The new Charity SORPs

Neal Gilmore
Two SORP’s

• Two SORPs – FRSSE and FRS102
• Why?

• FRS102 SORP not disrupted by withdrawal of FRSSE
FRSSE SORP

- FRSSE SORP can be used by any charity meeting the small company thresholds:
  - Two of the following:
    - Income not greater than £6.5m
    - Balance sheet total not greater than £3.26m
    - Not more than 50 employees
- Reduced disclosures and cash flow statement is optional
FRSSE SORP

- Because FRSSE has many gaps and limitations, FRSSE SORP includes charity specific requirements.
- FRSSE SORP will have a very short shelf life.
- Will there be much of a difference between the two?
- Many charities eligible for FRSSE SORP are choosing to follow the FRS102 SORP.
Why might I still go with FRSSE SORP?

- Fewer changes if you adopt
- Optional cash-flow statement
- Do not have to disclose remuneration and benefits of key management, pension scheme contributions and redundancy and termination payments
Why might I not go with FRSSE SORP?

- Changes are imminent
- Cost and effort of changing accounts twice
- Not as comprehensive as FRS102 SORP
FRS102 SORP
SORP requirements

- MUST – Mandatory to comply with SORP
- SHOULD – Good practice and improving standards
- MAY – Charity can choose to adopt or an alternative treatment is possible
When does it apply from?

- Accounting periods starting on or after 1 January 2015
- A charity with a year end 31 December 2014 will need to be thinking about comparative figures for the year end 31 December 2015 under new SORP
- A charity with a year end of 31 March 2015 will have this year as its first comparative for the accounting period 31 March 2016 under the new SORP
Preparing for the change

• Identify the **Transition date**
• Review assets and liabilities to see if there are any changes that need to be made at the transition date
• Identify any exceptions to re-statement
• Choose any relevant exemptions
• Prepare reconciliation and related disclosures
Transition date

- Transition date: first day of the earliest period of comparatives presented in the first set of financial statements prepared under FRS 102
- For an organisation with a year end of **31 December 2015**, the transition date would be **1 January 2014**. This is important because the exceptions and exemptions will not apply for any transactions that take place after this date.
Preparing for the change

• Check that accounting policies are in line with FRS102
• Any new accounting policies to consider?
• Gather relevant information at the time of the transaction to make it easier.
Preparing for the change

• Newly recognised assets & liabilities:
  – Holiday pay accrual

• Reclassifications
  – Freehold property now an investment property if rented out within group

• Re-measurements
  – Some investments, fixed assets at deemed cost
Preparing for FRS102 SORP

• **Exceptions** where they cannot retrospectively be changed e.g.
  – Accounting estimates cannot be changed (with the benefit of hindsight!)

• **Exemptions** (there are 17 in all)
  – Property, plant and equipment can be re-valued to market value and this can be a one-off if you wish, replacing historic cost but with no on-going requirement to obtain valuations.
Preparing for FRS102 SORP

• Additional reconciliations and disclosures
• If you prepare your own accounts is your template correct – time required to update it.
CHANGES TO THE TRUSTEE REPORT
Key changes – Trustees Annual Report

• Charity must explain any policy for holding reserves, amount and why.
• If the trustees have decided that holding reserves is unnecessary then this must be disclosed along with the reason.
Key changes – Trustees Annual Report – larger charities (audited)

- Explanation of social investment policy and explain how any programme related investments contribute towards your aims and objectives
- Must explain the financial effect of any significant events. This is in addition to reporting significant charitable activities undertaken.
Key changes – Trustees Annual Report – larger charities (audited)

• Statement concerning risk management is no longer required.
• Must provide instead a description of the principal risks and uncertainties facing the charity and its subsidiary undertakings, as identified by the charity trustees, together with a summary of their plans and strategies for managing the risks.
Key changes – Trustees Annual Report – larger charities (audited)

• Must disclose arrangements for setting the pay and remuneration of the charity’s key management personnel and any benchmarks, parameters or criteria used in setting their pay.
Charity Executive Pay

- Existing requirement to disclose the number of employees earning over £60,000 in reporting year in bands of £10,000
- New requirements: Total amount of salaries and benefits to “key management personnel”
- Charities over audit threshold – include in trustees annual report arrangements for setting pay of key management personnel & any benchmarks etc. used in doing this
In more detail.....

• Following recommendations are considered best practice for charities over audit threshold and good practice for others:
  – Charities should have a remuneration policy
  – Policy should consider “charity discount” to market rate
  – Consider use of remuneration ratios (relationship between highest paid and median salary)
In more detail…..

• Publish an annual statement explaining their charity’s ethos and remuneration policy
  – How does it impact on delivery of charitable purposes
  – Report actual remuneration, roles and names of individuals, higher paid staff as defined by the charity

• Adopt a set of principles when setting charity staff remuneration to achieve balance between fair pay and need to attract and keep staff, manage, support and deliver the charity’s aims and considerations of beneficiaries needs.
Charitable companies

• Need to include a strategic review if company qualifies as “medium” or “large”
• This is a discrete section within trustee report with appropriate heading
• Two of the following:
  – Income not greater than £6.5m
  – Balance sheet total not greater than £3.26m
  – Not more than 50 employees
Strategic review

- Strategic Report which includes:
  - Achievements and Performance
  - Financial Review
  - Plans for Future Periods
  - Principal Risks and Uncertainties
CHANGES TO THE STATEMENT OF FINANCIAL ACTIVITIES (SOFA)
Key changes – SOFA

- Basic structure remains the same
- Number of headings reduced / clearer descriptions
- FRS102 requirement that comparatives are provided for all columns in the SOFA either by using an additional column or providing information in the notes
- See hand-out
Key changes – SOFA

• Some of the line headings on the SoFA have been changed
• You can have a single column on the SoFA where only one class of funds is material
Key changes – SOFA

• Gains and losses on investment assets have changed – previously both “realised” and “unrealised” gains and losses were shown under “other gains and losses” after the total line “net incoming/outgoing resources”

• FRS102 requires this to be shown as part of profit or loss so it now moves higher up and is included before net income/expenditure
Key changes - SOFA

• This might not be desirable as your result for the year could be distorted by significant gains and losses

• Could of course insert another sub-heading – “Net income/expenditure before gains and losses”
CHANGES TO THE BALANCE SHEET
Key changes – Balance sheet

• No substantive changes to the balance sheet format
• Investment properties are measured at cost initially and subsequently at “fair value at the reporting date”
• SORP 2005 permitted “any reasonable approach to market valuations”
• FRS102 requires a valuation by an independent expert or a disclosure that this has not been done
Key changes – Balance sheet

• Mixed use investment property introduced with a property apportioned between its investment and operational use (unless impractical) – otherwise treat wholly as tangible fixed asset

• Property let or occupied by another group undertaking must be treated as an investment property
Key changes – Balance sheet

• Social investment is now a separate class of investment
• Debtors recoverable in more than 12 months must be discounted to Present Value if the effect is material – see legacies later
Fund accounting

• No change to fund classification
• Transfer line on SoFA must always net to NIL

• Used to show with transfers from other charities of assets and liabilities
• Now either a gain or loss (acquisition accounting) or merger accounting if criteria met
Charities preparing their accounts under FRS 102 **must** provide a statement of cash flows except where the disclosure exemptions relating to subsidiary entities – i.e. your entity is consolidated into another set of publicly available accounts where a cash flow is included.
Accounting policies concepts and principles

- There is no wholesale change to the accounting policies as set out in SORP 2005 but there are some changes that will affect particular charities.
WHEN DO WE RECOGNISE INCOME IN THE ACCOUNTS?
Income recognition - 1

• FRS102 has changed one of the three criteria for income recognition
• Under SORP 2005 income was recognised when receipt was “virtually certain”. Under FRS102 it becomes “probable”
• Evidence of entitlement and reliable monetary measurement remain the same
Does this mean we will have to bring in more income that we did not accrue for or would previously have deferred?

Not necessarily – if one or more of the other two tests cannot be met then it would still not be recognised
INCOME RECOGNITION IN MORE DETAIL
Donations and grants

- Income from donations or grants is recognised when there is evidence of entitlement to the gift, receipt is probable and its amount can be measured reliably.
- Grant - evidence of **entitlement** when formal offer of funding is communicated in writing to the charity.
- Some grants may contain **terms or conditions** that must be met before the charity has entitlement to the resources.
Donations and grants

- **Donation** - entitlement usually arises immediately on its receipt.
- Gifts may include conditions which must be met before the charity is entitled to the resources.
Contract income

• Income from the sale of goods and services under contract is normally classified as unrestricted funds because it is not a gift and so cannot be restricted by trust law and any surplus may normally be spent on any purpose of the charity.

• However, if a contract specifically requires all income received under it to be spent on a particular purpose of the charity and any unspent income to be returned to the funder or only applied for that particular purpose, then, in substance, the income may be regarded as restricted.

• If contract income is presented as restricted then all relevant disclosures required for a restricted fund must be made.
How can conditions affect recognition?

- Charities need to identify donations or grants that are subject to terms or performance related conditions or other conditions that must be met before there is unconditional entitlement to the income.

- Not all terms or conditions attaching to a grant or donation prevent its recognition as income. One that simply restricts the use of a grant or donation does not affect a charity’s entitlement to the gift and recognition of income.
Performance related conditions

• Conditions that specify the services to be performed by a charity in receipt of a grant.
• E.g. grant may be in the form of a service level agreement - conditions for payment are linked to the achievement of a particular level of service or the units of output delivered.
• Income must only be recognised to the extent that the charity has provided the specified goods or services.
Restrictions to use – a condition?

• A restriction on the use of a grant or donation to a particular purpose or activity of a charity does **not** create a performance-related condition.

• A restriction creates a requirement that limits or directs the purpose for which a resource may be used but it **does not** require a specific level of performance or output from the recipient charity.
Performance related grant vs. contract

- Important at the outset that charity identifies whether the funding agreement is a **performance-related grant** or a **contract**.
- Non-compliance with performance-related conditions and the liability for non-performance of a contract differ.
- The law of contract - buyer to seek costs, damages and recompense for any failure or breach of contract by the seller.
- Breach of grant conditions may lead to a partial or full repayment of the grant when repayment terms apply to the grant.
Match funding, planning consent.....

- Grant may be conditional on a charity obtaining matched funding, or subject to a successful planning consent.
- Meeting these conditions would not be wholly within the control of the recipient charity and the outcome of the specified event is uncertain.
- Charity would not have unconditional entitlement to the income until these conditions were met.
Time periods

• Donor imposed conditions may also specify the **time period** over which the expenditure of resources on a service can take place. Specification of a time period may amount to a pre-condition for use that limits the charity’s ability to spend a grant or donation until it has performed the activity related to the specified time period.

• E.g.: condition might specify the provision of a number of training weeks or the completion of a number of work placements in a particular period.
Time periods

• Time-related conditions may be implied.
• E.g. Multi-period grant is approved and is to be paid on the basis of agreed annual budgets
• Charity may not be entitled to spend part or all of that income in advance of its budgeted year(s) without the further prior approval of the grant-maker.
Deferring income

• Where terms and conditions have not been met or uncertainty exists as to whether the recipient charity can meet the terms or conditions otherwise within its control, the income should **not** be recognised but deferred as a liability until it is probable that the terms or conditions imposed can be met.
Deferring income

• A grant that is subject to performance-related conditions received in advance of delivering the goods and services required by that condition, or is subject to unmet conditions wholly outside the control of the recipient charity.

• Accounted for as a liability and shown on the balance sheet as deferred income. Deferred income is released to income in the reporting period in which the performance-related or other conditions that limit recognition are met.
Contingent asset

• When income from a grant or donation has not been recognised due to the conditions applying to the gift not being wholly within the control of the recipient charity, it should be disclosed as a contingent asset if receipt of the grant or donation is probable once those conditions are met.
Terms and conditions that do NOT prevent income recognition

• When meeting terms or conditions are **within the charity’s control** and there is sufficient evidence that they have been or will be met, then the income must be recognised.

• Terms or conditions such as the submission of accounts or certification of expenditure are administrative requirements and would not prevent the recognition of income.
Terms and conditions that do NOT prevent income recognition

• A donation or grant **without conditions** should not be deferred even if the resources are received in advance of the expenditure on the activity funded by them. Timing of the related expenditure is at the **discretion of the charity** and the income cannot be deferred simply because the related expenditure has not been incurred.

• E.g. Donation or grant specifically to provide a fixed asset or a fixed asset is donated (a gift in kind), the charity is normally entitled to that income when it is receivable. At this point, all of the income must be recognised in the SoFA and not deferred over the life of the asset.
Terms and conditions that do **NOT** prevent income recognition

• Condition that allows for the recovery by the donor of any unexpended part of a grant does not prevent recognition.

• Instead, a liability to any repayment is recognised when repayment becomes probable.
LEGACIES
Legacies

• Will charities have to accrue more legacy income than before?
• NO
• There has always been some flexibility on when charities recognise legacy income
Entitlement

• Can be problems if will does not clearly name the charity, more than one possible recipient or will is contested
• In a straightforward case probate will establish entitlement
• For accounting purposes, entitlement exists when the charity has evidence gift is left to them and executor is satisfied it will not be required to settle claims on estate.
Probability

• Receipt is normally probable when:
  – There has been a grant of probate
  – Executors have established there are sufficient assets in the estate, after settling any liabilities, to pay the legacy
  – Any conditions attached to the legacy are either within the control of the charity or have been met

• Knowing probate is granted is insufficient – maybe assets need to be sold to meet debts

• Legacy subject to interest of a life tenant only recognised as income on death of the life tenant
Measurement

• Should only be recognised when it can be measured or estimated with sufficient reliability
• Fair value receivable will generally be the expected cash amount to be distributed to the charity from the estate
• A residuary legacy is more uncertain than a pecuniary one. If it cannot be measured accurately then should be disclosed as a contingent asset until criteria for income recognition is met
Estimating value – Portfolio technique

• If your charity regularly receives a significant number of legacies there will be information on past trends.
• Can use an estimation technique to value legacies as income
• Unsuitable for material legacies or where legacies are received infrequently
Estimating value – Portfolio technique

• If not using portfolio technique, legacy must be recognised when executors have determined that a payment can be made following the agreement of the estate’s accounts or on notification by the executors that payment will be made
Legacy accounting

- Where payment is received from an estate or is notified as receivable by executors after the reporting date and before accounts are authorised for issue, but it is clear payment had been agreed by executors PRIOR to the end of the reporting period, then treat as an adjusting event and accrue income if receipt is probable
Legacy accounting

• If distribution is delayed for greater than 12 months and an estimate can be made of the likely date of distribution – providing the legacy is material – it could be discounted by the interest rate the charity anticipates it would earn on a deposit over a similar time frame (FRS102 – s11)

• The adjustment should be made to legacy income not interest receivable
Impairment of legacy

- If a legacy debtor becomes impaired then an adjustment is made to the legacy debtor and legacy income.
Other potential income items
Donated goods

- Under SORP 2005 income from donated goods was recognised on sale
- FRS102 requires recognition at the point of receipt at fair value
- Requirement is relaxed only if it is not practical and/or the costs of recognising it outweigh the benefits to the accounts user
Donated goods

• If you cannot measure at fair value when donated then they must be recognised as income when sold or distributed

• The FRS102 SORP provides guidance on an estimation technique for donated items under the UK retail gift aid scheme
Volunteers

• Placing a monetary value on their contribution presents significant difficulties. E.g. charities might not employ additional staff were volunteers not available, or volunteers might complement the work of paid staff rather than replace them. These factors, together with the lack of a market comparator price for general volunteers, make it impractical for their contribution to be measured reliably for accounting purposes.

• Given the absence of a reliable measurement basis, the contribution of general volunteers must not be included as income in charity accounts.
Expenditure
Allocation of costs by activity on SoFA

• Approach to allocating costs unchanged

• Support costs now include governance costs as a separate component
Disclosure of trustee & staff remuneration, related party and other transactions

• Although details of unconditional donations from trustees need not be disclosed, the total donated must be

• Total paid to key management personnel must be disclosed

• There are a few other specific points
Grant making activities

• Can no longer include the details in a separate publication rather than the notes to the accounts

• Can be on charity’s webpage providing certain conditions are met or in the trustees annual report.
Recognition of expenditure

• FRS102 requires discounting of liabilities and provisions where settlement is delayed for more than 12 months and the effect is material

• FRS102 requires accrual of material amounts for paid annual leave and sick leave
Financial assets and financial liabilities

• The FRS102 SORP distinguishes between “basic” and “other” financial assets and liabilities
• If a charity holds “other” then the relevant sections of FRS102 need to be consulted
Retirement and post employment benefits

• No change in respect of defined contribution plans

• Where a charity contributes to a multi employer scheme where its share of the actuarial deficit cannot be identified – treated as defined 
  contribution. However if there is an arrangement to make additional contributions then a liability for the 
  Present Value of outstanding additional contributions should be recognised.
Retirement and post employment benefit

• Pensions Trust – noted on internet although they will explain the NPV calculation they state that a suitable discount rate would need to be agreed by charity and its auditors

• Think about setting aside a designated fund to match PV of outstanding contributions to minimise effect of free reserves now
Transition

• Decide which SORP to follow *(Discuss with us if you feel that FRSSE SORP is one for your charity)*

• Identify the transition date

• Consider areas where a change may be required

• Does any information need to be obtained before the transition date. For some this may be difficult until nearer the time – e.g. holiday pay accrual
Transition

• One-off opportunities – revalue tangible fixed assets and treat as deemed cost
• Impact of major changes – e.g. discounted value of agreed funding plans where a multi-employer defined benefit scheme
• What additional information do we need for the trustee report?
QUESTIONS