Charity Finance Group

Preparing for SORP 2015: an essential overview for charities

Ray Jones - Training consultant to CFG and member of Charities SORP Committee
Preparing for SORP 2015

- Background and overview of new accounting framework
- The Trustees’ Annual Report (TAR)
- The format of charity accounts
- Impact on accounting policies
- Accounting Disclosures
- Transition to FRS 102 & the FRS 102 SORP
Background and overview of new accounting framework
Background and overview

- The new Framework
- Why new SORPs now?
- Why two SORPs?
- Implementation dates
- Who can use the FRSSE and FRSSE SORP?
- Is the FRSSE really a no change option?
- What about micro entities?
The new framework

- FRS 100 – Application of Financial Reporting Requirements
- FRS 101 – Reduced Disclosure Framework (disclosure exemptions from EU-adopted IFRS for qualifying entities)
- FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland
- FRSSE – Financial Reporting Standard for Smaller Entities
Two new standards and two new SORPs

FRS 102
The Financial Reporting Standard applicable in the UK and Republic of Ireland

July 2013
Overview of new framework

- Two new Charity SORPs – the FRS 102 SORP and the FRSSE SORP - one based on each new standard
- Both new standards and both new SORPs apply for financial years starting on or after 1 January 2015
- Both the new standards and SORP can be applied early (for company charities once new regulations are in place)
- FRS 102 and FRS 102 SORP cannot be applied for financial years ending before 31 December 2012
FRS 102 and the SORP

- FRS 102 SORP used in conjunction with FRS 102
- FRS 102 first accounting standard to address charity and public benefit entity (PBE) reporting
- FRS 102 contains specialist PBE section (section 34)
What is a public benefit entity?

“An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity’s primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.”
**SORP terminology**

**Must:** non-adherence to that recommendation is a departure from this SORP

**Should:** a matter of good practice, charities are encouraged to follow the recommendations but a failure to do so is not a departure from the SORP

**May:** charities may choose to adopt an example or an alternative treatments at their discretion

Additional requirements of SORP identified by – ‘this SORP requires…’
Who can use the FRSSE?

Current threshold
Meet 2 of the following 3 criteria:
- Turnover (gross income) not more than £6.5m
- Balance sheet total not more than £3.25m
- Not more than 50 staff

Anticipated new threshold
Meet 2 of the following 3 criteria:
- Turnover (gross income) not more than £10.2m
- Balance sheet total not more than £5.1m
- Not more than 50 staff
Is the FRSSE really a no change option?

- FRSSE SORP requires charities to apply current practice for sector specific transactions.
- Can retain existing accounting policies for other transactions provided they are in line with accepted practice.
- But new EU Accounting Directive to be implemented and a new FRSSE is in the pipeline.
- A new FRSSE will mean a new FRSSE SORP in 2015/16.
EU Accounting Directive: financial reporting

- BIS Consultation opened 29 August and closes 24 October 2014
- FRC Consultation on replacing the FRSSE opened 1 September and closes 30 November
Can charities apply the micro-entities framework?

- Charities scoped out of micro-entities regulations
- Cannot be applied by any company included in group accounts
Charities SORP – the Micro site
www.charitysorphp.org
The Trustees’ Annual Report (TAR)
Structure of the report

- Objectives and activities
- Achievements and performance
- Financial review
- Plans for the future
- Structure, governance and management
- Reference and administrative details
What’s changed - Reserves

All charities must explain policies, state amount and why reserves held. Larger charities now expected to provide more information about how reserves are calculated:

- State total about of funds held at year end
- Identify restrictions
- Identify and explain designations, commitments and funds tied up in tangible fixed assets & performance related investments
- State amount of reserves held at year end after adjustments
- Explain plans to spend funds set aside
- Compare reserves held to policy and explain steps to bring them in line
What’s changed - Going concern

- If there are uncertainties about the charity’s ability to continue as a going concern for foreseeable future this should be explained.
- If there are uncertainties then further note disclosures are required:
  - Explanation of factors supporting the conclusion the charity is a going concern;
  - A balanced, proportion and clear disclosure of uncertainties; or
  - Statement that there are no material uncertainties.
  - If not prepared on going concern basis this fact must be stated and explained.
What’s changed – Risk management

- A description of the principle risks and uncertainties faced
- A summary of plans and strategies for managing those risks
- Explain factors that affect financial performance and position going forward
What’s change - Reporting performance and public benefit

- No change on reporting public benefit – still need to explain main activities undertaken for public benefit
- Still need to confirm that trustees’ have referred to Charity Commission guidance
- A ‘nudge’ towards ‘outcome’ and ‘impact’ reporting but no requirement to adopt such approaches when explaining achievements
Executive remuneration

The SORP consultation period saw significant media attention given to executive pay in charities:

- Larger charities must now explain their ‘arrangements for setting pay and remuneration of key management personnel and any benchmarks, parameter and criteria used…’
- Also note disclosure of total employee benefits received by key management (including trustees)
- See NCVO report into executive pay
What’s new - the Strategic Report

Only applies to company charities – other than small companies:
- Main strategies and objectives
- Principle risks and impact on future prospects
- An analysis of past performance
- Information needs to be corralled into discrete section of TAR
- Strategic report must be approved by trustees
- See Charity Commission and FRC guidance
Getting the most from your annual report

- Plan early, decide responsibilities and involve your staff and trustees
- Focus on the important …quality rather than quantity
- You can choose how you order the content
- Make sure headings and amounts match the accounts
- It’s your account of your stewardship of the charity
The format of charity accounts
Charity accounts

- Statement of financial activities
- Balance sheet
- Statement of cash flows
- Summarised income and expenditure account (if SoFA does not meet companies law requirements)
- Notes to the accounts
SoFA – What’s changed

- A single comprehensive statement of income (FRS 102)
- Headings simplified
- Governance costs now in notes
- Single column if restricted and endowment funds immaterial
- Certain contracts can be presented as restricted
- Investment gains/losses now in income/expenditure section of SoFA
- Discontinued activities presented as a separate column
**Statement of Financial Activities (SoFA)**

<table>
<thead>
<tr>
<th></th>
<th>Unrestricted funds</th>
<th>Restricted funds</th>
<th>Endowment funds</th>
<th>Total funds</th>
<th>Prior period Total funds</th>
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<td><strong>Income and endowments from:</strong></td>
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<td>Donations and legacies</td>
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<td>Charitable activities</td>
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<td>Other trading activities</td>
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<td>Raising funds</td>
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<td>Net gains/(losses) on investments</td>
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<td><strong>Net income/(expenditure)</strong></td>
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<td>Transfers between funds</td>
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### Reconciliation of funds:

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<th>Other recognised gains/(losses):</th>
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<td>Gains/(losses) on revaluation of fixed assets</td>
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<td>Actuarial gains/(losses) on defined benefit pension schemes</td>
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<tr>
<td>Other gains/(losses)</td>
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<td><strong>Net movement in funds</strong></td>
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<td>Total funds brought forward</td>
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<td><strong>Total funds carried forward</strong></td>
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</table>
FRS 102 requires comparatives for all amounts presented on the face of the SoFA.
For charities with restricted income and endowment funds presenting comparatives will need careful consideration.
An 8 column SoFA, use of notes or even presenting last years SoFA as a note?
SoFA - Tips

- If you describe an activity in the TAR make sure costs can be identified in SoFA or notes
- You can add sub-headings
- You can add sub-totals
- You can vary the order of headings
- Think about how you will present comparatives
The balance sheet

- No significant changes to this statement – still based on Companies Act format
What’s changed – Cash flows statement

- Require if using FRS 102 irrespective of size
- Activities classified as:
  - Operating
  - Investing
  - Financing
- Operating activities – note to reconcile adjustments from SOFA’s income and expenditure
- Cash flow not needed for parent and subsidiary accounts if group cash flows statement presented
- FRS 102 SORP provides a format example
Impact on accounting policies
FRS 102 – ‘basic’ and ‘complex’ financial instruments. Basic financial instruments include:

- Cash
- Trade debtors and trade creditors
- Loans receivable and payable (that meet the conditions for a basic financial instrument)
- Overdrafts and bank deposits
- Investment in non-puttable shares and non-convertible preference shares
Subsequent measurement of basic financial instruments

- Trade creditors/debtors – amount expected to be paid or received
- Loans that meet the condition of a basic financial instrument – amortised cost using effective interest rate method
- Investment in traded shares – market value
- Investments in non-traded – use valuation technique or cost less impairment if valuation impractical
Loans that meet the conditions for a ‘basic financial instrument’

- Zero-coupon loans
- Fixed interest loan that reverts to the bank’s variable interest rate after a tie-in period
- Loan at bank’s variable interest rate plus a fixed percentage through-out period of loan
- Loan at bank’s variable interest rate with a minimum rate specified
Other fair value adjustments and options

- Extended credit terms (present value)
- Concessionary loans (cost less impairment or fair value)
- Valuing property, plant and equipment (cost less impairment or fair value)
- Investment property (fair value or cost less impairment if impractical)
- Investments in subsidiaries, associates and joint-ventures (fair value or cost less impairment in parent charity’s accounts)
More complex financial instruments

- Options and forward contracts
- Interest rate swaps
- Non-basic loans
- Convertible debt and convertible preference shares
- Use of ‘hedge’ accounting
Some practical examples...
## Donated services and facilities

<table>
<thead>
<tr>
<th>SORP 2005</th>
<th>FRS 102 SORP</th>
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<tbody>
<tr>
<td>- Recognise if provided as part of trade or profession</td>
<td>- Recognise if provided as part of trade or profession</td>
</tr>
<tr>
<td>- Contribution of volunteers not valued</td>
<td>- Contribution of general volunteers not included as income</td>
</tr>
<tr>
<td>- Measure at value to charity (what charity would pay in open market for service of equivalent utility)</td>
<td>- Measure at value to charity (amount the charity would pay in open market for alternative that would provide equivalent benefit)</td>
</tr>
</tbody>
</table>
**SORP 2005**

**Donated for own use:**
- Value to charity (current value)

**For Resale:**
- When receivable or on sale if impractical

**For Distribution:**
- At value to charity (current value) on distribution

**FRS 102 SORP**

**Donated for own use:**
- Fair value (adjust for cost of removing any restriction)

**For Resale:**
- On receipt when practicable
- If costs outweigh benefits on sale

**For Distribution:**
- At fair value on receipt
- If costs outweigh benefits on distribution
Retail Gift Aid

- Goods sold as agent for potential donor
- Therefore charity does not hold items as stock
- Entitlement does not arise immediately on sale
- But charities can look at substance of transaction and recognise at point of sale (adjusting for risk of some proceeds not being donated)
Legacies

- **Entitlement:**
  - Probate granted
  - Normally once executor establishes the funds will not be required to satisfy claims in the estate
  - No conditions prevent recognition

- **Probability:**
  - Normally once probate is granted and the executor has established that there are sufficient assets in the estate

- **Measurement:**
  - Reliable measurement of value of legacy
Legacies – Probability of receipt

- SORP 2005 - recognition when receipt is ‘virtually certain’
- FRS 102 - recognition when receipt is ‘probable’ (more likely than not)
- Will this change the timing of legacy recognition?
  
  **Probably Not!**

- FRS 102 SORP requires that the executor has established that the property in question will not be required to satisfy claims in the estate so the test of the test of ‘virtual certainty’ of SORP 2005 also likely to be met.
Estimation techniques when measuring the value of legacies

- Charities that have numerous immaterial legacies may estimate monetary value of legacies to which they are entitled using a portfolio approach.
- Estimate the monetary value of the income by applying a formula or mathematical model.
- **But** material or infrequent legacies must be considered individually.
No change on grant commitments

‘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 conditions attaching to its payment that limit its recognition…’

Remember criteria for constructive obligation:

- The commitment is specific
- The commitment communicated directly to recipient
- Established practice of meeting commitments
Holiday pay accrual

- FRS 102 requires an accrual for holiday entitlement been taken or paid at the year-end
- If material then will require adjustment to opening balances on ‘transition’ to FRS 102
- Adjustment could be more complex for charities if staff costs charged to restricted fund
Multi-employer pension schemes and deficit funding agreements

- If accounted for as a defined contribution plan then you will need to accrue a liability for a deficit funding agreements entered into
- Potentially a significant impact on balance sheet
- However, if you account for plan as defined benefit plan under FRS 102 then do not accrue additional amounts for funding agreements
Group pension schemes

- If there is a contractual agreement or stated policy, the defined benefit scheme is accounted for in individual accounts of group members.
- Otherwise it is recognised in the entity that has legal responsibility for the plan with other members accounting for their contributions payable.
- Disclosures can be reduced by cross-reference to disclosures in another group members accounts.
Defined benefit schemes

- FRS 102 does not require an independent actuary to perform the valuation
- Nor does FRS 102 state how often a comprehensive valuation need be performed
- However, it is anticipated that many charities will continue to have independent actuarial valuations at regular intervals
FRS 102 SORP requires use of ‘performance’ model:

- Grants with performance-related conditions are recognised when performance related conditions are met
- Grants without performance-related condition are recognised when received or receivable
- FRS 102 option of ‘accruals’ model - recognising grant income as costs incurred (‘matching’) is ruled out by the SORP
- All grant income recognised on same basis
Branches and group structures

- Merger accounting for combinations remains an option for charities and other public benefit entities
- Merger accounting may be used on restructuring of an unincorporated charity as an incorporated charity
- Fair value transferred on charity combinations recognised as donated income (net liabilities acquired recognised as charitable expenditure)
- No goodwill on combinations by way of gift
Branches and group structures (continued)

- In the absence of information to the contrary, an interest in a charitable associate is calculated by reference to voting rights
- Equity accounting for joint ventures (gross equity accounting under SORP 2005)
- Clarification that corporate subsidiaries are not branches that are aggregated into parent charity’s accounts but are consolidated into group accounts
Accounting Disclosures
Notes to accounts and disclosures

- The notes required by the FRS 102 SORP are in substance similar to current requirements
- But there are significant changes to the detail
- Requirements are set out at the end of each module of the FRS 102 SORP
- No short cuts – you will need to refer to the SORP and FRS 102
- Neither the SORP nor FRS 102 set out the sequence that the notes should be presented in the accounts.
Staff and trustee remuneration

- Total pay & benefits received by key management personnel (includes trustees) must be disclosed.
- A strong ‘nudge’ to larger charities to make fuller disclosures, for example:
  - employee benefits paid to the Chief Executive or highest paid staff member
  - employee benefits paid to its key management personnel on an individual basis
- Larger charities also explain remunerations policies in their Trustees’ Annual Report.
Disclosure of employee benefits

- Other employee benefits are now separately disclosed (for example health insurance, private use of cars etc.)
- Any redundancy or termination payments are also separately disclosed
- Anyone acting as a trustee but not formally appointed (a de-facto trustee) falls within the disclosure requirements
Related party transactions

- Definition includes those connected with charity/trustees in charity law
- SORP requires related party to be named
- Presumption of materiality
- Must substantiate any statement that the transaction is at open-market value
- Aggregate amount of donations received from related parties now must be disclosed (but not named)
- Total amount of any expenses waived by trustees must be disclosed if material
Grant-making activities

- Details of institutional grants can be provided by giving details of the charity’s webpage URL at which this information can be accessed.
Transition to FRS 102 & the FRS 102 SORP
Transition to FRS 102 and the SORP

- Mandatory for accounting periods commencing on or after 1 January 2015
- Earlier adoption for charities permitted once new Accounting and Reporting Regulations in force.
- SORP gives no guidance on first adoption of FRS 102
- Charities will need to refer to section 35 of FRS 102 - there are no short-cuts
Step 1
Understanding the transition date

- The transition date is the start date of the earliest period reported in the accounts, for example:
  - A charity with a 31 December year-end will first be required to prepare accounts in line with FRS 102 and the FRS 102 SORP for its 31 December 2015 year-end
  - Comparatives are for the year-ended 31 December 2014
  - The transition date will therefore be 1 January 2014 – the earliest date included in those accounts
Step 2
Understand potential adjustments

The opening balance sheet as of its date of transition to FRS 102 (i.e. the beginning of the earliest period presented) must:

- Recognise all assets and liabilities as required by FRS 102
- Not recognise items as assets or liabilities if not permitted by FRS 102
- Reclassify items that are a different type of asset, liability (or component of equity) under FRS 102
- Apply FRS 102 measurement bases to all recognised assets and liabilities.
Step 3
Review material accounting policies

- Identify accounting policies used in preparing the balance sheet at the transition date
- Identify those accounting policies (if any) that will change as of result of FRS 102.
- You should focus on those policies that have a material effect on the balance sheet and results
- Charity specific transaction unlikely to need restating
Step 4
Check if exemptions apply

- Check whether any accounting policies that will change are subject to mandatory or discretionary exemptions
- Paragraphs 35.9 to 35.11B of FRS 102 lists exemptions and identifies those which should not be retrospectively adjusted:
  - derecognition of financial assets and liabilities
  - accounting estimates
  - discontinued operations, and
  - measuring non-controlling interests.
Step 4 (continued)
Valuations as deemed cost

- Remember you can choose to value property, plant and equipment (and intangibles) at fair value on transition and use that valuation as deemed cost.
- A useful way to boost the balance sheet without the need for on-going valuation?
- Alternatively, a revaluation under ‘old GAAP’ can be taken as deemed cost on transition, again avoiding the need for ongoing valuations.
Other optional exemptions include:

- Not to restate business combinations that occurred before the transition date
- Use carrying value of investments in subsidiaries, associates and joint venture entities as deemed cost in individual accounts
- Not apply FRS 102 accounting to service concessions entered into before the transition date
- Not restate opening balance sheet of dormant entities
- Not apply FRS 102 accounting to lease incentives when lease commenced before transition
- Capitalise borrowing costs from transition date
Steps 5 and 6

- Step 5 - Review the presentation of assets, liabilities, and funds (components of equity) to establish whether any reclassification is necessary.

- Step 6 - Prepare reconciliation statements and note explaining accounting policy changes:
  - Reconciliation of funds at 2 dated – the transition date and date of last accounts prepared under old GAAP.
  - Reconciliation of profit and loss (income and expenditure) of last accounts prepared under old GAAP.
## Reconciliation of funds:

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<tr>
<th>Funds under previous GAAP</th>
<th>Unrestricted Funds 31.12.14</th>
<th>Restricted Funds 31.12.14</th>
<th>Total Funds 31.12.14</th>
<th>Unrestricted Funds 01.01.14</th>
<th>Restricted Funds 01.01.14</th>
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<td><strong>Funds restated under FRS 102</strong></td>
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Reconciliation of income and expenditure:

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<td>Holiday pay accrual</td>
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- www.cfg.org.uk/sorp
- info@cfg.org.uk
- @CFGtweets
- www.linkedin.com/groups/Charity-Finance-Group-Members-7465624
- www.charitysorpf.org