

Feedback from Engagement Strands on Grants and Accruals Basis Accounting

Editorial note:

The Secretariat notes that in the case of some suggestions made in the discussion the solutions offered may not be consistent with accounting standards, i.e. to allow future expenditure to be accrued against revenue recognised on receipt is, depending on the nature of the expenditure, unlikely to be compliant with accounting principles, specifically the definition of an expense. Expenses are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity investors [Glossary of FRS 102]. That is, outflows for a future period would not meet the definition of an expense.

The discussion is summarised as it was shared by the convenors and therefore it is not edited with comments about compliance with FRS102. The advisory SORP Committee is then able to put those views in context when considering the way forward.

| Engagement Strand: Smaller charities and Independent Examiners |
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| A. Options Considered by the Engagement Strand |
| The engagement strand considered the use of the accrual method. |
| B. Advantages/Disadvantages of Options Considered |
| <p>Advantages of the accrual method:</p> <ul style="list-style-type: none"> Capital grants should be spread over the life of the asset, which the accruals method would allow for. (Although where a columnar balance sheet is produced, the reader can quite easily separate out the different kinds of assets and liabilities within the separate funds and arrive at a figure for the free reserves) <p>Disadvantages of the accrual method:</p> <ul style="list-style-type: none"> Funders and trustees will not recognise figures that differ from amounts either awarded or received. Additional explanatory notes will be required. The accruals method would fix a problem (i.e. distortion of surplus/deficit) more relevant to commercial accounts than charity accounts. Charities SORP users are not interested in profit and loss, but are interested in resources being secured, application of charitable funds and the position on reserves. |
| C. Conclusions |
| <p>The majority view was in favour of allowing the accruals method.</p> <p>Additionally, the engagement strand recommended the following:</p> |

1. Explore and clarify with more examples where trustee discretion ends and conditions to prevent recognition begin – particularly in relation to implying time based conditions.
2. If the SORP committee's view is that it is essentially the full amount of the grant 'awarded' (rather than received) is what is expected to be presented in the first instance unless there is a condition to prevent that amount being recognised, then the SORP should include the relevant provisions making this clear at the beginning of the section.
3. Provide numerical examples of enough situations to make these principles as clear as possible to remove doubt and reduce the number of differing interpretations.
4. For activity based accounts – clarify the position on non-performance related restricted grants in terms of the SOFA income categorisation.
5. If clarity is not achievable within the SORP then consideration of a separate guide aimed at funders as well as charities, with numerous examples could be a possibility.

D. Other comments

- The engagement strand's focus was on non-performance related grant income.
- The engagement strand made no comments on grants payable, as this is less likely to be an issue for smaller charities.
- The view of the engagement strand is that the current SORP requirements are not being followed correctly or consistently. Non-compliance could be due to preparers not following the SORP requirements because "they don't like the outcomes". For example, due to fear of appearing to have ample resources or appearing to have resources but without being in receipt of the relevant cash amounts and the concern that funders will turn them down in bids believing that they don't need further resources.
- A huge number of charities will be affected by this section of the SORP, therefore the need for clarity in the guidance is vital.
- The majority of grants are restricted in nature, although are unlikely to be considered "performance related". Where restrictions exist, there are a wide variety of them – each grant has to be viewed in isolation and they are unlikely to have similar terms, use of language or restrictions.
- Grants are unlikely to coincide with a charity's financial year, creating difficulties.
- More clarity would be helpful with respect to time related conditions. There is room for different interpretations of the SORP (e.g., paras 5.21 and 5.22). Some preparers may take the view that where a project is a series of activities spread out over a period of time, that entitlement is connected to these events and defer or accrue income accordingly. Others may interpret the SORP in a way that conditions only arise in very specific situations.
- The wide range of variety in funders, use of language in grants, intentions regarding restrictions etc. is likely to mean that if the statutory accounts are prepared just showing the amounts received, or invoiced then there is likely to be inconsistency even within the same charity – e.g. one grant might be showing 2-3 year's income in year one whereas another grant might be showing income a quarter by quarter.
- Trustees appreciate disclosure of total amounts from each funder split into restricted and unrestricted funds. Funders are likely to appreciate the same presentation.
- Trustees make use of disclosures showing movements on restricted funds, with each major grant separately. Funders are likely to appreciate the same.
- SoFA classifications (for activity based accounts) need consideration - Donations and Legacies category only specifies grants of a general, unrestricted nature whilst Charitable

Activities only allows for performance related grants. This is unlikely to reflect trustees' and funders' understanding of how grant income is used in charities' activities.

- The engagement strand's experience is that trustees and funders alike are unwilling to accept the concept of **accruing** income in order to reflect the funding awarded in the year. Examples of difficulties with funders who question grant income that differs from amounts received by the charity were cited.
- More detail is required to make it as clear as possible what the SORP's intention really is. This should include:
 - Examples of what things meet the definition of a performance related grant. More clarity on situations when time based conditions can or cannot be implied would be useful. Clarity is needed in relation to grants which are funding a series of activities or part or all of a worker's salary.
 - Clarity on whether conditions only arise when there are very precise, quantifiable, identifiable situations or whether preparers have more discretion in applying conditions.
- Experience of working with smaller charities and their funders (which can include major national funders) indicates that this is an area where education is required. Further, experience has shown that training workshops can advocate for apparently inappropriate treatments, further emphasising the need for clarity in the SORP and education initiatives to support the SORP.

Engagement Strand: Trustees

A. Options Considered by the Engagement Strand

1. **Option 1** – to re-commit to the recommendations made by the engagement strand at the end of phase one. Specific recommendations relevant to income from grants include:
 - The use of Plain English accompanied by an additional 'think non-financial expert first' approach.
 - Inclusion of a comprehensive glossary (reflecting terms and definitions used by the regulators) and full indexation to assist cross-referencing.
2. **Option 2** – Reinstate accruals reporting for smaller charities (in line with three tiers) and a building block approach with additional reporting requirements for more complex/larger charities. The engagement strand asked its members to consider allowing future expenditure to be accrued against revenue recognised on receipt, and possibly accounting for multi-year grant income only when it is certain that it will be received for the whole period.

B. Advantages/Disadvantages of Options Considered

1. **Option 1** – to re-commit to the recommendations made by the engagement strand at the end of phase one.

Noted that the definitions for government grants, other grants, service contracts and donations are confusing. Improvements in the glossary would reduce this confusion.

2. **Option 2** – Reinstate accruals reporting for smaller charities.

The engagement strand noted that this may be challenging but would provide significant benefits for charities and users of accounts. Accrual accounting could resolve much of the complexity within grant reporting for both Trustees and users of the accounts.

The engagement strand noted that allowing accrual accounting for non-government grants would require amendments to FRS102 to allow wider application of the accrual model to other forms of non-exchange transactions and other grants.

C. Conclusions

Option 1 – to re-commit to the recommendations made by the engagement strand at the end of phase one – was **agreed** by the engagement strand. In particular, the need for clearer definitions for government grants, other kinds of grants, (service) contracts and donations was agreed. Furthermore, guidance on ‘performance’ in relation to grants is required.

Option 2 – to reinstate accruals reporting for smaller charities – was strongly supported. The engagement strand went further, showing support for a return to accrual accounting for grants for all charities (not just smaller charities). If this is not possible, the engagement strand suggested that the reserve option may be to extend the deferred income concept to demonstrate a more time sensitive reporting of the expenditure of grants. *As noted above, the Secretariat expects that this final suggestion may be challenging.*

Additional conclusion – With regards to the reporting of grants committed to be given to other organisations, the engagement strand suggests that the next SORP adopt the approach of a payments basis for monies promised in this fashion.

D. Other Comments

- The topic of accounting for non-exchange income is a technically difficult one. Grant accounting (giving and receiving) can be overly complex and unnecessarily so.
- There is a disconnect in the headings used on the SoFA when reporting by activity to identify and disclose income and expenditure. This does not help to promote clarity of understanding.
- The engagement strand noted that timing differences and disconnect between the SORP and a charity’s management accounts can create confusion for trustees. For example, a grant may be recognised in the annual report as income, but the money may not be in the bank and as such could be seen as a debt or deficit. This may not reflect the reporting of such funds in management accounts. These differences can confuse trustees.
- The engagement strand noted the need for educational materials to support trustees in the application of the SORP in this, and in other, respects. Suggestions for educational materials include worked examples, case studies, flow charts and decisions trees.

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| A. Conclusions |
| No conclusions or positions of consensus were drawn by the engagement strand, with some comments indicating support for change and others indicating change is not required. |
| B. Other Comments |
| <ul style="list-style-type: none"> • Guidelines on grant accounting can be unclear for the layperson. • The SORP would benefit from greater clarity on the conditions that limit the recognition of grant income. • The SORP would benefit from examples of how to distinguish grants/contracts/performance related grants. • Change is required in this area. There is inconsistency in the guidance on accounting for government grants as opposed to other grants when the underlying substance is often identical. • There is a lack of clarity in how to differentiate between unconditional, performance related, time constraints and conditional grants that can result in inconsistency. Further, the SORP does not consider grants that combine one or more of these characteristics. • Fundraising practice has evolved and the practical distinction between unrestricted and restricted grants has become more blurred than it was 10+ years ago. The SORP guidance has not yet been updated to reflect current practice. • One engagement strand member supported allowing small charities the option of accounting for grants on a cash basis to mitigate the risk of placing an undue burden on those with the least resources to analyse and systematically record all of the different possible grant structures. • Users of commercial as well as charity accounts are likely to misinterpret charity accounts. • Support was shown for the improvements suggested in the briefing paper coming from the 2016 research exercise. • There is a need for greater consistency, clarity and certainty, including clarity around the definition of 'probable', and where what is a 'true and fair' view may consequently be open to interpretation. • Cross-referencing within the SORP may help clarify why grant income is allocated as it is on the SoFA using activity-based accounting. Please see Appendix 1 to this annex for full details. • The SoFA heading 'Donations and legacies' could also be changed to 'Voluntary income'. • External stakeholders, including regulators, may need data on charities' total grant funding. This requires accurate and consistent figures, which can be difficult to obtain. There is no SORP requirement to disclose non-government grant funding, therefore additional accounting and disclosure requirements would be helpful. <p style="text-align: center;">○</p> |

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| Engagement Strand: Professional and Technical (B) |
| A. Options Considered by the Engagement Strand |
| 1. Option 1: Attempt to influence the FRC to include improved terminology for all grant accounting. The terms 'accrual model' and 'performance model' are arguably not fit for purpose as financial statements prepared under FRS 102 are accrual-based even where |

an entity applies the performance model. Conversely, the performance model applies to grants which have non-performance conditions attached.

Additionally, Section 24 of FRS 102 could be extended to cover grants from any source.

2. **Option 2:** Permit small and medium charities (in a three-tiered system) to have an accounting policy choice, allowing either the performance model or the accruals model to be used for income from grants.
3. **Option 3:** Change the SORP's approach as to what constitutes a condition.

B. Advantages/Disadvantages of Options Considered

1. **Option 1:** Attempt to influence the FRC to include improved terminology for all grant accounting, extend Section 24 of FRS 102 to cover grants from any source.
 - Improved terminology may be helpful to all entities which account for grant income, not just charities.
2. **Option 2:** Permit small and medium charities (in a three-tiered system) to have an accounting policy choice.
 - The accrual model is arguably simpler than the performance model.
 - The option to use the accrual model for accounting for all revenue grants would be consistent with generally accepted accounting practice in the UK for government grants and would enable some charities to better reflect their underlying financial performance and financial position in their financial statements.
 - Use of the performance model rather than the accrual model can have a distorting impact on charity financial statements. This can mislead funders and, in some cases, charity trustees about the underlying financial health of charities.
 - It is strange to permit choice for small and medium charities, but to mandate the approach large charities should follow.
 - Where an accounting policy choice is available, this would reduce comparability between the financial statements of charities.
3. **Option 3:** Change the SORP's approach as to what constitutes a condition.
 - There is a sense from the majority of engagement strand members that funding commitments are sometimes overstated.
 - There is some evidence from experience of engagement strand members of funding commitments being written back when charities don't meet funding conditions. This happens frequently enough to make engagement strand members question whether funding commitments are being overstated at times.
 - The SORP's interpretation of what constitutes a condition is considered too strict. This is resulting in some donor charities imposing unnecessarily burdensome conditions on recipient charities to prevent the donor charity from having to recognise the liability of the grant in full. Recipient charities are therefore devoting time and resources to collating information which does not add value.
 - A change in the SORP's approach as to what constitutes a condition would assist charities and their independent examiner or auditor reach agreement on the appropriate accounting treatment.
4. **Option 4:** There is scope for refining the SORP in relation to the recognition of funding commitments which are dependent on future income in that such commitments should only be recognised when payment to the recipient is probable. It may also be possible to re-frame the approach taken to a situation where a donation is subject to the donor charity receiving future funding by considering in the first instance whether a constructive obligation exists. This would better align the SORP with paragraph 34A.2 of FRS102 which states that "*a promise to provide cash conditional on the receipt of future income in itself*

may not give rise to a liability where the entity cannot be required to fulfil it if the future income is not received and it is probable that the economic benefits will not be transferred.”

C. Conclusions

1. **Option 1:** Attempt to influence the FRC to include improved terminology for all grant accounting, extend Section 24 of FRS 102 to cover grants from any source.

This option was agreed by the engagement strand and is therefore put to the SORP committee as a recommendation.

2. **Option 2:** Permit small and medium charities (in a three-tiered system) to have an accounting policy choice.

The majority view of the engagement strand was that **all** charities should use the accrual model to account for all revenue grant income and that charities should not have the option to use the performance model. The engagement strand noted that some members would prefer, or would not oppose, an accounting policy choice being permitted.

The approach taken towards revenue grants in the new SORP should be compatible with the treatment of capital grants.

For the performance model, changes are required to the drafting of the SORP to facilitate a more consistent approach by accounts preparers to judgements about whether performance-related or non-performance related terms and/ or conditions exist.

3. **Option 3:** Change the SORP’s approach as to what constitutes a condition.

The engagement strand recommends that where simple conditions are attached, these are considered to be conditions for the purposes of entitlement and therefore recognition of a multi-year award. In drafting the revised Charities SORP care should be taken to ensure that there is a common understanding of what constitutes a condition between the requirements for the recognition of income and for funding commitments.

The majority of engagement strand members recommend that a time-related condition in a funding agreement should be treated as a condition by the new Charities SORP, with one engagement strand member stating that “simply providing clarity [of existing SORP guidance] wouldn’t ease the burden on ... charities, who are simply trying to get their accounts to reflect reality.” There is a dissenting view where this approach is not seen as compatible with the recognition of funding commitments which must be recognised when they satisfy the definition of a constructive obligation and where payment of the grant is probable i.e. there is an over 50% likelihood of payment being made.

4. **Option 4:** The wording of the SORP should be amended to align with FRS102 on the topic of funding commitments which are dependent on future funding being available to the donor charity. This includes consideration of the possibility that a constructive obligation may not arise in such circumstances and the ‘test of probability’ falls away.

Further detailed recommendations are included in Appendix 2 to this Annex.

D. Other Comments

- Determining whether funding comes with terms and/ or conditions attached (whether performance or non-performance related) can be difficult in the real world. Changes to the SORP are therefore needed to create a more consistent approach to judgements about the existence of terms and conditions which must be fulfilled prior to income recognition.
- Changes to the structure of the requirements and guidance on grant income would be welcomed to help preparers navigate to the material relevant to the circumstances. Suggestions for a decision tree are included in Appendix 2 to this Annex below.
- Charities should not be changing accounting policy to avoid a particular form of scrutiny or to avoid more complex or 'less favourable' accounting requirements.
- Grants, particularly capital grants and grants with no or non-performance conditions attached merit greater prominence in the SoFA. Income from capital grants should be presented as a line item the SoFA – the engagement strand believes that this would be welcomed by funders. However, such a presentation could be challenging as grant income needs to be recorded under either 'donations and legacies' and 'income from charitable activities' depending on whether there are performance-related conditions attached.
- Where the performance model is used, it should still be necessary to distinguish deferred grants, including deferred capital grants, in the deferred income note to the financial statements.
- A fairly fundamental disagreement with FRS 102's approach to recognition was noted. 'Probable' is viewed by some engagement strand members as being insufficiently likely to justify recognition of a liability (and also recognition of income).
- The engagement strand recommends that the recognition and measurement requirements for funding commitments are in a separate SORP module from the presentation and disclosure requirements for grant-making activities.
- The engagement strand believes that the presentation and disclosure requirements should be rationalised.
- The engagement strand noted that the current accounting for capital grants means that some charities end up in audit for one year (or seek dispensation from the Charity Commission for England and Wales) when they receive capital funding. For this reason, some charities may welcome being able to apply the accrual model to capital grants.

| Engagement Strand: Professional and Technical (A) |
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| A. Options Considered by the Engagement Strand |
| <ol style="list-style-type: none"> 1. Option 1: Allow a choice between performance model or accruals. 2. Option 2: Leave the SORP unchanged |
| B. Advantages/Disadvantages of Options Considered |
| <ol style="list-style-type: none"> 1. Option 1: Allow a choice between performance model or accruals. <ul style="list-style-type: none"> • The accruals model would help solve the multiyear problem especially for capital grants. • The option to use accrual accounting would increase understanding 2. Option 2: Leave the SORP unchanged <ul style="list-style-type: none"> • There is more flexibility in the SORP than people think, reducing the need for change. |

C. Conclusions

Generally, the choice between performance and accruals model was supported, particularly for multiyear and capital grants.

However, some engagement strand members felt that lumpy accounting could and should be explained in the TAR and that you can get to a similar position as accruals by adding conditions.

D. Other Comments

- The difference in treatment in FRS102 between government and non-government grants could be confusing to preparers and users of accounts.
 - This could be particularly problematic for charities with trading subsidiaries where accounts are prepared under FRS102.
 - i.e. the trading subsidiary could adopt an accounting treatment for government grants not permitted by the SORP, adding to complexity.
- There is often misunderstanding between 'conditions' and 'restrictions' and there could be greater clarity in respect of this.
- There should be more guidance on revenue recognition e.g., including a flow chart to help with revenue recognition in a revised SORP.

Engagement Strand: Large Charities

A. Options Considered by the Engagement Strand

1. **Option 1:** Allow the use of the accruals model for accounting for grant income.

B. Advantages/Disadvantages of Options Considered

1. **Option 1:** Allow the use of the accruals model for accounting for grant income.
 - Funders may send grant funding to charities just before their year end; recording this as income immediately can show a very misleading and confusing story and does not apply the accruals principle.
 - On capital grants, it is potentially confusing and misleading to show all the grant in income and depreciation of asset according to depreciation rules in expenditure i.e. it creates a surplus in the SoFA.
 - Charities struggle due to the accrual model not being permitted as it increases the difficulty for users in understanding the accounts, particularly as they are so different to commercial accounts.
 - However, it was noted that the easiest way to address the issues would be to include a note to explain a grant is towards X many years, and then the same note for grant giving (where the charity gives out grants to beneficiaries).
 - It was noted that if a charity builds up fundraising for a future capital project, this income is recognised in SoFA and there is no current issue with this approach – receiving a multi-year grant is not dissimilar and the current treatment needs to be maintained for consistency.

C. Conclusions

There was no consensus that a compelling case could be made for change to the current accounting treatment under SORP.

However, there was a strong feeling put forward that SORP should be much more aligned to FRS 102 and matching/the accruals concept.

The engagement strand recommended that the SORP needs better examples (particularly for performance related grants) and should require more use of narratives and disclosures.

D. Other Comments

- This issue highlights that charities are trying to squeeze themselves into a model designed for companies. The SORP could do more to help charities explain why things are the way they are to help users.
- There is a need for the SORP to offer more clarity and explanation, particularly paragraphs 5.20 – 5.22.
- Even in the accrual model, it is always judgemental whether the criteria to recognise are met. An alternative could be to classify income from grants as grant less than 12 months or more than 12 months.
- The issue highlights the need for good narrative disclosure. One engagement strand member commented that the funds note quite often lacks narrative, particularly with respect to unrestricted funds. The SORP could require more detail on funds to be disclosed to aid understanding.
- It was noted that grant giving gave rise to fewer problems than income recognition with grants.
- It was noted that current accounting rules may be detrimental to charities when applying for funding – funders may use simple maths to determine whether they will give money to a charity, looking at funds only without looking at the notes.
- The engagement strand identified the need for education of users and trustees to enhance understanding.

Appendix 1

Suggested cross-referencing in the SORP – suggested by the Academics and Regulators and Proxies for the Public Interest Engagement Strand

We understand the need for SORP to allow income from grants to be allocated between voluntary income (for unconditional grants) and income from charitable activities (for grants with performance conditions attached), to comply with activity-based accounting. One thing that might bring additional clarity for those less familiar with accounting for grants in charity accounts would be to cross-reference the relevant paragraphs in SORP:

Paragraph 4.32, A1: Income from donations and legacies (explains what should be included in this category in the SoFA) - Third bullet point – include a cross reference as follows:

- 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 ([For grants included within 'Income from charitable activities', see paragraph 4.34](#)).

Likewise, in paragraph 4.34, A2: Income from charitable activities (explains what should be included in this category in the SoFA) - Fourth bullet point – include a cross reference as follows:

- performance-related grants where the income is conditional on delivering certain levels or volumes of a service or supply of goods ([For grants included within 'Income from donations and legacies', see paragraph 4.32](#))

Appendix 2

Detailed changes suggested by Professional and Technical Engagement Strand B

Revenue grant income

If the accrual model is available and applied under the new SORP, details of any multi-year grants awarded should be disclosed. However, consideration will need to be given as to whether it is appropriate to describe awards made but not recognised as contingent assets.

The following wording changes are recommended for specific paragraphs in the SORP:

- At the beginning of paragraph 5.20, the following wording or similar wording is included: “Grant income must not be recognised until the entitlement criterion is met, this includes until non-performance related terms or conditions are met.” This change would require some existing material to be deleted.
- Paragraph 5.22 is amended to include the following, or similar wording, to provide more clarity about time-related conditions: “For example, a time-related condition exists when a funder awards a multi-year grant to a charity, specifying the amount of funding awarded for each year or agreeing with the recipient charity that it cannot spend more of the grant than it (the recipient) has budgeted for. This means that the charity must only recognise the grant funding as income, pro rata, in the year specified by or agreed with the funder.”

In circumstances where the performance model can be applied as an accounting policy choice, the engagement strand was of the view that the following should be treated as an adjustment in calculating a charity’s free reserves:

- Any unrestricted revenue grant income recognised which relates to future reporting periods.

This is on the basis that a charity cannot spend that income nor can it raise any finance on the basis of that income. This adjustment should be visible as part of the calculation of a charity’s ‘free’ reserves and the charity should include an explanation for the adjustments being made.

Where charities are permitted an accounting policy choice under the new SORP, wording should be included which makes it clear it is not appropriate to change between permitted models.

It would be helpful if the material in Module 5 could be re-structured to give preparers more assistance in identifying which requirements apply to a particular grant. A decision-tree could be one way of achieving this.

Elements of the decision-tree could include the following:

- Revenue or capital.
- Restricted or unrestricted.
- Conditions attached or no conditions attached.
- Performance-related conditions attached or no performance-related conditions attached.
- Non-performance-related conditions attached or no non-performance related conditions attached.

Accounting for funding commitments

Any funding commitments, considered to be constructive obligations, made with conditions attached, under any new definition of 'conditions', should be disclosed as contingent liabilities.