# Extract from the Scope and Application chapter of the SORP (chapter one)

## ‘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:

    a) the charity is registered in England and Wales or Northern Ireland and gross income exceeds £250,000

    b) the charity is registered in Scotland and gross income for the year is £250,000 or more

    c) the charity is a company registered with Companies House

    d) the charity's governing document requires accounts to be prepared on the accruals basis.

    If none of the items listed in a) to d) above apply, charities may be eligible to opt to prepare receipts and payments accounts. 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.’

# 4. Statement of financial activities

## Introduction

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

Table X Tiered Reporting for Module 4

| | |
|---|---|
| Tier 1 | Charities within tier 1 may choose to adopt either the activity basis of reporting or the natural classification basis of reporting. This SORP requires charities within tier 1:<br>• that have adopted the **natural classification** basis of reporting to use the format of the statement of financial activities as presented in **Table 2a**<br>• that have adopted the **activity basis** of reporting to use the format of the statement of financial activities as presented in **Table 2b** |
| Tier 2 | This SORP requires charities within tier 2 to adopt the activity basis of reporting. Charities in tier 2 are therefore required to adopt the format of the statement of financial activities as presented in table 2b. |
| Tier 3 | This SORP requires charities within tier 3 to adopt the activity basis of reporting. Charities in tier 3 are therefore required to adopt the format of the statement of financial activities as presented in table 2b. |

~~4.1.~~4.2. All charities ~~preparing their accounts on an accruals basis to give a true and fair view of their financial activities and financial position~~ must prepare a statement of financial activities (SoFA) for each reporting period; termed statement of comprehensive income in FRS 102. ~~The structure, format and headings of the SoFA required by this SORP (when prepared on an activity basis) are set out in Table 2. FRS 102 does not address the presentation of charitable funds within the statement of comprehensive income provided by the SoFA.~~

~~4.2.~~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 ~~must be~~is presented on the face of the SoFA, and~~.~~ that comparative information for separate classes of funds may be provided either on the face of the SoFA or in the notes to the accounts.~~Comparative information provided for the separate classes of funds, if any, held by a charity may be presented either on the face of the SoFA or prominently in the notes to the accounts.~~

~~4.3.4.1. The column in Table 2 headed 'Further details' provides references to later sections of this module that set out those activities and transaction(s) falling within each of the SoFA's headings.~~

4.4. The statement of financial activities (SoFA) is a single ~~accounting~~ financial statement that includes all income, expenses, gains~~, expenditure~~ and losses recognised for the reporting period. It provides the user with an analysis of the income and endowment funds received



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

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

and the expenditure by the charity on its activities, and presents a reconciliation of the movements in a charity's funds for the reporting period.

4.5. Charities in tier 1 may report their expenses using natural classifications or on an activity basis. An illustrative SoFA setting out the structure, format and suggested headings of the SoFA when prepared using natural classifications is set out in Table 2a.

4.6. This SORP requires charities in tiers 2 and 3 ~~expenditure~~ to ~~be~~ reported expenses on an activity basis to show how the charity has used its resources to further its charitable aims for the public benefit. ~~However, smaller charities may opt to report their charity's expenditure in a different way, for example by the nature of expenditure rather than on an activity basis.~~

4.7. The structure, format and headings of the SoFA required by this SORP when prepared on an activity basis are set out in Table 2b.

~~4.5.~~4.8. ~~T~~For all charities, the SoFA should be prepared with the needs of the charity's stakeholders in mind (see the SORP module 'Accounting and reporting by charities – the statement of recommended practice (SORP) scope and application'). Charities reporting on an activity basis should ensure that those activities reviewed in the trustees' annual report are also reported on the face of the SoFA or in the notes to the accounts.

~~This SORP requires expenditure to be reported on an activity basis to show how the charity has used its resources to further its charitable aims for the public benefit. However, smaller charities may opt to report their charity's expenditure in a different way, for example by the nature of expenditure rather than on an activity basis.The structure, format and headings of the SoFA required by this SORP (when prepared on an activity basis) are set out in Table 2.~~ FRS 102 does not address the presentation of charitable funds within the statement of comprehensive income provided by the SoFA. The column in Tables 2a and 2b headed 'Further details' provides references to later sections of this module that set out those ~~activities and~~ transaction(s) and, in the case of Table 2b, activities falling within each of the SoFA's headings.

~~4.6.~~4.9.

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

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

| | Unrestricted funds | Restricted funds | Endowment funds | Total funds | Prior period Total funds | Further details |
|---|---|---|---|---|---|---|
| | £ | £ | £ | £ | £ | £ |
| **Income and endowments from:** | | | | | | |
| (e.g.) Donations and legacies | | | | | | A1 |
| (e.g.) Charitable activities | | | | | | A2 |
| (e.g.) Other trading activities | | | | | | A3 |
| (e.g.) Investments | | | | | | A4 |
| (e.g.) Other | | | | | | 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 and impairment charges | | | | | | B1 |
| (e.g.) Other expenses | | | | | | B1 |
| **Total** | | | | | | |
| | | | | | | |
| 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 2b: Statement of financial activities – expenses presented on an activity basis**

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

| | Unrestricted funds | Restricted funds | Endowment funds | Total funds | Prior period Total funds | Further details |
|---|---|---|---|---|---|---|
| | £ | £ | £ | £ | £ | £ |
| **Income and endowments from:** | | | | | | |
| Donations and legacies | | | | | | A1 |
| Charitable activities | | | | | | A2 |
| Other trading activities | | | | | | A3 |
| Investments | | | | | | A4 |
| Other | | | | | | A5 |
| **Total** | | | | | | |
| **~~Expenditure~~ Expenses incurred on:** | | | | | | |
| Raising funds | | | | | | B2~~1~~ |
| Charitable activities | | | | | | B3~~2~~ |
| Other | | | | | | B4~~3~~ |
| **Total** | | | | | | |
| | | | | | | |
| Net gains/(losses) on investments | | | | | | B4~~5~~ |
| **Net income/(~~expenditure~~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** | | | | | | |

~~4.7.~~4.10. The module is divided into two parts as follows:

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

  Line headings used in the statement of financial activities:

  - A1 Income from donations and legacies;
  - A2 Income from charitable activities;
  - A3 Income from other trading activities;
  - A4 Investment income
  - A5 Other income;
  - Analysis of income in the notes to the accounts;
  - B1 Expenses incurred (natural classification analysis);
  - B~~1~~2 ~~Expenditure~~ Expenses incurred on raising funds;
  - B~~2~~3 ~~Expenditure~~ Expenses incurred on charitable activities;
  - B~~3~~4 Other ~~expenditure~~expenses;
  - Analysis of ~~expenditure~~ expenses in the notes to the accounts (analysis on an activity basis);
  - B~~4~~5 Gains/(losses) on investments;
  - C Transfers between funds;
  - D1 Gains/(losses) on revaluations of fixed assets;
  - D2 Actuarial gains/(losses) on defined benefit pension schemes;
  - D3 Other gains/(losses); and
  - E Reconciliation of funds.

## Presentation of information

### Structure of the SoFA – all charities

~~4.8.~~4.11. A charity's statement of financial activities (SoFA) must:

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

- provide comparative amounts for the total funds presented on the face of the SoFA; and
- omit headings where there is nothing to report in both the current and preceding reporting period.

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~~4.9.~~4.12. The columns of the SoFA must be used to distinguish restricted income funds, which may only be spent for a particular purpose of the charity, from unrestricted funds, which can be spent on any of its purposes, and endowment 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).

~~4.10.~~4.13. All of the charity's income and ~~expenditure~~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.

~~4.11.~~4.14. If a class of funds would not be considered material it may be combined with another class of funds and shown as a single combined funds column. If a single combined total funds column is used the heading must be changed to 'all unrestricted and restricted funds' or 'all unrestricted, restricted and endowed funds' as appropriate. Where a single column approach is followed the summary of fund movements must include an analysis for each class of fund for each row in the SoFA together with a total that corresponds to the total shown in the SoFA. For more information refer to the SORP module 'Fund accounting'.

~~4.12.~~4.15. A charity may vary the order in which it presents headings within the income and ~~expenditure~~ expense sections of the SoFA to meet its own presentational needs. Some charities may also find it informative to their users to insert additional subtotals.

~~4.13.~~4.16. A charity may add additional columns to the SoFA to present material funds or activities on the face of the statement rather than in the notes. 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**

~~4.14.~~4.17. All charities must disclose the nature and amount of any material item(s) of income or ~~expenditure~~ expense when this information is relevant to an understanding of the charity's financial performance.

~~4.15.~~4.18. The disclosure of material items must be made either in the notes or by the insertion of an additional line within the relevant ~~activity~~ heading on the face of the SoFA when necessary for the presentation of a true and fair view of a charity's financial activities. For example material items that should be disclosed separately are a material fraud or the loss of a material tangible fixed asset.

**Accounting for extraordinary items – all charities**

~~4.16.~~4.19. Events and transactions falling outside a charity's ordinary activities are by their nature extremely rare and are referred to as extraordinary items.

~~4.17.~~4.20. Extraordinary items are material events or transactions that:

- fall outside of the charity's ordinary activities;
- are abnormal in their nature; and
- are not expected to recur.

~~4.18.~~4.21. In the unlikely event of their occurrence, extraordinary items must be disclosed on the face of the SoFA immediately after the total of net income/(~~expenditure~~expense). The nature of each extraordinary item should be explained in the notes to the accounts.

**Accounting for discontinued operations – all charities**

~~4.19.~~4.22. Charities are established to pursue one or more charitable purposes for the public benefit. Decisions as to the use of resources and the relative priority given to the charity's aims may differ from year to year to reflect the demands placed on the charity by its beneficiaries and social and economic circumstances. Such changes in the way in which activities are provided, or goods or services are delivered, or the range or extent of the activities pursued, do not represent discontinued operations.

~~4.20.~~4.23. 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.~~4.24. Discontinued operations represent the complete discontinuation of, or disposal of, a separate line of business activity or charitable activity and not simply the spending out of a restricted fund. 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 – ~~smaller~~ charities in tier 1**

~~4.22.~~4.25. The analysis of ~~income and expenditure~~expenses by activity is encouraged for all charities preparing accruals accounts. However, ~~smaller~~ charities in tier 1 are not required to report their ~~income and expenditure~~expenses on an activity basis and may adopt ~~an alternative approach to their analysis~~the natural classification basis for reporting the charity's expenses. See section B1 for further details.

~~4.23. This analysis may be based on the nature of the income and expenditure. For example, expenditure 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 expenditure in its own accounting records could be used.~~

~~4.24.~~4.26. Where ~~an alternative approach to analysis~~the natural classification basis for reporting is adopted, this SORP requires that charities must disclose in their SoFA:

- total income of the charity;
- a relevant analysis of the components of income;
- total ~~expenditure~~ expenses incurred by~~of~~ the charity;

- a relevant analysis of the components of ~~expenditure~~expenses incurred;
- gains/(losses) on investments (where applicable);
- net income/(~~expenditure~~expense);
- 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; and
- total funds carried forward at the end of the reporting period.

~~4.25.~~4.27. If a material component of income or ~~expenditure~~ 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.~~4.28. Charities preparing their accounts using ~~a~~ the natural ~~or alternative basis of analysis~~classification basis of reporting must also provide those disclosures required by other modules relevant to the charity. For example, a charity must disclose any remuneration, benefits or expenses paid to trustees and any related party transactions.

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

~~4.27.~~4.29. This SORP requires that ~~larger charities and those smaller charities opting to~~those charities reporting on an activity basis must classify their ~~income and~~ ~~expenditure~~ expenses by activity.

~~4.28.~~4.30. Income must be analysed according to the activity that produced the resources. This SORP requires that ~~Expenditure~~ expenses ~~must be~~are analysed by the ~~nature of the~~ activities undertaken.

~~4.29.~~4.31. Where relevant to the understanding of material activities, the ~~expenditure~~ expense analysis headings should enable the user of the accounts to understand the relationship with income derived from the activity. For example:

- a charity selling donated goods through a shop could use the description 'Shops' within row A3 ('Income from other trading activities') and row B2~~1~~ ('~~Expenditure~~ Expenses incurred on raising funds');
- a charity running a care home could use the description 'Residential care fees' within row A2 ('Income from charitable activities') and 'Residential care costs' in row B~~2~~3 ('~~Expenditure~~ Expenses incurred on charitable activities');
- an arts charity providing a mix of paid-for and free services could use the description 'Admission fees for galleries and exhibitions' within row A2 ('Income from charitable activities') and use the heading 'Operation of art gallery and touring exhibitions to schools and community' in row B~~2~~3 ('~~Expenditure~~ Expenses incurred on charitable activities'); and
- an endowed grant-making charity mainly making grants to advance education could use the description 'Investment income' within row A4 ('Investment income') and 'Grants to education and research institutions, student bursaries and other grants' in row B~~2~~3 ('~~Expenditure~~ Expenses incurred on charitable activities').

~~4.30.~~4.32. In most cases, it will be clear which activity generated the income or ~~expenditure~~expense. ~~Expenditure~~ Expenses shared between two or more activities should be apportioned between them on a reasonable, justifiable and consistent basis (see the SORP module 'Allocating costs by activity in the statement of financial activities').

## Line headings used in the statement of financial activities

**A: Income and receipt of endowment**

*A1: Income from donations and legacies*

~~4.31.~~4.33. 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.~~4.34. Donations and legacies do not provide any significant benefit to the donor in return for their payment other than the knowledge that the charity must use the gift to further its purposes. Income from donations and legacies includes:

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

*A2: Income from charitable activities*

~~4.33.~~4.35. Income from charitable activities includes income earned both from the supply of goods or services under contractual arrangements and from performance-related grants which have conditions that specify the provision of particular goods or services to be provided by the charity. To fall within this analysis heading, the activities specified by the contractual terms or grant conditions must be undertaken for the charitable purposes of the charity.

~~4.34.~~4.36. Income from charitable activities includes:

- 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;
- contractual payments from government or public authorities and other parties which fund the provision of particular goods or services, for example the provision of care;
- the sale of goods or services made or provided by the beneficiaries of the charity;
- performance-related grants 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; and
- the letting of non-investment property in furtherance of charitable purposes.

*A3: Income from other trading activities*

~~4.35.~~4.37. Income from other trading activities includes income earned from both trading activities to raise funds for the charity and income from fundraising events. To fall within this analysis heading, the income must be received in exchange for supplying goods and services in order to raise funds for the charity. While selling donated goods is legally considered to be the realisation of a donation in kind, in economic terms it is similar to a trading activity and should therefore be included in this analysis heading.

~~4.36.~~4.38. 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 such as jumble sales, firework displays and concerts by the charity (or by volunteers working under the charity's management direction) or its agents;
- shop income from selling donated and bought-in goods;
- income from letting and licensing arrangements for property held primarily for functional use by the charity but temporarily surplus to operational requirements; and
- income from sponsorships and social lotteries which cannot be considered pure donations.

*A4: Investment income*

~~4.37.~~4.39. Investment income is earned from holding assets for investment purposes and includes dividends, interest, and rents from investment property. Where income from investments is material, it must be presented as a separate heading on the face of the SoFA.

~~4.38.~~4.40. 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.~~4.41. Other income represents income that cannot be reported under the other analysis headings provided within the SoFA. Other income may also include the conversion of endowment funds into income with the equivalent offsetting reduction to endowment funds shown as a deduction under other income in the 'Endowment funds' column. This approach may be helpful in those jurisdictions that include such items in the calculation of gross income for audit threshold purposes. Alternatively, a conversion of endowment funds into income may be included under the heading 'Transfers between funds'.

~~4.40.~~4.42. The conversion of endowment into income includes:

- capital funds released to an income fund from expendable endowment; and
- the release of funds to income from the 'unapplied total return fund' held within the permanent endowment fund where a charity has authority to adopt a total return approach to investment.

~~4.41.~~4.43. This heading should also include all other sources of income unless the amount is sufficiently material as to require its presentation as a separate SoFA heading. Other income may include:

- a gain on the disposal of a tangible fixed asset held for the charity's own use;
- a gain on the disposal of a programme related investment;
- any royalties from the exploitation of intellectual property rights; and
- any other income not falling into the other income categories.

*Analysis of income in the notes to the accounts*

~~4.42.~~4.44. Unless analysed on the face of the SoFA, this SORP requires that the notes to the accounts must provide an analysis of the material components of income included within each analysis heading of the SoFA. Amounts for similar activities should be aggregated so as to provide an analysis of:

- donations and legacies, distinguishing between the types of gift receivable, for example the amount of donations, grants of a general nature and legacies;
- income from charitable activities, identifying the nature of the activities undertaken and the income produced;
- income from other trading activities, identifying the nature of the trading or fundraising activity and income produced;
- investment income analysed according to each class of investment shown on the balance sheet or in the investment note to the accounts; and
- the nature and amount of other income receivable.

~~4.43.~~4.45. 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: ~~Expenditure~~Expenses**

*B1: Expenses incurred (natural classification analysis)*

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

*B2: ~~Expenditure~~ Expenses incurred on raising funds*

~~4.44.~~4.47. ~~Expenditure~~ Expenses incurred on raising funds includes all ~~expenditure~~ expenses incurred by a charity to raise funds for its charitable purposes. It includes the costs of all fundraising activities, events, non- charitable trading activities, and the sale of donated goods. However, any costs incurred in providing goods or services as a charitable activity must not be included in this heading, even if a charge is made for their provision.

~~4.45.~~4.48. ~~Expenditure~~ Expenses incurred on raising funds may include~~s~~ those costs incurred in:

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

~~4.46.~~4.49. Investment management costs include the costs of:

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

~~4.47.~~4.50. Where investment management costs are material, these costs should be presented as a separate heading on the face of the SoFA or in the notes to the accounts.

~~4.48.~~4.51. Costs associated with acquiring and disposing of investments would normally form part of the acquisition cost of the investment or reduce the return on disposals. These costs are therefore not part of investment management costs. Where investment managers deduct management fees from investment income, the charity should report the gross investment income before fees and report the management fees charged in this cost category. However, charities are not expected to prorate investment management fees charged to a collective investment scheme to identify the notional cost attributable to its own holding in the scheme.

~~4.49.~~4.52. Investment management costs associated with endowment fund investments should generally be charged to the endowment fund in the SoFA. Further guidance on the charging of investment management costs to endowment funds is provided in the SORP module 'Fund accounting'.

~~4.50.~~4.53. 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 ~~expenditure~~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.

~~4.51.~~4.54. Charities may choose to expand the analysis provided within this heading for example by identifying separately '~~Expenditure~~ Expenses incurredo ~~n~~ raising donations and legacies' (A1), '~~Expenditure~~ Expenses incurred on other trading activities' (A3) and 'Investment management costs' (A4) either in the SoFA or by way of an explanatory note.

*B3~~2~~: ~~Expenditure~~ Expenses incurred on charitable activities*

~~4.52.~~4.55. ~~Expenditure~~ Expenses incurred on charitable activities includes all costs incurred by a charity in undertaking activities that further its charitable aims for the benefit of its beneficiaries, including those support costs ~~and costs relating to the governance of the charity~~ 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.

~~4.53.~~4.56. Additional sub-headings should be added to the analysis of charitable activities to identify the significant charitable activities undertaken which have been reviewed in the trustees' annual report. The sub-headings used should reflect the ~~nature of the~~ activity undertaken.

~~4.54.~~4.57. On occasions, a subsidiary entity may undertake activities specifically to further the purposes of a parent charity rather than as a fundraising activity. ~~Expenditure~~ 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.

~~4.55.~~4.58. Charities may carry out their activities through a combination of direct service provision and the grant funding of third parties to undertake work that contributes to the charity's aims or programme of work. The cost of charitable activities presented in the SoFA includes the costs of both direct service provision and the payment of grants. Charities making grants must refer to the SORP module 'Presentation and disclosure of grant-making activities', which sets out the particular disclosures required for grant-making in the notes to the accounts.

*B3~~4~~: Other ~~expenditure~~expenses*

~~4.56.~~4.59. Other ~~expenditure~~ expenses includes all ~~expenditure~~ expenses that ~~is~~ are neither related to raising funds for the charity nor part of its ~~expenditure~~ 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 sub-heading should be used.

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

~~4.57.~~4.60. 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 ~~expenditure~~ expense heading provided on the face of the SoFA. The analysis provided should aggregate the cost of similar activities and provide the user of the accounts with an understanding of the charity's main activities.

~~4.58.~~4.61. 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 ~~expenditure~~ expense headings of the SoFA. This information may, for example, be presented in a tabular format. An illustrative example of a tabular format that charities may wish to use is presented below in Table 3.

4.62. ~~(see Table 3).~~Paragraph 8.13 of the SORP module 'Allocating costs by activity in the statement of financial activities' requires the disclosure of the accounting policy adopted by the charity for the apportionment of costs between activities and any estimation technique(s) used to calculate their apportionment. Charities may opt to include this disclosure alongside analysis of expenses incurred on charitable activities as illustrated in the column headed 'Basis of Apportionment' in Table 3.

~~4.59.~~

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

| ~~Activity or programme~~ | ~~Activities undertaken directly~~ Activity 1 | Activity 2~~Grant funding of activities~~ | Activity 3 ~~Support costs~~ | Total | | Basis of Apportionment ~~Total~~ |
|---|---|---|---|---|---|---|
| | ~~£~~ | ~~£~~ | ~~£~~ | ~~£~~ | | ~~£~~ |
| Activities undertaken directly~~Activity 1~~ | | | | | | |
| Grant funding of activities~~Activity 2~~ | | | | | | |
| (e.g.) Salaries and wages (indirect) | | | | | | Text describing method |
| (e.g.) Fundraising costs | | | | | | Text describing method |
| (e.g.) IT costs~~Activity 3~~ | | | | | | Text describing method |
| Total | | | | | | |

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



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~~4.60.~~4.63. This heading is used to record any realised and unrealised gains or losses on investment assets and investment properties, including those gains or losses arising from their revaluation in the reporting period.

**C: Transfers between funds**

~~4.61.~~4.64. All transfers between the different classes of funds must be shown in the transfer row of the SoFA. The transfer line must always net to nil. Refer to the SORP module 'Fund accounting' for more information.

~~4.62.~~4.65. The transfer row may also be used to record the conversion of endowment funds (including the release of any unapplied total return where a total return approach to investment is adopted) into income. Alternatively, charities may choose to present the conversion of endowment funds in row A5 ('Other income').

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

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

~~4.63.~~4.66. This heading includes gains or losses on the revaluation of property, plant and equipment used by a charity, and heritage assets and intangible assets. This heading should not be used when adjusting for a reversal in a previous charge for impairment.

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

~~4.64.~~4.67. This heading is used to record actuarial gains or losses on defined benefit pension schemes and post-employment benefit plans.

~~4.65.~~4.68. Charities which operate defined benefit pension schemes must refer to the SORP module 'Retirement and post-employment benefits', which provides recommendations on the recognition of pension costs, assets and liabilities and their disclosure in the accounts.

*D3: Other recognised gains/(losses)*

~~4.66.~~4.69. A charity must insert additional headings to report any other gains and losses required by accounting standards or which company law (when the charity is a company) requires to be recognised outside of a charity's income and expenditure account.

~~4.67.~~4.70. Items presented within this category include:

- where hedge accounting is adopted for that portion of the change in fair value of the hedging instrument that cannot be recognised as income or ~~expenditure~~expense; and
- foreign exchange gains or losses arising on conversion of non-monetary assets at the end of the reporting period where the valuation, gains or losses on those assets are not accounted for in headings B4, D1 and D2.

**E: Reconciliation of funds**

~~4.68.~~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 on the balance sheet.

# 7. Recognition of ~~expenditure~~expenses and liabilities

## Introduction

7.1. The reporting tiers for Module 7 are as outlined in Table X below

**Table X:** Tiered reporting for Module 7

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

~~7.1.~~7.2. Expen~~ditures~~ses are ~~is~~ the amount of a charity's resources that have been spent or ~~otherwise used up~~consumed in carrying out its activities. ~~An e~~Expenses arise from ~~results in~~ either ~~a a~~ decrease in ~~in~~ a charity's assets or an ~~an~~ increase in ~~in~~ its liabilities leading to a decrease in the funds of the charity.

~~7.2.~~7.3. Examples of an expense include ~~cash spent to~~the purchase of goods or services either for cash or on credit, or the depreciation charge on tangible fixed assets.~~, and incurring a liability when goods and services are purchased on credit.~~

~~7.3. Liabilities~~ Expenses can result from exchange transactions ~~that are contractual, for example the purchase of goods or services or the employment of staff. Liabilities can also arise~~or from

7.4. 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 ~~rules~~ principles for the recognition of liabilities and ~~expenditure~~expenses;
- ~~rules~~ principles on measurement of liabilities;
- principles for recognising liabilities from constructive obligations;
- ~~conditions that limit the recognition of a funding commitment;~~
- accounting for liabilities arising from performance-related grants; and
- ~~provisions for liabilities;~~
- ~~treatment of commitments not recognised as provisions or liabilities;~~
- ~~accounting for onerous contracts;~~
- treatment of employee benefits.~~; and~~
- ~~disclosure of provisions and funding commitments in the accounts.~~

## General ~~rules~~ principles for the recognition of liabilities and expen~~diture~~ses

~~7.6. Liabilities arise from legal or constructive obligations that commit the charity to expenditure.~~

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7.6. A liability and related expense~~diture~~ must be recognised when all of the following criteria are met:

- ~~Obligation~~ the charity has~~–~~ a ~~present~~ legal or constructive obligation ~~exists~~ at the reporting date as a result of a past event.
- ~~Probable –~~ it is probable (~~-~~i.e. more likely than not) that the charity will be required to ~~a~~ transfer ~~of~~ economic benefits, often cash, ~~will be required~~ in settlement.
- ~~Measurement –~~ the settlement amount ~~of the obligation~~ can be measured ~~or estimated~~ reliably.

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7.7. ~~A legal obligation arises when a charity enters into a binding contract or there is a statutory requirement to make a payment.~~ When a charity enters into a contract for the supply of goods or services, the expen~~diture~~se is recognised once the supplier of the goods or services has performed their part of the contract.

~~7.7.~~7.8. 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 'Provisions, contingent liabilities and contingent assets'.

~~7.8. A constructive obligation arises as a result of a charity's actions when it indicates to other parties that it accepts particular responsibilities and thereby creates a valid expectation on their part that the charity will meet them.~~

## ~~Rules on m~~Measurement of liabilities

7.9. A~~A~~ liability must be measured on recognition at its historical cost and then subsequently measured at the best estimate of the amount required to settle the obligation at the reporting date, unless otherwise indicated in this SORP. ~~The e~~Exceptions include:

- ~~7.9.~~ ~~is that c~~certain financial instruments; ~~must be adjusted to their present value; these include financial liabilities where settlement is deferred for more than 12 months after the reporting date. R~~refer to the SORP module 'Accounting for financial assets and financial liabilities' for more information~~.~~
- defined benefit pension liabilities; refer to SORP module 'Retirement and post-employment benefits' for more information
- provisions which are expected to be settled in more than 12 months after the reporting date; refer to SORP module 'TBC' for more information.

~~7.10. When a charity accrues a provision in the reporting period that it will settle over several years, the future payments have a reduced value in today's terms (known as its present value). Where this adjustment would be material, the payments required to settle the obligation should be discounted to their present value.~~

~~7.11. The discount rate used should reflect the cost of money to the charity, and its current assessment of the time value of money and the credit risks specific to the provision that affect the time value of money. 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.~~

~~7.12. The unwinding of the discount must be treated as a financing cost in the statement of financial activities (SoFA). It should be allocated to the appropriate expenditure heading. For example, the unwinding of a discount resulting from a grant liability should be allocated to charitable expenditure.~~

## Principles for recognising liabilities from constructive obligations

~~7.13.~~7.10. 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



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constructive obligation, and therefore a liability,~~Although a charity's commitments to provide services or grants are not always legally binding under contract, a liability~~ can still ~~arise~~ exist if the charity has no realistic alternative to settling an obligation resulting from a commitment it has made. However, not all commitments to provide future services or funding will result in a constructive obligation. Without a legal or constructive obligation, the charity is not required to recognise~~ing a constructive obligation as~~ a liability ~~or provision~~.

~~7.14.~~7.11. A charity may make general statements or policy statements about their 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 mission statements, setting out future plans within a trustee's annual report or simply making a general policy statement. Statements such as these do not normally create a valid expectation that a charity will meet a specific commitment. General statements do not create a constructive obligation as discretion is retained by the charity as to their implementation.

~~7.15.~~7.12. 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 ~~directly~~ to particular beneficiaries or grant recipients; ~~and~~or
- there is an established pattern of practice that indicates to the recipients of services or funding that the charity will ~~meet its commitment~~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.~~.~~

~~7.16.~~7.13. 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.

~~7.17.~~7.14. The formal written offer of a grant indicates to the recipient that it is probable that settlement will take place. 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.

## ~~Conditions that limit the recognition of a funding commitment~~

~~7.18. Funding commitments can be made which give the funder the discretion to avoid future expenditure based on their assessment of whether the conditions attached to the commitment will be met by the recipient.~~

~~7.19. The award of a grant is a non-exchange transaction. A charity awards a grant to further its own charitable purposes but without creating a contractual relationship with the recipient. The award of a grant is recognised as a liability only when the criteria for a constructive obligation are met, payment is probable, it can be measured reliably, and there are no~~



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~~conditions attaching to its payment that limit its recognition.~~

~~Funding commitments can be made which give the funder the discretion to avoid future expenditure based on their assessment of whether the conditions attached to the commitment will be met by the recipient.~~

~~7.20. Where a grant commitment is payable over a period of more than one year, a liability must be recognised for the full amount of the constructive obligation unless conditions apply to payments falling due after the reporting date. Where payments for later years are subject to performance-related conditions, the donor charity may be able to legitimately withdraw from its commitment if a particular condition attaching to the grant is not met.~~

~~7.21. Where a condition remains within the control of the donor charity, then the donor charity retains the discretion to avoid the expenditure and therefore 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 review condition has been communicated to the recipient as part of the funding agreement and the review has substance, then a constructive liability is unlikely to arise for payments relating to periods subsequent to the review date.~~

~~7.22. Alternatively, when there is no condition attaching to the grant that enables the donor charity to realistically avoid the commitment, a liability for the full funding obligation must be recognised.~~

~~7.23. Not all terms attaching to a funding commitment create a condition that gives a donor charity discretion to withdraw from its funding obligation. For example, a term in a grant offer that seeks to relieve the donor charity from a future obligation in the event of a lack of funds at a future settlement date would not normally prevent the recognition of a liability if payment is probable. The liability would only be derecognised (reversed) if a future event requires the funding offer to be rescinded. The reversal of the balance sheet provision must be recognised in the SoFA and deducted from the heading to which the expenditure was originally charged.~~

~~7.24. 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.~~

~~7.25. Certain grants may contain specific conditions that closely specify a level of output or service to be performed by the recipient of the grant. These are termed performance-related grants.~~

## Accounting for liabilities arising from performance-related grants

7.15. Certain grants may contain specific conditions that closely specify a level of output or service to be performed by the recipient of the grant. These are termed performance-related grants.

~~7.26.~~7.16. The key characteristic of a performance-related grant 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.

~~7.27.~~7.17. The payment of a performance-related grant 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 expenditure arising from performance-related grants must be recognised to the extent that the recipient of the grant has provided the specified service or goods.

~~7.28.~~7.18. 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 performance-related grant simply because the funding obligation is to be met over an extended period of time.

~~7.29. Charities must distinguish separately on the balance sheet provisions for liabilities. The expenditure related to a provision must be charged to the appropriate heading in the SoFA.~~

~~7.30. The amount recognised as a provision should be the best estimate of the expenditure required to settle 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; and~~
- ~~future events and uncertainties which may affect the amount required to settle the obligation.~~

~~If a provision is likely to be settled within 12 months of its initial recognition, it need not be discounted for the time value of money as it does not constitute a financing transaction. If the expected settlement date of the obligation is 12 months or more after making the provision and the effect would be material, the present value of the provision must be calculated using an appropriate discount rate.~~

~~7.31. Charities must review the best estimate of a provision at the reporting date and adjust it appropriately. If a transfer of resources is no longer needed to settle the obligation, the amount of the provision no longer required should be reversed, with a corresponding credit to the expenditure heading in the SoFA against which the provision was originally charged.~~

~~7.32. If a provision is likely to be settled within 12 months of its initial recognition, it need not be discounted for the time value of money as it does not constitute a financing transaction. If the expected settlement date of the obligation is 12 months or more after making the provision and the effect would be material, the present value of the provision must be calculated using an appropriate discount rate.~~

## ~~Treatment of commitments not recognised as provisions or liabilities~~

~~7.33. Not all funding commitments are recognised as liabilities or provisions and so it is important that charities disclose the existence of unrecognised commitments and explain how these will be funded. For example, a grant offer may have been made but there is uncertainty as to whether the recipient charity will be able to proceed with its proposal. If it becomes clear that the payment is possible but not probable, then a liability for the commitment should not be recognised. Instead, the funding commitment should be disclosed as a contingent liability. Further guidance on accounting for contingent liabilities is provided in the SORP module 'Balance sheet'.~~

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~~7.34. 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 on the balance sheet to identify that portion of unrestricted funds that have been set aside to meet the commitments. However, activities that are to be wholly financed from future income must not form part of such a designation.~~

## ~~Accounting for onerous contracts~~

~~7.35. Situations may arise where the unavoidable costs of fulfilling a contract exceed the expected economic benefit derived from it. In such circumstances, a charity must recognise these~~

~~irrecoverable costs. An onerous contract may arise, for example, when a charity leases a property which it subsequently leaves unused and the property cannot be sub-let to recover the charity's costs.~~

~~7.36. 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 loss. This provision is the lower of the costs involved in completing the contract and the cost of any compensation payable as result of withdrawing from the contract.~~

~~7.37. However, 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.~~

~~7.38. 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 'Impairment of assets'.~~

~~7.39. 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 which cannot be recovered under the terms of the contract.~~

## Treatment of employee benefits

7.19. In addition to the guidance included in the Treatment of Employee Benefits section of this module, charities should refer to section 28 *Employee Benefits* 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

7.20. Employee benefits include all costs incurred by the charity in exchange for the services of its employees and any remunerated trustees. ~~Expenditure~~ Expenses ~~are~~is 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.

~~7.40.~~

~~7.41. Charities must recognise a liability for the cost of all benefits to which employees are entitled at the reporting date that have yet to be paid. Employee benefits are measured as follows:~~

~~7.42.~~ Short-term employee benefits such as wages and salaries are measured at the amount



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7.21.

7.22. 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.

7.23. 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.

7.24. The cost of non-accumulating compensated absences, which may include sick leave, must be recognised as an expense when the absences occur.

~~liability for paid annual leave and paid sick leave is recognised, if a material component of total expenditure, and not discounted for the time value of money.~~

~~7.43.~~ Termination benefits are measured at the best estimate of the ~~expenditure~~ 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.

7.25.

7.26. 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 'Retirement and post-employment benefits').

~~7.44.~~7.27. Disclosure requirements for ~~expenditure~~ expenses incurred on staff costs are set out in the SORP module 'Disclosure of trustee and staff remuneration, related party and other transactions'.

## Disclosure of provisions and funding commitments in the accounts

7.28. Disclosure requirements for funding commitments and provisions are set out in the SORP module 'Provisions, contingent liabilities and contingent assets'.

~~7.45.4.1. All charities must analyse the expenditure resulting from recognised funding commitments and provisions across the appropriate heading(s) in the SoFA and provide in the notes to the accounts:~~



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- ~~a reconciliation of the movements in provisions and funding commitments showing:~~
  - ~~the carrying amount at the beginning of the reporting period;~~
  - ~~additions during the reporting period, including adjustments that result from changes in measuring the discounted amount;~~
  - ~~amounts charged against the provision during the reporting period;~~
  - ~~unused amounts reversed during the reporting period; and~~
  - ~~the carrying amount at the end of the reporting period;~~
- ~~a brief description of the nature of the provision or commitment made and the expected amount and timing of any resulting payments;~~
- ~~an indication of the uncertainties about the amount or timing of those payments, including any performance-related conditions attached to the commitment; and~~
- ~~the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.~~

~~7.46. Charities must also disclose for any funding commitment that is not recognised as a liability or provision:~~

- ~~details of commitment made;~~
- ~~the time frame of that commitment;~~
- ~~any performance-related conditions attached to that commitment; and~~
- ~~details of how the commitment will be funded.~~

~~7.47. Comparative information for prior periods is not required for any of the disclosures set out in this section.~~

~~7.48. This SORP requires that if unrestricted funds have been designated to fund a commitment on the face of the balance sheet, the notes to the accounts must disclose:~~

- ~~the nature of any amounts designated; and~~
- ~~if not explained in the trustees' annual report, the likely timing of that expenditure.~~

# 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 X below.

Table X 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.<br><br>Charities in tier 1 that have chosen to use natural classifications **are not required** to apply this module.<br><br>This SORP requires that charities in tier 1 that have chosen to use the activity basis of reporting apply this module. |
| Tier 2 | This SORP requires charities within tier 2 to adopt the activity basis of reporting. The requirements of this module apply to charities in tier 2 in full. |
| Tier 3 | This SORP requires charities within tier 3 to adopt the activity basis of reporting. The requirements of this module apply to charities in tier 3 in full. |

~~8.1. This module applies to all charities that prepare their statement of financial activities (SoFA) on an activity basis. This SORP requires larger charities to report on an activity basis. FRS 102 does not address how to present a SoFA on an activity basis or the allocation of costs to activities in that statement.~~

8.2. The SoFA must distinguish between ~~expenditure~~ 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. ~~The activity analysis must be on a full cost basis. Full cost is made up of the total of the direct costs and shared costs, including support costs, involved in undertaking each reported activity.~~ This module sets out:

- general principles for reporting activities;
- identification of support costs;
- methods of allocating costs to activities;
- accounting for costs shared between fundraising and charitable activities; and
- disclosures required in the notes to the accounts.

## General principles for reporting activities



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8.4. A charity's SoFA or related notes should 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. ~~Significant activities are those which, due to their scale or importance, are key to the charity in meeting its aims and objectives.~~ 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 ~~expenditure~~ 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 the charity's activities. ~~t~~The cost of ~~certain central or regional~~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, personnel (human resources), 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 enables/supports in order to arrive at the full cost for each reported activity including 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) which are ~~not attributable to a single~~incurred to enable a range of ~~-~~activit~~y~~ies must also be apportioned between the activities 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; or
- 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; and
- educational publicity or information to further the charity's aims and objectives.

8.11. For publicity or information to be regarded as a charitable ~~expenditure~~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; and
- 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 ~~expenditure~~ 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 ~~expenditure~~ 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); and
- 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 ~~4~~3 in Module 4 for an illustration of how the information might be disclosed).



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# Extracts from Module 10 – Balance Sheet

## C: Liabilities (C1 to C3) – headings, classification and disclosures

10.76. A liability is a present obligation (legal or constructive) incurred by the charity as a result of a past event, the settlement of which is expected to lead to a transfer of economic benefits, usually in the form of a cash payment, from the charity. For example, when a charity buys an item on credit, the charity is obliged to pay the supplier, representing an outflow of economic benefits, as a result of the past event of making the purchase. A purchase on credit therefore meets the definition of a liability. Paragraphs 7.6 – 7.8 of this SORP set out when a liability should be recognised in the balance sheet. Paragraph 7.9 of this SORP sets out the requirements for measurement of liabilities.

~~Liabilities are amounts due to creditors and any provision made as a result of an obligation to transfer economic benefits, usually in the form of a cash payment, to a third party. 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.~~

*Disclosures*

10.77~~80~~. 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; and
- (C3): provisions for liabilities.

10.78~~81~~. The notes to the accounts must explain, within the disclosure of accounting policies, the basis on which creditors and provisions for liabilities and charges are recognised and measured.

10.79~~82~~. 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 performance-related grants;

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- accruals and deferred income;
- taxation and social security; and
- other creditors.

10.8~~03.~~ Disclosure requirements for provisions and contingent liabilities are included in SORP module 'TBC'. ~~Charities must also disclose:~~

- ~~an analysis reconciling the opening and closing carrying amounts of each class of provisions;~~
- ~~a brief description of the nature of the obligation and the expected amount and timing of resulting payments;~~
- ~~an indication of the uncertainties about the amount or timing of those outflows; and~~
- ~~the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.~~

~~Contingent liabilities and contingent assets~~

~~10.84. 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 probable; or~~
- ~~the amount of the obligation cannot be estimated reliably.~~

~~10.85. A contingent asset is a possible asset that arises from a past event but is not recognised in the balance sheet as its existence can only be confirmed by future events which are not within the charity's control.~~

~~Disclosures~~

~~10.86. Contingent liabilities are disclosed unless the possibility of their existence is remote. Contingent assets are disclosed when their existence is probable.~~

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~~10.87. 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.~~

~~10.88. Charities must, where practicable, also provide:~~

- ~~an indication of the uncertainties relating to the amount or timing of settlement; and~~
- ~~the possibility of any reimbursement; or~~
- ~~if it is impractical to make one or more of these disclosures that fact must be stated; or~~
- ~~in extremely rare cases where FRS 102 allows non-disclosure of information that would be expected to seriously prejudice the position of the entity in a dispute with other parties, the general nature of the dispute and the reason why disclosure has not been made must be given.~~

# C4: Defined benefit pension scheme asset or liability

10.8~~9~~1. Charities that participate in a defined benefit pension scheme must refer to the SORP module 'Retirement and post-employment benefits' for the recognition, measurement and disclosure of defined benefit pension scheme assets and liabilities.

~~8.15.~~

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~~Table 4: Analysis of support costs~~

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| ~~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~~ | |

# New Module – Provisions, contingent liabilities and contingent assets

X.X Charities should refer to sections 21 *Provisions and Contingencies* and 34 *Specialised Activities* of FRS 102 for more information. In particular, charities should refer to:

1. paragraphs 21.4 – 21.6 on initial recognition
2. paragraphs 21.7 – 21.9 on initial measurement
3. paragraphs 21.10 – 21.11 on subsequent measurement
4. paragraph 21.11A on onerous contracts
5. paragraph 21.12 on contingent liabilities
6. paragraph 21.13 on contingent assets
7. paragraphs 21.14 – 21.16 on disclosures
8. paragraphs 34.57 – 34.63 on funding commitments

## Provisions ~~for liabilities~~, contingent liabilities and contingent assets

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

X.X 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.

X.X A contingent asset is a possible asset that arises from a past event but is not recognised in the balance sheet as its existence can only be confirmed by future events which are not within the charity's control. 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

X.X A provision must be recognised 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; and
- the amount of the settlement can be estimated reliably.

X.X A provision should initially be measured 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; and
- future events and uncertainties which may affect the amount required to settle the obligation.

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X.X If the obligation is likely to be settled within 12 months of its initial recognition, it need not be discounted for the time value of money.

X.X If the expected settlement date of the obligation is 12 months or more after making the provision and the effect would be material, the present value (i.e. the amount in today's terms) of the provision must be calculated using an appropriate discount rate. The discount rate used should reflect the cost of money to the charity, and its current assessment of the time value of money and the credit 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.

X.X 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 should be allocated to the appropriate expense heading. For example, the unwinding of a discount resulting from a grant liability should be allocated to expenses incurred on charitable activities.

X.X Charities must review the best estimate of a provision at the reporting date and adjust it to reflect the current best estimate of the settlement amount.

X.X Charities must review the likelihood of settlement of a provision at the reporting date. 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 off the balance sheet, with a corresponding credit to the expense heading in the SoFA against which the provision was originally charged.

## Recognition of a funding commitment as a liability

X.X 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 criteria for an obligation (either legal or constructive) are met,
- payment is probable,
- the liability can be measured reliably, and
- there are no conditions attaching to its payment that limit its recognition.

X.X Where a grant is payable over a period of more than one year, a liability must be recognised for future payments unless conditions apply to payments falling due after the reporting date. Where payments for later years are subject to conditions, the donor charity may be able to legitimately withdraw from its commitment if a particular condition attaching to the grant is not met, therefore the recognition of a liability is not required.

X.X Funding commitments can be made which give the funder the discretion to avoid future expenses based on their assessment of whether the conditions attached to the commitment will be met by the recipient. Where a condition remains within the



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control of the donor charity, then the donor charity retains the discretion to avoid the expense and a liability must not be recognised.

X.X 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 review condition has been communicated to the recipient as part of the funding agreement and the review has substance (i.e. the review has a potential impact on future payments), then a liability is unlikely to arise for payments relating to periods subsequent to the review date.

X.X Alternatively, when there is no condition attaching to the grant that enables 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.

X.X Not all terms attaching to a funding commitment create a condition 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 requires the funding offer to be rescinded. The removal of the balance sheet provision must be recognised in the SoFA and deducted from the heading to which the expenditure was originally charged.

X.X 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.

## Accounting for onerous contracts

X.X 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. An onerous contract may arise, for example, when a charity leases a property which it subsequently leaves unused and the property cannot be sub-let to recover the charity's costs.

X.X In the event of a contract becoming onerous, a charity must recognise the unavoidable costs as a provision and associated expense. The unavoidable costs are the least net cost of exiting the contract, being the lower of either the cost of fulfilling the contract or the cost of compensation or penalties arising from failure to fulfil the contract.

X.X 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

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immediate provision for the unavoidable costs.

X.X 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.

X.X 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 'Impairment of assets'.

X.X 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 which cannot be recovered under the terms of the contract.

## Treatment of commitments not recognised as provisions or liabilities

X.X Not all funding commitments are recognised as liabilities or provisions. For example, a grant offer may have been made but there is uncertainty as to whether the recipient charity will be able to proceed with its proposal.

X.X 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 for which payment is considered possible rather than probable at the end of the current reporting period.

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

X.X 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 on the balance sheet to identify that portion of unrestricted funds that have been set aside to meet the commitments. However, activities that are to be wholly financed from future income must not form part of such a designation.

## Disclosure of provisions and funding commitments

X.X Charities must include a separate line item for provisions in the balance sheet (see paragraph 10.77 of this SORP).

X.X All charities must analyse the ~~expenditure~~expenses resulting from provisions and recognised funding commitments ~~and provisions~~ across the appropriate heading(s) in the SoFA and provide in the notes to the accounts:

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

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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; and

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 ~~the~~recognised funding commitments; and

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.

## Disclosure of contingent liabilities and contingent assets

X.X Contingent liabilities must be disclosed unless the possibility of their existence is remote.

Contingent assets must be disclosed when their existence is probable.

X.X The notes to the accounts must provide for each class of item:

a) a brief description of each contingent item; and

b) where practicable, an estimate of its financial effect.

X.X Charities must, where practicable, also provide:

a) an indication of the uncertainties relating to the amount or timing of settlement; and

b) the possibility of any reimbursement; or

c) if it is impractical to make one or more of these disclosures that fact must be stated.

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

a) details of the commitment made;

b) the time frame of that commitment;

c) any performance-related conditions attached to that commitment; and

d) details of how the commitment will be funded.

X.X This SORP requires that if unrestricted funds have been designated to fund a commitment on the face of the balance sheet, the notes to the accounts must disclose:

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a) the nature of any amounts designated; and

b) if not explained in the trustees' annual report, the likely timing of any payments.

## Prejudicial disclosures

X.X In extremely rare cases, disclosure of some or all of the information required by paragraphs X.X – X.X 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 are advised to refer to paragraph 21.17 of FRS 102 for disclosure requirements.

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**Commented [ED3]:** To include disclosures relate to both provisions and contingent liabilities and assets

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*Disclaimer*

*This Charities SORP Committee paper has been developed to assist in the development and drafting of the Charities SORP. Readers should not treat the information contained in these papers as being definitive for the production of the Charities SORP FRS 102 (Third Edition) which will be subject to due process including a detailed consultation.*

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