

**Annex A - Drafting amendment to FRED 48 (Draft FRS102)
 Charity Commission and Office of the Scottish Charity Regulator response as the Joint SORP-making Body for UK
 Charities to the ASB's consultation on the 'Revised Financial Reporting Exposure Drafts'**

Suggested re-draft

Why amendment is necessary

Glossary p.280 – Restrictions

<p>1.</p>	<p>Restrictions: A requirement that limits or directs the purposes for which a resource may be used. but does not require that resource to be returned to the donor if the resource is not used as specified.</p>	<ul style="list-style-type: none"> • A restricted gift should not be defined by the presence or absence of a repayment clause. • Unless the definition is changed, all restricted resources received with a repayment clause would be deferred until the gifted resource was expended even if it was probable that the resources would be used in line with the restriction. The recognition of restricted income should only be deferred if repayment is probable which, we believe, is the intention behind paragraph PBE34.69. • The existing definition if not amended would result in restricted income subject to a repayment clause being treated as a gift subject to a performance condition and this would result in income only being recognised as the resource was expended. • The amendment ensures a clear distinction is made between a restriction, which limits or directs the purposes for which a resource may be used and a condition that must be overcome before there is entitlement to the gift. • The amendment proposed also ensures paragraph PBE34.66 to work as intended i.e. to ensure a restriction does not prevent recognition of a donated resource.
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Glossary p.278 - Performance condition

<p>2.</p>	<p>Performance condition: A requirement that specifies that the resource is either to be used by the recipient as specified, or if not so used, to be returned to the donor.</p> <p><u>A term that requires an entity to provide a specified level of service (or provision of goods) with payment/entitlement being conditional on that specified service (or goods) being provided.</u></p> <p><u>Or</u></p> <p><u>A term that requires the performance of a particular level of service or units of output to be delivered with payment/entitlement conditional on that performance.</u></p>	<ul style="list-style-type: none"> • As with any other condition, a performance condition needs to be met (or overcome) before there is unconditional entitlement to the resource received. It is the conditionality of the gift that needs to be the focus of the definition not the presence or absence of a repayment clause. • At present the definition of a performance condition makes it difficult to distinguish between a restriction and a performance condition. • The existing ASB definition would change the way charities currently account for both their funding commitments and the income receivable from non-exchange transactions. • The first alternative definition offered is taken from paragraph 4.32 of the Statement of Principles – Interpretation for Public Benefit Entities. • A second alternative definition offered is taken from paragraphs 99 and 100 of the Charities SORP and is more specific.
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Addition to glossary – 'Condition'	
3.	<p>Condition: <u>A condition specifies an uncertain future event which must occur or fail to occur before the recipient of a resource has an unconditional right to the resource.</u></p> <ul style="list-style-type: none"> • Necessary to clarify term used in PBE34.69 • Establishes that conditions other than 'performance conditions' may affect entitlement to a resource.
Income from non-exchange transactions p252	
4.	<p>PBE34.69 An entity shall recognise a liability for any resource <u>received with specified performance if as a result of a failure to meet restrictions or conditions attached to it, that becomes repayable due to non-compliance with the performance conditions, when that repayment becomes probable.</u></p> <ul style="list-style-type: none"> • Repayment may arise when the conditions attaching to a conditional gift are not met. • Conditions that could trigger repayment are wider than just performance conditions. • Therefore we need to define a 'condition' so that this paragraph applies to any repayment that arises through the failure of a condition attaching to a gift being met. • It is the failure to meet a condition that triggers the possibility of repayment and the recognition of a liability. • The proposed amendment also creates consistency with Paragraph PBE34.72(b) which is drafted to included 'conditions and contingencies' and not limited to 'performance conditions' • This amendment also necessitates defining a 'condition' in the glossary.

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Guidance on Incoming Resources from Non-exchange Transactions p.258

5.	<p>PBE34B.13 Some resources are given with performance conditions attached which require the recipient to use the resources for <u>to provide a specified level of service a particular purpose</u> in order to be entitled to retain the resources. An entity will not recognise income from those resources until these performance conditions have been met.</p>	<ul style="list-style-type: none"> • This paragraph muddles the definition of a restriction and a performance condition. • Restrictions, not conditions, limit the purpose for which resources can be used. • Re-draft needed to be consistent with the suggested revisions to definitions.
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Guidance on Incoming Resources from Non-exchange Transactions A p.258

6.	<p>PBE 34B.15 Paragraph PBE34.71 requires resources received to be measured at their fair value. These fair values are usually the price that the entity would have to pay on the open market for an equivalent item. <u>In the case of goods that are expected to be sold, market value may be derived from the estimated resale value (which may reflect the amount actually realised) after deducting the cost to sell the goods.</u></p>	<ul style="list-style-type: none"> • Goods and facilities may be donated to a charity with expectation of their use by the charity or for their distribution to beneficiaries in furtherance of purposes. • Where restrictions or conditions attaching to a gift make it impractical for the good or service to be sold then a notional market value may overstate the gift's value to the recipient particularly where goods or facilities of a lower specification would meet the service needs of the recipient.
6a	<p>PBE34B.16 <u>On occasions, due to a restriction, condition or term attaching to a gift, it may not be practical for goods or facilities donated to a PBE for its own use to be resold. In such instances, a value may be derived from the amount that the recipient of the donation would have to pay in the open market for goods or facilities providing the same service potential.</u></p>	<ul style="list-style-type: none"> • In the view of the SORP Committee, these circumstances are not as rare as envisaged in the ASB explanation in paragraphs 10.31 and 10.32 of Part Three of its consultation pack. • The amendments suggested would also mean that the cost of purchasing an asset or facilities with the same service potential would only arise when it was impractical

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	When there is no direct evidence of an open market value for an equivalent item a value may be derived from sources such as: (a) the cost of the item to the donor; or (b) in the case of goods that are expected to be sold, the estimated resale value (which may reflect the amount actually realised) after deduction the cost to sale the goods.	for the recipient to re-sell the goods or facilities it has received. This approach should therefore ameliorate the ASB concerns as to the cost, subjectivity and risks of undervaluation.
	Funding Commitment p.251	
7.	34.57 (a) the obligation (which may be <u>a constructive obligation</u>) is such that the entity cannot realistically withdraw from it; and...	<ul style="list-style-type: none"> • Important that it is clearly understood that recognition is based on the existence of a constructive liability. • Non-exchange transactions and indeed many grants are not contractual hence it is vital that we establish clearly that it is the existence of a constructive obligation that drives recognition.

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Guidance on Funding Commitments p.256

8.	<p>34A.2 ... Similarly, a promise to provide cash conditional on the receipt of future income does not give rise to a liability as the entity cannot be required to fulfil it if the future income is not received.</p>	<ul style="list-style-type: none"> • This guidance paragraph will result in accounting for the form of an agreement rather than its substance. • It is preferable to simply rely on the definition of a constructive obligation rather than base liability recognition on a term of a funding offer that may or may not change a recipient's expectations of receipt. • It is agreed that if an economic outflow is not probable then a liability should not be booked.
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Section 24 Grants p.196

9.	<p>24.1A government grant is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified <u>performance condition</u> relating to the operational activities of the entity.</p> <p>24.2.....trading transactions of the entity. <u>Government and other grants also exclude the transfer of resources to an entity on a non-exchange basis.</u></p>	<ul style="list-style-type: none"> • In the charity sector grants are often made and received as gifts under trust law rather than under contract. The terms grant and donation are often used inter-changeably and where the substance of the transfer is that of a gift then the two terms are indistinguishable (Charities SORP GL29 & 30 pp. 68-69). We are therefore concerned that there will be uncertainty as to when a grant is accounted for as a non-exchange transaction under the PBE section of the proposed standard and when Section 24 of the proposed standard applies. • The text of Section 24 was initially written to apply only to government grant but has been expended to include 'grants made by others' and so could include corporate and charity sector donors such as trusts and foundations.
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		<ul style="list-style-type: none"> • The definition of a government grant refers to specified conditions and that resources are transferred in 'return' for compliance with conditions. This raise the issue of distinguishing 'condition' and 'restriction' and being clear that the conditions referred to are 'performance conditions'. In addition, the specific statement that grants excludes 'non-exchange transactions' would add clarity to when section 24 applies to grants as the term is used by charities. • As you are aware, we have concerns over the application of accrual model proposed in paragraphs 24.5C to 24.5G particularly where a grant is not subject to a performance condition as resources available to spend will not be recognised in the performance statement until spent. This impacts on the transparency of charity accounts.
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Section 11 Basic Financial Instruments p.111

<p>10.</p>	<p>11.14(a) Debt instruments that meet the conditions in paragraph 11.8(b) shall be measured <u>as follows:</u></p> <ul style="list-style-type: none"> • <u>If the debt instruments are publicly traded or their fair value can otherwise be measured reliably, the investment shall be measured at fair value with changes in fair value recognised in profit or loss.</u> • <u>All other debt instruments shall be measured at amortised cost using the effective interest method.</u> 	<ul style="list-style-type: none"> • Charities, particularly endowed charities often hold government stock and corporate bonds as part of their investments portfolios that generate income and gains to be used for their charitable purposes. • Existing practice in charity accounting is to include such investments in the accounts at their market value. • Where debt instruments such as government stocks or corporate bonds are traded on an active market then the best evidence of fair value is the quoted price of the instrument. Obtaining the quoted price is also far less onerous than calculating a proxy for fair value using the effective interest method. The concept of amortised cost has little practical use in the context of an investment portfolio. • Introducing an 'active market option' would also be a more proportionate solution than requiring charities with investment portfolios to refer to the recognition and measurement provisions of IAS 39.
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