the recipient, may lead to the grant, or property acquired with the aid of the grant or part of it, being reclaimed by the charity.

A charity may make a performance-related grant, in which case it recognises its liability, as the goods or services specified in the grant terms are provided by the recipient.

Gross income is a term defined in charity law and is used to determine the thresholds governing the requirements for accounts' scrutiny, the preparation of accruals accounts by non-company charities, submission of reports and accounts and any annual return to the charity regulator.

The definition of gross income may vary by jurisdiction. In relation to consolidated accounts, gross income is the gross income of the group after any adjustments arising from consolidation (e.g. intra-group sales).

Group is a parent and all its subsidiaries.

Group accounts is an alternative term for consolidated accounts.

Heritage assets are tangible and intangible assets with historic, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture.

Holding trustees have no power to make management decisions and can only act on the lawful instructions of the charity trustees regarding the property they hold on behalf of the charity.

Impact reporting is the term used in this SORP to describe the difference a charity's work has made to the circumstances of its beneficiaries and, if practicable, any wider benefits to society as a whole.

Inalienable asset is an asset held by a charity which it must retain indefinitely. Inalienable assets have all of the following characteristics:

- the asset is retained indefinitely for a charity's own use and benefit to further its charitable purposes
- the charity is effectively prohibited from disposing of the asset without external consent
- the asset, by its nature, will belong to a charity's restricted funds and, depending on the trusts attached to the asset, may be part of the permanent endowment

Disposal without external consent could be prohibited by the charity's governing document, the donor's imposed conditions or in some other way. Normally, the asset will belong to the charity's permanent endowment, where it is held on trusts that contemplate its retention and continuing use but not its disposal.

However, in the case of a gift in kind of a wasting asset, such as a building, a long lease or a non- durable artefact, the terms of trust may not have provided for its maintenance in perpetuity or its replacement. The asset will be expended to the extent of the aggregate amount of its depreciation or amortisation, properly provided for in the annual accounts (i.e. based on its useful life).

Intangible asset is an accounting term for an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:

- it is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
- it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations

For the purposes of this definition, an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Interest rate implicit in the lease is the rate of interest that causes the present value of the lease payments and the unguaranteed residual value, to equal the sum of the fair value of the underlying asset and any initial indirect costs of the lessor.

Investment management costs include the costs of:

- portfolio management
- obtaining investment advice
- administration of the investments
- rent collection, property repairs and maintenance charges relating to investment properties

Investment property is an accounting term for property (land, a building and/or part of a building) that is held to earn rental income or for capital appreciation, or both, rather than for:

- use by the charity as functional property to further the charity's charitable purposes
- use in the production or supply of goods or services or for administrative purposes
- sale in the ordinary course of business

Key management personnel is a term used by FRS 102 for those persons having authority and responsibility for planning, directing and controlling the activities of the charity, directly or indirectly, including any director (whether executive or otherwise) of the charity. This definition includes trustees and those members of staff who are the senior management personnel to whom the trustees have delegated significant

authority or responsibility in the day-to-day running of the charity.

Lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Lease liability is the liability recognised at the commencement date by a lessee, measured at the present value of the lease payments that are not paid at that date discounted using the interest rate applicable to that lease.

Lease term is the aggregate of:

a) the non-cancellable period of a lease;

b) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

c) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option

Liability is an accounting term for a present obligation of the entity to transfer an economic resource as a result of past events.

It includes an obligation of an entity to transfer economic benefits that results from a duty or responsibility obligating the entity either legally or practically (a constructive obligation), because it would be financially or otherwise operationally damaging to the entity not to discharge the duty or responsibility.

A moral obligation does not create a liability unless it meets the definition of a liability or the definition of a constructive obligation.

For the purposes of Sections 21 and 22 of FRS 102, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Licence agreement is a term used by this SORP to describe an arrangement that allows temporary (a period of 12 months or less), non-exclusive use of an asset. Refer to paragraph 10B.8 for more information.

Low value asset is where in a lease arrangement, the underlying asset is considered to be of low underlying value on an absolute basis, regardless of whether such leases would be material to the lessee. The value of lease payments has no bearing on the assessment of whether an underlying asset is of low value.

Market participants Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

(a) they are independent of each other, that is they are not related parties;

(b) they are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information;

(c) they are able to enter into a transaction for the asset or liability; and

(d) they are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so

Material or **materiality** is an accounting test of what elements of information should be given in a particular set of accounts (financial statements).

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Immaterial information will need to be excluded to avoid clutter that impairs the ability to understand other information provided. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects.

Materiality is identified from a combination of factors, rather than any one in particular. The principal factors normally taken into account are:

- the item's size judged in the context of the accounts as a whole and the other information available to users that would affect their evaluation of the accounts (this includes, for example, considering how the item affects the evaluation of trends and similar considerations)
- the item's nature in relation to:
    - the transactions or other events giving rise to it
    - the legality, sensitivity, normality and potential consequences of the event or transaction
    - the identity of the parties involved
    - the particular headings and disclosures that are affected

If there are two or more similar items, the materiality of the items in aggregate as well as of the items individually needs to be considered.

Decisions about whether an item is material or not will be made at the time of preparing the accounts. The trustees are ultimately responsible for the preparation of the charity's accounts. This process may result in different materiality considerations being applied, depending on which aspect of the accounts is being considered. For example, there is a requirement for a high degree of accuracy in the case of certain disclosures such as trustees' remuneration and expenses, which will override normal materiality considerations.

Measurement is the process of determining the monetary amounts at which the elements in the accounts are to be recognised and carried in the Balance Sheet (statement of financial position) and Statement of Financial Activities (statement of comprehensive income).

Non-company charity is any charity that has not been established as a company charity under company law. Non-company charities include unincorporated trusts or associations, charitable incorporated organisations and charities established by Royal Charter.

Onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected under the contract.

Operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.

Parent is an entity that has one or more subsidiaries.

Peppercorn arrangement – in this SORP such arrangements are considered to have the legal form of a lease, but with nil or nominal consideration and are unlikely to meet the FRS 102 definition of a lease but are considered therefore to be a form of non-exchange transaction.

Performance-related condition (in respect of funding commitments, government grants and other non-exchange transactions) are follows:

A condition under which entitlement to resources is conditional on the performance of:
(a) a specified activity; or
(b) a particular level of service or units of output to be delivered

Pooling scheme is a class of Common Investment Fund that provides for the pooling of investments belonging to two or more charities (which may be special trusts) that are administered by the same trustee body as the body managing the pooling scheme. Such schemes are referred to as 'pool charities'.

Provision is an accounting term for a liability of uncertain timing or amount. For the purposes of this definition, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Public benefit entity is defined by FRS 102 as: 'an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members'. Charities are one type of public benefit entity.

Recognition is the process of capturing in the financial statements an item that meets the definition of one of the elements of financial statements: assets, liabilities,

equity, income or expenses. Recognition involves depicting the item in one of those statements - either alone or in aggregation with other items - in words and by a monetary amount, and including that amount in one or more totals in the statement.

Related parties is a term used by the SORP that combines the requirements of charity law, company law and the Financial Reporting Standard applicable in the UK and the Republic of Ireland. The term is used to identify those persons or entities that are closely connected to the reporting charity or its trustees.

The following 'natural persons' are classed as related parties:

A. any charity trustee and trustee for a charity

B. a person who is the donor of any land to the charity (whether the gift was made on or after the establishment of the charity)

C. any person who is:

1. a child, parent, grandchild, grandparent, brother or sister of any such trustee (A) or donor (B) of land

2. an officer, agent or a member of the key management personnel of the charity

3. the spouse or civil partner of any of the above persons (A, B, C1 and C2)

4. carrying on business in partnership with any of the above persons (A, B, C1, C2 and C3)

5. a person, or a close member of that person's family, who has control or joint control over the reporting charity

6. a person, or a close member of that person's family, who has significant influence over the reporting charity

'Close member of a person's family' refers to:

- that person's children or spouse
- the children or stepchildren of that person's spouse or domestic partner
- dependants of that person
- that person's domestic partner who lives with them as husband or wife or in an equivalent same-sex relationship

A charity is not necessarily related to another charity simply because a particular person happens to be a trustee of both. For example, it will be 'related' if the relationship means that one charity, in furthering its charitable purposes , is under the direction or control of the trustees of another charity.

The following entities, which are not 'natural persons', are classed as related parties of a reporting entity (including a reporting charity) if any of the following conditions apply:

- the entity and the reporting charity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)
- one entity is an associate or joint venture of the other entity (or a member of the group in which the other entity is the parent or a member)
- both entities are joint ventures of the same third entity
- one entity is a joint venture of a third entity, and the other entity is an associate of the third entity
- the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity
- the reporting charity provides/receives key management personnel services to/from the entity
- an entity that is controlled or jointly controlled by a person, or two or more persons, identified in A, B or C
- an entity in which a person, or two or more such persons, identified in A, B or C, taken together, have a substantial interest or significant influence over the entity

Control is presumed to exist when one or more persons identified in A, B or C, taken alone or together, hold directly or indirectly, more than half the voting power of an entity. However, control can also exist when they, directly or indirectly, control half or less than half of the voting power of an entity, if they have:

- power over more than half of the voting rights by virtue of agreement with other investors
- the power to govern the financial and operating policies of the entity under a statute or an agreement
- the power to appoint or remove the majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body
- the power to cast the majority of votes at the meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body

An individual has a substantial interest or significant influence in an entity where that person, or two or more persons identified in A, B or C, taken together, have an interest in the equity share capital of that entity of a nominal value of more than one-fifth of that share capital, or is entitled to exercise, or control the exercise of, more than one-fifth of the voting power at any general meeting of that entity.

Related party transactions are the transfer of resources, services or obligations between a reporting charity and related parties, regardless of whether a price is charged.

Reporting charity is the charity preparing and filing the statutory annual report and accounts (financial statements) for itself and one or more connected (Scotland) or linked (England and Wales) charities or subsidiaries that it controls. The accounts of the reporting charity will combine any restricted funds or connected or linked charities administered by the reporting charity. The accounts of the reporting charity will be consolidated where they include one or more subsidiaries.

Reporting date is the last date of the charity's reporting period (its financial year).

Reporting period is the accounting period (financial year) for the reporting charity. The reporting period, which is normally 12 months long, is the period of time over which the transactions of the charity are measured and reported in the accounts (financial statements).

Reserves - In this SORP the term "reserves" (unless otherwise indicated) describes that part of a charity's income funds that is freely available to spend on any of the charity's purposes.

The starting point for calculating reserves is the amount of unrestricted funds held by a charity. However, some or all of the unrestricted funds may not be readily available for spending and may need to be excluded. For example:

- Fixed assets, such as land and buildings, used to carry out the charity's activities
- Investments for the purpose of achieving the charity's purposes
- Designated funds if committed for spending
- Commitments that have not been provided for as a liability in the accounts

This definition of reserves normally excludes:

- permanent endowment funds
- expendable endowment funds; and
- restricted funds

However, you may need to consider:

- where restricted funds are held, the nature of the restriction, as such funds may reduce the need for reserves in particular areas of the charity's work
- whether expendable endowment is readily available for spending
- the impact on reserves of having a pension provision, a long-term mortgage or a revaluation reserve in the charity's accounts

Restricted funds may be either endowment or restricted income funds, depending on the nature of the restriction. Where the fund is not an endowment fund and is held

on trust for spending on specific purposes, it is known as a restricted income fund.The resources (the assets and liabilities) of each restricted fund are held and maintained separately from other funds. This is in recognition of the circumstances in which the resources were originally received, and/or the restrictions on that fund that determine the way those resources are subsequently to be treated.

Right- of- use asset is an asset that represents a lessee's right to use an underlying asset for the lease term.

Service potential is the capacity to provide services that contribute to achieving a charity's purposes. Service potential enables a charity to achieve its objectives without necessarily generating net cash inflows.

Short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

Significant activities are the activities that the trustees consider to be the main or the most important activities undertaken to further the charity's purposes in the reporting period.

Social investment is a class of assets that comprises investments undertaken for both a financial return and to further the investing charity's purposes.

Social donation lease is a lease that contains a non-exchange component. A social lease is one where the lessor chooses to accept lower rent for the philanthropic intention of providing a benefit to a public benefit entity.

Social lotteries are lotteries that are permitted by the law of the jurisdiction(s) in which the charity is fundraising and are not operated for private or commercial gain for a non-charitable purpose. The regulations applying to social lotteries normally have limitations on the amount of money that can be raised through the sale of tickets, and/or have specific requirements for registration or licensing. They may also set limits on the size of the prize or prize fund.

Special purpose entity is a term referring to a corporation, trust, partnership or unincorporated entity established by the charity (the sponsor) or on its behalf to achieve a narrow, well-defined objective. A feature of a special purpose entity is that its managing board has only limited decision-making powers: the entity is, in substance, controlled by the sponsor.

Special trust as defined in section 353 of the Charities Act 2011 (charities registered in England and Wales only) is property that 'is held and administered by or on behalf of a charity for any special purposes of the charity, and is so held or administered on separate trusts relating only to that property'. Whether registered or not, a distinguishing feature of special trusts is that they do not file a separate trustees' annual report and accounts. Instead, a reporting charity combines within its annual report and accounts the results of the special trusts it holds or administers as

a component of the restricted funds it reports.

Statement of financial activities (SoFA), analogous to a statement of comprehensive income, shows the income, the expenditure, gains and losses, and transfers between restricted funds/unrestricted funds during the reporting period (the financial year). The statement reconciles total funds brought-forward and total funds carried forward at the end of the financial year.

Stock (also known as inventories) is assets which are:

- held for sale in the ordinary course of business
- in the process of production for sale
- in the form of materials or supplies to be consumed in the production process or in the rendering or providing of services

Subsidiary is an entity that is controlled by another entity (known as the parent).

Support costs are costs incurred to facilitate an activity. Unlike direct costs, which result directly from undertaking the activity, support costs do not change directly as a result of the activity undertaken. Support costs include the central or regional office functions, such as governance, general management, payroll administration, budgeting and accounting, information technology, human resources and finance.

Total return is an approach to investment management that allows trustees to manage investments without the need to take account of whether the return is income (dividends, interest, etc.) or capital gains (and losses). Refer to the SORP module 'Total return (investments)' for more information.

Trading is an activity which has the 'badges of trade' that have been established by the courts. These are: profit-seeking motive; existing trade connections (linked or connected trading activity); repetition; method of finance (borrowing); interval between purchase and sale; selling organisation; method of acquisition (purchased for sale); operations pending sale (making it fit for sale); and the nature of the asset.

Trustees has the same meaning as charity trustees.

Unrestricted fund is a legal term for the unexpended resources held by a charity on trust, comprising money and other assets that can be used for any of the charitable purposes of the charity. The use of unrestricted funds is not restricted to any specific charitable purpose of the charity.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

Unrestricted funds are funds which can be spend for any charitable purpose. They are unrestricted in their use.

Appendix 2: The Charity Accounting (SORP) Committee (2019-2025)

Membership

Joint Chairs

Laura Anderson

Nigel Davies (till 2021)

Fiona Muldoon (till 2020)

Damien Sands (2020–2021)

Will Lifford (2021–2022)

Rossa Keown (from 2021)

Amie Woods (from 2022)

Members

Caron Bradshaw

Michael Brougham

Tom Connaughton

Noel Hyndman

Carol Rudge

Jenny Simpson

Diarmaid O Corrbui

Joanna Pittman

Daniel Chan

Neal Trup

Tony Clarke

Tim Hencher

Gareth Hughes

Max Rutherford (till 2022)

Francesca de Munnich (2022–2025)

Observers

Jelena Griscenko

Adrian Wallis (until September 2023), Financial Reporting Council

Omadevi Jani (from October 2023), Financial Reporting Council

Secretariat

CIPFA (till 2023)

Appendix 3: Charity law thresholds for the UK and the Republic of Ireland

Threshold for the preparation of accruals accounts

A.1. Company charities, irrespective of size, must prepare accruals accounts that give a true and fair view. However, certain jurisdictions permit the trustees of smaller non-company charities to prepare their accounts on a receipts and payments basis, instead of preparing accounts on an accruals basis to give a true and fair view.

A.2. In England and Wales, the threshold at which accruals accounts must be produced by non- company charities is a gross income of more than £250,000.

A.3. In Scotland, the threshold at which accruals accounts must be produced by non-company charities is a gross income of £250,000 or more.

A.4. In Northern Ireland, the threshold at which accruals accounts must be produced by non- company charities is a gross income of more than £250,000.

A.5. In the Republic of Ireland, section 48 of the Charities Act 2009 has yet to be implemented. Prior to its implementation, there are no form and content requirements for charity accounts in charity law; however, company charities must prepare accruals accounts giving a true and fair view.

Threshold for statutory audit

A.6. In England and Wales, an audit is required if either the charity's gross income exceeds £1 million, or its gross assets exceed £3.26m and gross income exceeds £250,000.

A.7. In Scotland, an audit is required if either the charity's gross income is £500,000 or more or its gross assets exceed £3.26m and the charity has prepared accruals accounts.

A.8. In Northern Ireland, an audit is required when the charity's gross income exceeds £500,000.

A.9. In the Republic of Ireland, section 50 of the Charities Act 2009, which provides for the minister to set an audit threshold of €500,000 (or less), has yet to be implemented. Consequently, there is no audit or reporting framework for non-company charities in charity law. The audit of company charities is conducted under Irish company law. Company charities must have an audit unless the company qualifies for an audit exemption.

Threshold for the preparation of consolidated (group) accounts

A.10. In England and Wales, any parent charity where the aggregate gross income of the group, the parent charity and its subsidiaries, exceeds £1 million after consolidation adjustments must prepare consolidated accounts. These consolidated accounts are prepared in accordance with the Charities Act 2011 and applicable regulations. However, where a company charity is required by section 399 of the Companies Act 2006 to prepare consolidated (group) accounts, its group accounts are prepared under the Companies Act 2006.

A.11. In Scotland, any parent charity where the aggregate gross income of the group, the parent charity and its subsidiaries, is £500,000 or more after consolidation adjustments must prepare consolidated accounts. These consolidated accounts are prepared in accordance with the Charities and Trustee Investment (Scotland) Act 2005 and applicable regulations. However, where a company charity is required by section 399 of the Companies Act 2006 to prepare consolidated (group) accounts, its group accounts are prepared under the Companies Act 2006.

A.12. In Northern Ireland, any parent company charity where the aggregate gross income of the group, the parent charity and its subsidiaries, is more than £500,000 after consolidation adjustments must prepare consolidated accounts. These consolidated accounts are prepared in accordance with the Charities Act (Northern Ireland) 2008 and applicable regulations. However, where a company charity is required by section 399 of the Companies Act 2006 to prepare consolidated (group) accounts, its group accounts are prepared under the Companies Act 2006.

A.13. In the Republic of Ireland, the only legal requirement for consolidated (group) accounts applies to parent company charities. Consolidated accounts are prepared in accordance with the Companies Act 2014.

Appendix 4: Basis for conclusions

Introduction

B.1. This appendix outlines the main issues considered by the joint SORP-making body in producing the Exposure Draft of the Charities SORP 2026. It summarises the deliberations of the joint SORP-making body in developing this Exposure Draft of the SORP which has been driven by the need to maintain consistency with FRS 102 and a desire for improvement for both users of the SORP and users of charity annual reports and accounts. The development of this SORP has been informed by input from volunteer SORP engagement partners and the advisory Charities SORP Committee.

Background

B.2. In 2018-19, the joint SORP-making body carried out a Governance Review of the process used to develop the Charities SORP. The aim of the review was to improve the SORP for both users of the SORP (preparers of accounts) and users of the resulting charity annual reports and accounts. As a result of the Review, a new SORP Committee and over 70 volunteer engagement partners were recruited to help the SORP-making body in its work.

B.3. The engagement partners assisted the work of the SORP-making body by identifying areas and issues that needed to be addressed for the benefit of both user groups. Fifteen areas were identified by the engagement partners and their feedback on these areas was discussed by the SORP Committee. This provided clarity on the issues being experienced and allowed exploration of the potential solutions to deal with these.

B.4. In 2021, the Financial Reporting Council (FRC) commenced a Periodic Review of FRS 102. This resulted in publication in March 2024 of Periodic Review Amendments to FRS 102 which take effect for accounting periods starting on or after 1 January 2026. This Exposure Draft SORP contains updates that are necessary to ensure consistency with FRS 102 for accounting periods starting on or after 1 January 2026.

B.5. Throughout the Exposure Draft SORP, minor changes were made to the drafting and some paragraphs were re-organised to provide incremental improvements and clarity to users of the SORP. Some minor changes were also made to include additional content from FRS 102 to provide some context to charities. These amendments were not intended to change the requirements of the SORP, but to improve the usability of the SORP.

B.6. In developing the Exposure Draft SORP, the SORP-making body has focused on explaining the requirements set out in the SORP in a way that is simple and easy to understand to support good quality financial reporting by all charities applying the SORP. The SORP-making body has sought to think about the needs of smaller

charities in particular when drafting the SORP and have drafted the SORP text with this in mind including relevant examples where necessary to help illustrate requirements.

Changes made in this SORP as a result of amendments to FRS 102

B.7. This section outlines the main changes that have been made in the Exposure Draft SORP as a result of amendments made to FRS 102, which were published in 2024 following the FRC's Periodic Review of FRS 102. Every SORP must maintain consistency with UK Generally Accepted Accounting Practice under the FRC's Policy on Developing SORPs. As a result, changes made to FRS 102 necessitate corresponding amendments to the Charities SORP.

Leasing

B.8. The amendments to FRS 102 introduce new requirements for lease accounting which affect both entities leasing assets to others and those leasing assets from another entity. A new module has been introduced to the Exposure Draft SORP that explains the relevant requirements for charities in both situations.

B.9. The module is designed to allow preparers to understand where the requirements of section 20 of FRS 102 apply and where they do not as well as where there are recognition exemptions and what these mean in practice. The recognition exemptions apply to short term leases and leases of low value assets.

B.10. The new lease accounting module provides more examples of situations that charities may encounter in comparison to other modules. This is to help illustrate the explanations and requirements of the module and support good quality reporting of such transactions.

Revenue recognition

B.11. FRS 102 has been updated to include new accounting requirements for revenue recognition based on the five-step model set out in IFRS 15 *Revenue from Contracts with Customers*. The underlying principle of this model is that revenue is recognised according to when the entity transfers to the customer, control of the good or service that it has promised to provide. For charities, this change will impact on income that is derived from exchange transactions.

Other changes made in the SORP

Tiered reporting

B.12. One of the recommendations from the SORP Governance Review was that the needs of smaller charities should be better served by the SORP and reporting requirements made more proportionate where possible. The needs of smaller charities have been considered when developing the SORP against the need for charity reports and accounts to provide adequate information to stakeholders.

B.13 A simpler receipts and payments framework is available to unincorporated charities and charitable incorporated organisations with income below £250,000. Research shows that some charities eligible to prepare receipts and payments accounts will opt to voluntarily produce accrual accounts which requires them to follow the SORP requirements. In developing the SORP, the SORP-making body have sought to include further guidance on the option available for smaller charities to produce receipts and payments accounts. Outside of the SORP, the SORP-making body is considering further options for promoting the receipts and payments option.

B.14. Section 1A of FRS 102 sets out the presentation and disclosure requirements that are specific to small entities choosing to apply the small entities regime. It sets out the minimum requirements that small entities under FRS 102 are required to provide. The SORP-making body believes that the public have different transparency and accountability expectations of charities compared to for-profit entities, meaning that more information is required about how charities operate. The SORP-making body previously considered whether using Section 1A of FRS 102 as a starting point, the SORP could be developed to reduce any burden of reporting on smaller charities. This consideration included the partial drafting of a SORP based on Section 1A of FRS 102 which was discussed with the Charities SORP Committee. The conclusion from that work was that there would be very little practical benefit arising for charities from developing a SORP on the basis of Section 1A of FRS 102 as the requirements set out in Section 1A of FRS 102 would require significant additions to meet the transparency and accountability expectations of relevant stakeholders. Consequently, the SORP-making body have concluded that the Section 1A of FRS 102 regime is not suitable for charities and therefore the SORP continues not to permit the use of Section 1A of FRS 102.

B.15 The SORP-making body have sought to develop the requirements of the SORP proportionately for smaller charities within the constraints of FRS 102 and applicable law but without using Section 1A of FRS 102 for the reasons stated above at B12. In considering proportionality, the SORP-making body took into account a number of factors including:

- the number of requirements that entities have to meet
- the needs of users of charity annual reports and accounts
- the changing operating environment for charities
- the ease of fulfilling reporting requirements.

B.16. The SORP-making body are also committed to advancing financial reporting for charities as this positively contributes to public trust and confidence in charities. The Exposure Draft SORP proposes to add requirements for information to be included within the Trustees' Annual Report for all charities, but it is expected that this information is already available to the charity trustees in governing the charity appropriately. The SORP-making body therefore considers the reporting requirements to be proportionate, taking into account all relevant factors.

B.17. Previously, the Charities SORP differentiated some requirements for smaller and larger charities, defining larger charities as those with income over £500,000. The main areas where there were differences for smaller and larger charities in the SORP related to the Trustees' Annual Report, the reporting of the charity's expenditure on the basis of natural classification or activities, the preparation of a cash flow statement and some disclosures in relation to trustee remuneration.

B.18. This Exposure Draft of the SORP proposes to introduce three tiers:

- Tier 1 - charities with gross income of not more than £500,000 (EUR 500,000)
- Tier 2 - charities with gross income above the tier 1 threshold but not more than £15 million (EUR 15 million)
- Tier 3 - charities above the tier 2 threshold

B.19. The threshold selected to distinguish tier 3 from tier 2 only takes into account the gross income criteria used in defining a small company in company law and a small entity in FRS 102. The additional criteria for defining a small company (employee numbers and total assets) were not selected to try to avoid confusion for smaller charities about the requirements that apply to them and to be consistent with the approach in the extant SORP. Similarly, the upper threshold for tier 1 maintains consistency with the upper threshold for smaller charities in the extant SORP.

B.20. To take advantage of the flexibility that the SORP-making body has to differentiate the requirements for different sizes of charity, the modules of this Exposure Draft SORP where different requirements apply depending on which tier the reporting charity is in are:

- Module 1 – Trustees' Annual Report
- Module 4 – Statement of Financial Activities
- Module 8 – Allocating costs by activity
- Module 9 - Disclosure of trustee and staff remuneration, related party and other transactions
- Module 14 – Statement of cash flows

B.21. For all other modules in the Exposure Draft SORP tiering does not apply and those modules will be applied in full to all charities, where applicable. The SORP-making body cannot provide an exemption from a requirement of FRS 102 but it introduce additional requirements and apply those on a tiered basis. There are also areas of the SORP where the reporting requirements are considered by the SORP-making body to be critical to the understanding of the charity's finances, operations and

governance for users of the annual report and accounts and so are applied to all charities regardless of size.

B.22. The different reporting requirements for the tiers in each of these modules is further explained below.

Changes made in each module of the SORP

Scope and Application

B.23. Preparers can early adopt the 2024 Periodic Review amendments to FRS 102, and this Exposure Draft SORP will also be available for early adoption. Note, FRS 102, including the Periodic Review amendments 2024, must be applied at the same time as this SORP. In those jurisdictions where the applicable SORP under which accounts are prepared is specified in regulations, this SORP cannot be adopted until the new regulations are made allowing its use.

Module 1 - Trustees' Annual Report

B.24. This module has been largely rewritten with the aim of helping charity trustees to understand the narrative reporting requirements placed on them and to encourage trustees to link the narrative information to the financial detail in the accounts. Recognising that this module is the one that charity trustees are most likely to engage with, the module has been restructured to support clarity as to the requirements for the reporting charity.

B.25. Narrative reporting is not covered by FRS 102, meaning the SORP-making body has some latitude about what the requirements should be in the SORP. However, there are some specific reporting requirements outlined in the relevant regulations for charities in England and Wales, Scotland and Northern Ireland and these are incorporated into module 1.

B.26. The reporting requirements included for the Trustees' Annual Report focus on information that is of greatest interest to users of charity annual reports and accounts. Input from engagement partners allowed consideration of the information provided under the requirements of the extant SORP and how it is most commonly used, to help inform decisions about how that information should be presented and who should be required to present it.

Impact reporting

B.27. Charities are increasingly required to explain the impact they are making. As all charities exist to provide public benefit, it follows that they should be able to communicate the benefit provided to the beneficiaries that the charity exists to serve and support. To facilitate this, prompt questions have been included in module 1 for charities to consider and answer within their Trustees' Annual Report. This approach was supported by the Charities SORP Committee. The engagement

process highlighted a strong desire for charities to report on the difference they are making and consequently, the charity's impact on the wider environment also now forms part of the considerations that charity trustees must make and report on.

Sustainability reporting

B.28. It was acknowledged in the engagement process that stakeholders are increasingly interested in how charities are responding to environmental, governance and social issues. To reflect this and to advance reporting in this area in a proportionate manner, the Exposure Draft SORP proposes that charities in tiers 1 and 2 are **encouraged** to explain how the charity is responding to and managing environmental, governance and social matters. Charities within tier 3 are **required** to explain how the charity is responding and managing environmental, governance and social matters.

Volunteers

B.29. Volunteers help charities carry out their activities and achieve their purposes. It is often difficult to produce financial information on volunteers and to obtain a reliable measurement of volunteer time for recognition in the financial statements but the SORP-making body consider this information to be important in telling the charity's story. The extant SORP requires all charities to disclose in the notes to the accounts a description of the role played by general volunteers (Module 6, Donated goods, facilities and services, including volunteers). With support from the Charities SORP Committee, some of the disclosure requirements have been relocated from module 6 of extant SORP and instead included in the requirements for all charities in the Trustees' Annual Report. In addition, the Exposure Draft SORP extends the application of the existing requirement for larger charities to provide a narrative explanation of the scale and nature of activities undertaken by volunteers to charities in all tiers. This should aid clarity in reporting and make it easier for those using charity annual reports and accounts to locate and use the information about volunteers that they require.

B.30. In relation to general volunteers, the SORP-making body propose that charities in Tiers 2 and 3 should provide information on the number of volunteers and where practicable, the contribution of volunteers may be expressed in terms of full-time equivalent hours. These disclosures are considered helpful to a user of the accounts in telling the charity's story and in addressing the difficulty of producing financial information on volunteers and/or obtaining a reliable measurement of volunteer time for recognition in the financial statements. The SORP-making body believes that as this kind information is provided as part of the annual return process to each charity regulator, that there would be minimal cost associated with including this information.

Reserves

B.31. Charity reserves are an area of interest for stakeholders but there is sometimes a

lack of understanding about the meaning of reserves from a charity perspective. This issue was clearly identified in the early engagement activity undertaken and it was agreed that improvements needed to be made to how reserves are defined in the SORP and how the disclosure requirements are explained. The Exposure Draft SORP proposes an updated definition of reserves in the glossary and more clarity about the relevant disclosure requirements for the Trustees' Annual Report. Other issues identified by engagement with stakeholders included the perceived isolation of the reserves figure in the Trustees' Annual Report from figures in the statements of account and from the consideration of going concern. The Exposure Draft SORP now includes requirements to address these points.

B.32. In the extant SORP, there is a requirement for larger charities to provide a summary of the charity's plans for the future. This requirement has now been extended to charities in all tiers. The SORP-making body is of the view that future plans would need to be considered by charities in all tiers when considering whether the charity is operating as a going concern so it would not increase the reporting burden for smaller charities to include this information in the Trustees' Annual Report. The SORP-making body believes that this information would be beneficial to encourage transparency and allow relevant stakeholders to be informed of the charity's future plans.

Going concern

B.33. Module 3 of the Exposure draft SORP outlines the disclosures that must be made in relation to going concern in the accounting policies note. In particular, where there are no material uncertainties about the charity's ability to continue to report on a going concern basis, this judgment should be disclosed. When the trustees are aware, in making their assessment, of material uncertainties related to events or conditions that may cast significant doubt on the charity's ability to continue as a going concern, the charity must disclose those uncertainties.

B.34. The extant SORP requires that all charities, where at the date of approving the report and accounts there are uncertainties about the charity's ability to continue as a going concern, the nature of these uncertainties should be explained. This requirement has been included as a 'must' in the Exposure draft SORP to align with module 3 and FRS 102. A new requirement has also been included such that where a charity has no reserves (or negative net assets on the balance sheet), it must explain why it is still operating as a going concern.

B.35. The SORP-making body is of the view these changes would not increase the reporting burden charities as they already need to produce and consider this information to comply with module 3.

Legacies

B.36. A new requirement has been included for tier 2 and tier 3 charities, to provide a narrative explanation of how legacies are included in the accounts. The aim of this

requirement is to help users of the accounts to understand that a legacy may be recognised as income before the resources are received. The difficulty regarding recognition of legacies in charity accounts arose in discussions with engagement strands and the SORP-making body included this requirement to help address this issue.

Module 2 - Fund accounting

B.37. Fund accounting is an important area of charity accounting and charities must ensure that different classes of funds are accounted for and reported on correctly in the accounts. Feedback provided to the SORP-making body and charity regulatory experience indicated that further clarification on fund accounting in the SORP would be helpful. This module has been updated to give more guidance for users to assist with appropriate stewardship of the funds with further guidance being included on restricted funds. The Exposure Draft SORP proposes to require charities to disclose the details of the legal power(s) used to remove the capital restrictions or amend the purposes of a restricted fund.

B.38. The module has been updated for changes to the Charities Act 2011 updated. Text has been added to clarify that trustees can remove the designation on designated funds and trustees are now required to disclose this fact when disclosing the details of material designated funds. The content on tangible fixed assets has been moved to its own section, this amendment intends to improve the clarity of the provisions, make them easier to understand and avoid any unintended consequences which might arise from it previously being included in the restricted funds section.

B.39. The funds note was considered by the engagement strands and SORP Committee who felt that the funds note was an important note. Taking account of feedback the example funds note at table 1 in the module has been updated and now illustrates the different funds. This change has been made to assist charities in producing the note.

Module 3 – Accounting policies

B.40. Relevant updates have been made to this module stemming from changes made to FRS 102. Greater explanation has been added to module 3 about principles underlying the preparation of accounts that charities should be aware of, in particular how to consider the usefulness of information for stakeholders to ensure their needs are being met.

B.41. The going concern basis of preparation is now explained in more detail within module 3, with reference to where material uncertainties exist about the charity’s ability to continue to report on a going concern basis.

B.42. Similarly, more explanation is now provided about the concept of materiality and how it applies to the preparation of charity accounts, clarifying that materiality is entity specific and how a preparer of charity accounts should determine if information is material or not.

Module 4 - Statement of Financial Activities

B.43. The structure of the Statement of financial activities (SoFA) has been retained. There was support for retaining the two approaches for reporting on activities in the SoFA being the ‘natural classification’ for smaller charities and the ‘activity-based’ reporting basis for larger charities. Therefore, the Exposure Draft SORP has retained the requirement for tier 2 charities to report on an activity basis.

B.44. In supporting smaller charities making a choice as to whether they wish to report on an activity basis or use natural classification, module 4 has been updated to make clearer how the SoFA will appear depending on the basis of reporting selected. An example table 2a has been included to illustrate how the reporting on a natural basis could look in the SoFA. The module has also been updated to reflect the requirements of FRS 102 more closely and setting out that joint ventures and associates must be presented as a separate line.

B.45. A further illustrative table 3 has been included in this module to assist charities with presenting support costs and the basis for apportionment of the costs.

B.46. The Exposure Draft SORP proposes to retire the terms programme related and mixed motive investments (see module 21 below). Consequential amendments have been made to module 4 in terms of the gains and losses on social investments. This module now sets out the requirement that gains and losses on social investments must be presented in the investment gains and losses line heading of the SoFA.

Module 5 - Recognition of income

B.47. As explained in paragraph B.11 above, module 5 has been updated to include the new accounting requirements for revenue recognition for exchange transactions based on the five-step model in FRS 102. To accommodate the extra detail on exchange transactions and to assist users of the SORP to identify the paragraphs relevant to them, the module has been split into two main sections: section one deals with exchange transactions and section two deals with non-exchange transactions.

B.48. Following on from the division of the module into two main sections, it was necessary to make other changes to the format and structure. As in the extant SORP, all the accounting disclosures are at the end of the module.

B.49. In the extant SORP, income can only be recognised when three criteria are met; these are entitlement, probable and measurement.

B.50. The approach to income recognition in the Exposure Draft SORP is that income is recognised in the statement of financial activities (SoFA) when the relevant criteria that apply to a particular type of income are met. Different criteria apply to recognising income from exchange transactions to those that apply for non-exchange transactions. For example, for exchange transactions, there are now five

stages in income recognition.

B.51. The approach to recognising income in the Exposure Draft SORP more closely aligns with FRS 102 and consequently, the three existing income recognition criteria are no longer relevant. The terms 'entitlement', 'probable' and 'measurement' are used in the Exposure Draft SORP only when they are the relevant criteria for recognising a particular type of income. The effect of this is that the term 'entitlement' is only used in relation to the recognition of dividend income and in the definition of a 'performance related condition'.

B.52. The recognition of income from legacies has been revised in accordance with the principles in FRS 102 and to reflect feedback received from engagement strands that there were issues with understanding the accounting treatment and lack of consistency in charity reporting on this matter. Additional guidance has been included on the information sources available to charities when developing their accounting policy for recognising income from legacies.

B.53. Finally, the section on 'Disclosures and notes to the accounts' contains some additional disclosure requirements that have come from FRS 102.

Module 6 – Donated goods and services

B.54. Minor updates have been made to this module to reflect the new lease accounting requirements within module 10B so that charities are clear on how to account for the non-exchange component of a lease arrangement where the lease arrangement also contains a donation.

B.55. Some of the disclosure requirements in module 6 of the extant SORP relating to the role played by general volunteers are now included in the Trustees' Annual Report as explained in module 1. In addition, the Exposure Draft extends the application of the existing requirements for larger charities to provide a narrative explanation of the scale and nature of activities undertaken by volunteers to charities in all tiers. This should aid clarity in reporting and make it easier for those using charity annual reports and accounts to locate and use the information about volunteers that they require. Module 6 still requires the notes to the accounts to include information about the contribution of unpaid general volunteers.

Module 7 – Recognition of expenses and liabilities

B.56. In reviewing the extant SORP and considering how improvements could be made to aid preparers of accounts, it was identified that it would be advantageous to minimise duplication in the SORP and to make more use of cross references between modules where appropriate. The SORP Committee considered this point in relation to module 7 in particular and the relationship with module 10. A decision was taken to create a new module on provisions and liabilities that modules 7 and 10 could refer to, ensuring that all requirements and explanations relating to that topic are in one place to avoid confusion.

B.57. Module 7 therefore no longer contains explanations of how to account for and disclose provisions or how to treat commitments that are not provisions or liabilities all such matters are now dealt with in the new module 10A.

B.58. A key terminology change in module 7 is the switch to refer to 'expenses' instead of 'expenditure' which has been introduced to fall into line with terminology used in FRS 102. The meaning of the term is unchanged for preparers however. The module now contains greater explanation of when an obligation arises which is a key component that must be present for a liability to be recognised in the charity's accounts.

Module 8 - Allocating costs by activity in the Statement of Financial Activities

B.59. Activity based reporting is mandatory for charities with income above £500,000 (that is, those in tiers 2 and 3) which is unchanged from the extant SORP. In order to support a more informed choice for charities in tier 1, more detail has been provided in this SORP about what the option for natural classification means in practice. Corresponding changes have been made to module 4 so that an illustrative SoFA on a natural classification basis is now also included. The majority of engagement partners supported increasing the visibility of the natural classification option in the SORP.

B.60. To support charities in tier 1 that elect to report on an activity basis and charities in tiers 2 and 3, module 8 has been amended to highlight the importance of charities being clear about the activities that are significant in their organisation and using those to drive how the charity reports in both the trustees' annual report and also the accounts.

B.61. Greater explanation has also been provided in the module about what support costs are. This is in response to engagement input which indicated that the understanding of what support costs are in a charity has been mixed in the past, with some viewing such costs as 'bad' or undesirable. Such costs are incurred by a charity to enable the delivery of some or all of a charity's activities and to aid greater understanding of this, amendments have been made to how such costs are described in module 8. Again, corresponding changes have been made to module 4, in particular the movement of the illustrative table providing an analysis of support costs from module 8 to module 4.

Module 9 - Disclosure of trustee and staff remuneration, related party and other transactions

B.62. The disclosure requirements set out in this module are important for transparency. Research and regulatory experience show that there is a potential lack of understanding and awareness of the disclosure requirements for related party transactions. Updates to this module have been made to clarify existing requirements of the SORP and FRS 102. Information has been added to highlight

that consideration must be given to the timing of a transaction when considering its substance. FRS 102 requires outstanding balances with related parties to be disclosed. In setting out the transactions with related parties that do not require disclosure the extant SORP did not refer to the fact outstanding balances needed to be disclosed. This module has been updated to reflect this point.

B.63. To ensure consistency with other guidance and the legal position the section on ex-gratia payments has been updated to reflect more clearly the glossary definition of ex-gratia payments.

B.64. The Exposure Draft SORP proposes to remove the option to aggregate ex-gratia payments and related party transactions. This has been removed to improve transparency over these transactions.

Module 10 - Balance sheet

B.65. Amendments in this module are primarily related to the requirements of FRS 102, with additional information now included in this module to reflect the new lease requirements within FRS 102. Although the detailed considerations of lease accounting are included in the new leasing module, module 10B, further information and cross-reference to the new leasing module has been added to provide clarity for users. This includes reference to right of use assets in paragraph 10.20, the leasing of items of property, plant and equipment at paragraph 10.30 and disclosure requirements set out at paragraphs 10.90 - 10.91.

B.66. Other amendments to this module include:

- removal of provisions, contingent liabilities and contingent assets and funding commitments, which are now included as a new module, module 10A. (See more information on this at section B.68 below)
- clarity provided in relation to the recognition of intangible assets with additional information provided including determining when internally generated intangible assets should be recognised
- additional information relating to the accounting for the derecognition of property, plant & equipment including how to account for any gain/loss on disposal
- additional information to assist in accounting for the revaluation of property, plant and equipment, including guidance on when assets should be reviewed for revaluation purposes
- references to social investments have been removed except for a cross reference to the relevant SORP module
- clarity has been provided on the measurement of stock for goods which are provided as part of a charitable activity
- additional disclosure requirements have been introduced for investments and investment properties to ensure consistency with FRS 102

B.67. The remaining amendments to this module are included to ensure consistency with FRS 102 or to assist users understanding and usability of the module by including additional explanatory text or by providing specific cross references to sections of

FRS 102.

Module 10A - Provisions, contingent liabilities and contingent assets and funding commitments

B.68. The creation of this module has been to aid preparers to understand what provisions, contingent liabilities and contingent assets are more clearly and how transactions that commonly arise in charities must be dealt with in this area. The wording removed from module 7 on these matters was used to develop the new module, with amendments where necessary to ensure consistency with FRS 102.

Module 10B – Lease Accounting

B.69. The development of this module has been to aid preparers of charity accounts following updates to lease accounting as set out in section 20 of FRS 102, in particular the removal of the distinction between operating and finance leases for lessees, with more leases now being recognised in the balance sheet. This will be a significant change in accounting treatment for those charities with operating leases.

B.70. It should be noted that not all arrangements entered into by the charity for the use of assets will meet the definition of a lease, and therefore the leasing requirements will only apply when they do meet the definition of a lease as set out in FRS 102.

B.71. As many of these requirements will be new for charities with lease arrangements, a detailed approach has been taken to this module, providing charity specific clarity on the requirements and accounting treatment, where possible. Some of the key terms that preparers need to be familiar with to understand the reporting requirements are set out in the body of the module as well as in the Exposure Draft SORP glossary to support the ease of reading and understanding the module.

B.72. The navigation of the module is key to helping charities understand:

- if the new requirements apply to the arrangements they have
- if they do apply, whether a recognition exemption is applicable, and if not
- how to account for the arrangements that are in place

B.73. The module is therefore designed in a logical way to help charities easily understand what is relevant for them and what they need to do to help focus their attention on the applicable parts. The distinct sections of the module that deal specifically with the requirements applicable to lessees and lessors are also geared towards easier navigation.

B.74. The SORP-making body considered in great detail how charities are required to account for lease arrangements where the payments due by the lessee are significantly lower than market rates as it is considered that this is an arrangement which would apply to charities. While FRS 102 provides some requirements and guidance in this area, it does not provide significant detail.

B.75. FRS 102 states using information readily available to it, a lessee must determine whether it is in receipt of incoming resources from a non-exchange component of a lease arrangement. This is likely to arise where the payments made under the arrangement are significantly below market rate because the lessor has the intention of supporting the charity in delivering on its charitable purposes. The Exposure Draft SORP aims to provide further guidance on the application of FRS 102 in this area.

B.76. The SORP-making body consider that what is being received in a non-exchange transaction will most likely be classed either as an asset or a facility/service. The SORP within module 6 already explains that the measurement of a donated asset is at fair value and a donated facility or service is at value to the reporting entity, in line with the requirements of FRS 102 and this remains unchanged. It then follows that the nature of what is being received is critical to the measurement of any non-exchange component that is present in a lease arrangement so that the SORP sets out a consistent accounting treatment for the donation of assets, facilities and services to charities regardless of whether they form part of a lease arrangement or not. The module provides a way for charities to determine the substance of the arrangements they are party to which in turn determines the accounting treatment.

B.77. In considering the disclosure requirements of FRS 102 in relation to lease accounting, the SORP-making body identified a need to introduce a specific disclosure requirement in relation to social donation leases, both for charities as lessees and lessors in such arrangements. This disclosure requirement seeks to ensure that users of charity accounts are able to properly understand these types of lease arrangements that the charity is party to and the impact of such arrangements on the charity's finances in future periods.

Module 11 – Accounting for financial assets and financial liabilities

B.78. The amendments made to this module were primarily minor and aimed at improving usability and ensuring consistency with FRS 102. It also provides more clarity on what is a financial instrument.

Module 12 – Impairment of assets

B.79. This module has been updated to reflect the updates to FRS 102 and a new section has been included to cover impairment of inventories. The module has been slightly restructured and the section on indicators of impairment has been moved higher in the module to improve the flow of the module.

Module 13 – Events after the reporting period

B.80. There have been no changes made to this module in terms of requirements. Amendments have been made, however, to support better understanding about those events that require adjustments to be made to the accounts and those events

that do not require adjustments to be made. In addition, new text has been included that cross refers to further information that is provided in module 3 about how a charity should consider whether it is a going concern or not when preparing its accounts. More charities have experienced severe financial challenges following the pandemic, meaning assessment of going concern is often an issue that arises more commonly than before.

Module 14 – Statement of cash flows

B.81. The key change in this module relates to the threshold at which charities are required, under the Exposure Draft SORP to prepare a statement of cash flows following the proposed introduction of three tiers as outlined at section B.12 above.

B.82. The requirement within the previous SORP was that all charities with income over £500,000, preparing their accounts in line with the SORP, were required to prepare a statement of cash flows. The Exposure Draft SORP proposes to increase this income threshold to £15m (tier 3). Section 7 of FRS 102 allows an exemption for small entities, applying full FRS 102, from the requirement to prepare a statement of cash flows. The Exposure Draft SORP proposes that only tier 3 charities will be required by this SORP to prepare a statement of cash flows. Tier 1 and 2 charities may be exempt from providing a statement of cash flows when they are eligible for the exemption for small entities in FRS 102.

B.83. The additional criteria for defining a small entity (employee numbers and total assets) are not considered in the threshold of the SORP tiers. It should be noted that the small entity definition applies to all entities, not just those constituted as companies. Tier 1 and 2 charities, who meet the small entity criteria in FRS 102, are not required to prepare a statement of cash flow but may wish to do so.

B.84. The SORP-making body, in its considerations of how the requirements of the SORP could be as proportionate as possible for the wide variety of charities that prepare their accounts in line with it, decided to relieve those charities in tier 2 from the requirement to prepare a statement of cash flows when eligible; meaning only the very largest charities are required to prepare the statement, consistent with all companies of the same size. The SORP-making body believes this change will have a positive impact as it will reduce the reporting requirements for more charities.

B.85. Whilst the SORP-making body recognises that some users of charity accounts may find the statement of cash flows helpful in allowing them to understand more about the charity’s finances, it is unlikely that this is relevant for all charities in tier 2. Where a user does require this information, it is likely to be as a result of a funding or other relationship where the user is likely to have the power to request that information from the charity in any case so information needs can be better met on a more targeted basis.

B.86. Another significant amendment to this module stems from Section 7 of FRS 102, which includes information on accounting for supplier finance arrangements. As a

small number of charities may be party to supplier finance arrangements paragraphs 14.21 to 14.24 have been introduced to the SORP to provide information on this section of FRS 102.

B.87. The final significant amendment to this module relates to the template cash flow statement provided at Table 8. The previous SORP included a separate Reconciliation of net income/(expenditure) to net cash flow from operating activities (Table 9). This information has now been amalgamated into Table 8 to assist users understanding and usability of the template.

B.88 The remaining amendments to this module are included to ensure consistency with FRS 102 or to assist users understanding and usability of the module by including additional explanatory text or by providing specific cross references to sections of FRS 102.

Module 15 – Charities established under company law

B.89. Amendments in this module are minimal but the key amendment relates to the disclosure of equity in the balance sheet section, specifically at paragraph 15.20 which now highlights that charitable companies with share capital need disclose information in accordance with paragraph 4.12 of FRS 102.

B.90. Other minor amendments to this module are included to ensure consistency with FRS 102 or to assist users understanding and usability of the module by including additional explanatory text or by providing specific cross references to sections of FRS 102.

Module 16 – Presentation and disclosure of grant-making activities

B.91. Little change has been made to this module as a result of the limited feedback received from engagement partners about issues in this area. The SORP-making body considered that it would be helpful to provide more clarity about when a grant is made to an institution as opposed to an individual and have made changes to reflect this.

Module 17 – Retirement and post-employment benefits

B.92. The module's original title, 'Retirement and post-employment benefits,' suggested broader coverage than it provided, as the primary focus is on pensions. To better reflect its content, the title has been amended to 'Retirement benefits.' Users seeking information on other post-employment benefits, such as termination benefits or long-term employee benefits, are directed to Section 28 of FRS 102. References within the module to 'post-employment benefit plans' have also been updated to 'retirement benefits' for consistency with the revised title.

Module 18 – Accounting for heritage assets

B.93. The main amendments to this module relate to providing clarity to users of the SORP on the measurement of heritage assets which have been donated, with further information included in paragraphs 18.18 - 18.19. Additional clarity has also been added in relation to several heritage asset disclosure requirements.

B.94. Amendments have also been made to include reference to heritage assets which may be held by a lessee as a right of use asset, although it is acknowledged that this scenario is likely to be uncommon.

B.95. Other minor amendments to this module are included to ensure consistency with FRS 102 or to assist users understanding and usability of the module by including additional explanatory text or by providing specific cross references to sections of FRS 102.

Module 19 – Accounting for funds received as agent or as a custodian trustee

B.96. The amendments made to this module were primarily minor and aimed at improving usability. Specifically, the module now includes references to related modules in the SORP to make it easier for preparers to navigate the document. These minor amendments align with the overall aim of the SORP revision process, which is to enhance clarity, usability, and consistency while maintaining compliance with FRS 102.

Module 20 – Total return (investments) – (England and Wales only)

B.97. This module has been updated for changes arising in the Charities Act 2022. Section 104AA(2) of the Charities Act 2022 gives trustees a power, once they have made a section 104A(2) resolution, to then resolve to use permanent endowment to invest the total return fund, or part of it, in social investments with a negative or uncertain financial return, provided that any losses are offset by gains made elsewhere in the relevant fund.

B.98. No additional disclosures are required by the legislation but the SORP-making body have included three new disclosures to help users of the accounts to understand the effect of making such investments and to give assurance that any losses made on such investments are covered by gains in the fund.

Module 21 – Accounting for social investments

B.99. The Exposure Draft has retired the terms programme related and mixed motive investments and now uses the term ‘social investment’ to cover both terms. This is to align the definition of social investments in SORP with the definition in the Charities Act 2011 definition. The Exposure Draft SORP proposes that all gains

and losses on social investment will be presented in the SoFA as gains and losses on investments whereas in the extant SORP, a gain on a programme related investment is included within ‘other income’. It is thought that this change will simplify the requirements for charities that have social investments. This change may result in a change in accounting practice for some charities and may result in charities being required to adjust comparatives.

B.100. The structure of the module has been amended and a new section on social investment loans has been included. This section more clearly aligns with FRS 102 requirements for concessionary loans. The section also sets out information on social investment loans that are not concessionary loans.

Module 22 – Accounting for charities pooling funds for investment

B.101. The wording in this module has been clarified to reflect that Common Investment Funds (CIFs) and Common Deposit Funds (CDFs) should consider the charity specific reporting requirements set out in the applicable jurisdiction and that the regulations also currently require CIFs and CDFs to consider the Investment Association SORP.

B.102. A section has been added to this module setting out that a Charitable Authorised Investment Fund (CAIF) must follow the Investment Association SORP. A CAIF is a form of collective investment scheme which is authorised by the Financial Conduct Authority and is also registered with the Charity Commission England and Wales. CAIFs are similar to CIFs and CDFs but they are authorised by the FCA which is why they are required to follow the Investment Association SORP.

Modules 23 – 29 – Overview of charity combinations and related modules

B.103. There has been little feedback on modules 23 to 29 during the SORP development process. As a result, only minor amendments have been made to these modules to ensure consistency with FRS 102 or to assist users understanding and usability of the modules by including additional explanatory text or by providing specific cross references to sections of FRS 102.

Appendix 1 – Glossary

B.104. The Glossary has been updated to reflect changes in FRS 102 and legislation. It has also been updated where the SORP definition has been amended to provide clarification on particular terms.