CHARITIES SORPS (FRS 102 AND FRSSE)

How the new accounting rules affect aspects of your charity
DO YOU OWN A FREEHOLD PROPERTY?

With the introduction of FRS 102 and the new SORP, not much has changed in relation to tangible fixed assets with the basic recognition guidance and depreciation issues still applying as they did under SORP 2005 and FRS 15.

So what does this mean to freehold properties? Well not that much, you might be thinking, if we are maintaining the status quo – that should certainly be true of functional properties, but other issues may need to be considered for investment properties.

The problem with the new SORP is that, being prepared on the basis of ongoing future use, it does not pick up on any of the transitional elections and exemptions that are available under FRS 102. For instance, what SORP does not make obvious is the choice that you now have over the deemed value of your assets.

One of the options available to organisations under FRS 102 is the opportunity to choose a “fair value as the deemed cost” election of assets on transition to FRS 102, without the need to then adopt a policy of revaluation (although this option of course remains). This would therefore be a one-off cost which it may be worthwhile incurring now, as a revaluation policy would not need to be followed after implementing the new SORP. FRS 102 contains other transitional elections, such as if your organisation was already following a policy of revaluation and does not wish to continue doing so. Therefore consultation of FRS 102 is necessary as part of the adoption of the new SORP.

You may therefore find in some circumstances it is advantageous to use the fair value of your functional freehold property as a way of reflecting its true value to the charity – FRS 102 allows this, but the new SORP does not make it obvious that this option is available.

Although this would improve the balance sheet it would also mean that the depreciation charges would be higher going forward. Additionally, residual values are now based on prices current at the reporting date rather than those prevailing at the date of acquisition. Whilst in practice, residual values tend to be immaterial, they may be material for buildings because these can be appreciating assets. FRS 102 transition rules will guide you through any adjustments that might be necessary on transition.

The key point to take from this issue is that (particularly in the year of adoption), the SORP is not a one stop shop and the wider guidance in FRS 102 should always be considered. This would mean that available elections and exemptions can be identified and applied.
DO YOU HAVE A CHARITY SHOP?

When we think of charity shops, we usually think of them being staffed by volunteers who are predominantly selling goods that have been donated by the general public.

As you might expect, both these stereotypes have accounting implications and it goes without saying that the SORP committee gave them some thought when writing the new SORP.

You will be relieved to know that the Committee still conclude that it is not practicable to place a value on the time and service provided by volunteers. However, the new SORP does now require disclosure in a note which will enable the user of the accounts to understand the scale and nature of the role played by volunteers.

The only downside to this is that inclusion of this information in a note to the accounts brings it within the scope of being audited – therefore clear supporting documentation will need to be retained by charities to reconcile to the disclosure note.

It is also good to see that the SORP Committee have remained reasonable about the way in which some of these goods or services are to be valued for the purposes of the accounts. For instance, in respect of goods for resale, it is recognised that many of these could be high in volume and low in value making it hard to identify a fair value, particularly in the absence of detailed stock systems and records. As such, in this circumstance it is permissible to recognise income in respect of the donation on the actual sale of the item, rather than having to attribute a value to stock.

In concluding on the most practicable method of valuing donated goods for resale, Charities may need to revisit their thoughts on the maintenance of detailed stock systems and records.

Additionally, the new SORP recognises that the UK retail gift aid scheme is now widely adopted and so specific guidance on how to account for transactions under this scheme has now been provided.
LEGACY INCOME – IS IT PROBABLE?

As you are aware, SORP 2005 defined income recognition around the three recognition criteria of (1) Entitlement (2) Certainty and (3) Measurement. While the entitlement and measurement criteria were often easy to establish, it could be tricky to determine when receipt of income was certain and this could lead to income, such as legacies, not being recognised until nearly the point at which the cash was received.

This could sometimes prove frustrating to some charities as they knew they were more than likely to receive the income but the supporting paperwork could not substantiate this. As such, income could not be recognised until later in the process.

Therefore, we like aspects of being able to recognise income at an earlier stage, since it is often clearer that receipt of income, such as a legacy, is probable rather than certain.

However, there can be issues with how, in practice, you define what is probable which could result in there being a lack of consistency within the charity sector. It is likely that charities will need to devise their own policy that defines “probable” in order to try and maintain some internal consistency, but this may vary from organisation to organisation.

There is also a risk that where income is recognised on the premise that the receipt is probable, some or all of it may not be received. For example, in the case of a residual legacy, it may be tempting to recognise too much income too early only for not all of it to be received. This could give rise to the need to de-recognise some of the income.

It is because of these risks and lack of consistency that we welcome this development in the SORP with mixed feelings. However, we do recognise that it would have been difficult for a standardised approach to have been developed when there is no consensus amongst lawyers even as to when legacies are probable to be received. Also differing availability of information, and systems developed by different charities and experience will affect judgements about probability made by charities, particularly those that regularly receive legacies. Therefore it seems reasonable that the SORP committee added more guidance but stopped short of a standardised approach.
DO YOU RECEIVE GOVERNMENT GRANTS?

SORP 2005 did not provide much detailed guidance on government grants and certainly nothing that was specific to the charity sector. Therefore it is helpful that the new SORP now provides details of what should be disclosed.

The requirements are perhaps motivated by the challenges faced in the sector in securing government funding as quite a lot of detail is required, such as disclosure of unfulfilled conditions and other contingencies attached to a particular piece of funding.

This enables the user of the accounts to understand the activities that have been undertaken and how the funding has been used. However, there could be some cause for concern that this disclosure requirement is overly transparent. At least, though, the SORP committee didn’t go down the route of requiring an analysis of income by funder or source of income, for which there was some demand.

It may not be in the charity’s best interests to disclose on public record how they have performed against conditions applicable to a grant and so we do have some reservations about the new disclosure requirements.
DO YOUR STAFF ACCRUE LEAVE?

Under SORP 2005, staff costs included in a charity’s set of accounts would just have been based on the cash value of what was paid to their staff during the financial year.

However, that is set to change under the new SORP where it is now required that untaken annual leave and sick leave are accrued as a liability. This is in contrast to the commercial sector, where some companies are already providing for untaken leave, where it is material, under FRS 12.

The updated approach has the benefit of showing the true cost of employing staff and can also help to reflect the efforts made by staff for the charity. Additionally, as this requirement is derived from FRS 102, it means that all sectors will be required to disclose the same level of detail. This could mean that the cost of employing staff becomes more comparable across different sectors making this data more transparent.

That said, there has to be a question mark over the value that including liabilities for untaken holiday and sick leave, has on the financial statements.

There might also be a worry that having to keep track of and value untaken leave will be unnecessarily burdensome for charities, although there is a get out clause on the grounds of materiality.
DO YOU APPLY A TOTAL RETURN APPROACH TO INVESTMENTS?

The total return approach to investments is where permanently endowed funds are invested to produce an investment return without regard as to whether that return is in the form of income (eg dividends or interest); or capital appreciation (eg investment gains).

Under the current regime, total return on investments is tucked away towards the end of the SORP and therefore not very accessible to charities. The guidance was very brief and presented in such a way that it might be presumed its use was being discouraged.

The new SORP is much more bold in its presentation of total return accounting and includes a whole chapter dedicated to this approach. As a consequence there is far more clarity over the way in which this should be presented in a set of financial statements and it is therefore much more accessible to charities.

Perhaps this will provide the opportunity for more organisations to consider this approach where it fits with their model and structure.

That said, whilst the guidance is more broken down in the new SORP, it still remains a complex issue and could therefore still be off-putting to charities. It would have been useful to have seen even more detail so that the implications could be fully accessible to all charities. For instance, the guidance provided is only on the accounting treatment and there is still no assistance with the understanding of the underlying legislation.
Therefore it is useful to see that the new SORP dedicates a whole module to social investments and seems to recognise the different forms in which these can arise. The module very usefully provides guidance on the accounting treatment of some of the various forms of social investment, which has been lacking to date.

It can also be helpful to charities to be able to recognise the appreciation in value of social investments, whereas in the past they were not considered to grow (other than through additions) but could decrease in value via impairment. As such, not only does the charity benefit from the income earned from social investments but also from the impact they have on the value of a charity’s reserves.

That said, whilst there may be clear indications of impairment for a particular social investment, it is potentially going to be time consuming to assess the fair value of certain social investments, simply because they may be so unique in their nature.

It should be remembered that social investments can come in many guises and the accounting treatment therefore varies. For instance, social investments such as concessionary loans don’t follow the fair value approach. In other words, whilst treatment under the new SORP has broadly changed, social investments should be reviewed on a case by case basis.

The use of social investments, particularly mixed motive investments, is still developing and certainly would have been at an early stage when SORP 2005 was developed. The SORP committee have mooted that because this is still a developing area that a ‘future SORP committee’ might usefully revisit this topic in the light of developing sector experience.

IS SOCIAL INVESTMENT ON YOUR AGENDA?

Social investments have been growing more popular in the sector, with some organisations pioneering the creation of different social investments over the last few years. SORP 2005 did not really tailor its guidance to the various forms in which social investments can arise. Charity Commission guidance in CC14 which introduced more detail on the differences and treatment of programme related and mixed-motive investments also did not go far enough in providing clarity to the sector.
DO YOU HAVE FINANCIAL INSTRUMENTS?

The table below shows what would typically be classed as a financial instrument. As you can see, this includes items as simple as cash, debtors and creditors. These are basic financial instruments, but charities also need to be aware of complex financial instruments such as interest rate swaps.

Although the new SORP refers the reader to FRS 102 for certain details, there is much more guidance, by way of a dedicated module, on financial instruments.

Therefore, as a charity, you will now be able to see what financial instruments you carry (and in fact have always carried). Whilst this might just be appealing to those accounting technicians out there, it is very helpful to find detailed and relevant guidance for charities which will enable comparison and consistency across all sectors.

Care should be taken about the complexity of some financial instruments and amendments to their accounting treatment. For example interest rate swaps – the treatment of these has changed such that rather than just being disclosed, they should now be brought onto the balance sheet. Therefore, remember to now be alive to the impact of basic and complex financial instruments and don’t be afraid to consult with your RSM contact if any arise or if you have any doubts.

<table>
<thead>
<tr>
<th>FINANCIAL INSTRUMENT</th>
<th>MEASUREMENT ON INITIAL RECOGNITION</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Cash held</td>
</tr>
<tr>
<td>Debtors – including trade debtors and loans receivable (trade accounts and notes receivable)</td>
<td>Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced by the charity</td>
</tr>
<tr>
<td>Creditors – including trade creditors and loans payable (trade accounts and notes payable)</td>
<td>Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced to the charity</td>
</tr>
<tr>
<td>Overdraft (loan payable on demand)</td>
<td>Amount of the overdraft facility drawn down</td>
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<tr>
<td>Qualifying long-term loans (that meet the debt instrument criteria in FRS 102)</td>
<td>Amount of principal advanced less material arrangement or similar fees</td>
</tr>
<tr>
<td>Bank deposit</td>
<td>Cash amount of deposit</td>
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DO YOU MAKE GRANTS?

Grantmaking forms a large part of many charity’s activities and some significant changes were suggested in the draft SORP to the level of disclosure that was going to be required.

In the end, the new SORP has not changed much at all — no change in the extent to which institutions must be named in the notes to the accounts. This provides a little flexibility to charities based on how they interpret the requirement to provide details of a sufficient number of institutions — after all, what constitutes a sufficient number? Maybe this will lead to some inconsistency in the level of detail included — only time will tell.

Pleasingly there has been no change in the accounting for future grant commitments which is still dictated by the extent to which conditions are attached to future grant payments. Unfortunately the complication in forming a conclusion on this matter remains in the detail of the grant agreement rather than the SORP and so the same debates are likely to continue into the future.

The draft SORP had mooted the enhancement of disclosure around listing the recipients of grants. It can be argued that this is a very valuable disclosure and serves to fully demonstrate how a charity has supported its beneficiaries. In the end the compromise was agreed whereby the listing could be provided in a separate location, which must be the charity website, as long as reference to the location is included in the accounts. Otherwise, the listing must be disclosed in the Trustees’ Report or notes to the accounts.

Whilst this does not go as far as some would have liked it does seem to be a fair compromise, albeit there is no flexibility on the alternative location.

Of interest to a minority of charities, both new SORPs now include reference to the statutory exemption available to charitable trusts created by a person (settlor) from disclosing details of grants made out of the settlement during that person’s lifetime, or that of his spouse or civil partner. This was acknowledged in SORP 2005 Help Sheet 1 (but not in the SORP itself — so possibly it was often overlooked), but it concluded that the SORP’s requirements were best practice. Thus disclosure was often made when legally it wasn’t required. Under FRS 102 and the new SORPs, it is now likely that this exemption will be used.
PENSION SCHEME COMPLICATIONS

Under UK GAAP, FRS 17 meant that defined benefits (DB) schemes where the charity’s share of the assets and liabilities could be identified accounted for the value of the liability (occasionally asset) on the balance sheet. But where the share of assets and liabilities could not be identified, such as in some multi-employer schemes, only the contributions payable in the year needed to be accounted for and disclosed. This was the same relatively simple treatment applicable to defined contribution schemes.

FRS 102 guidance in respect of DB schemes that are already on the balance sheet has not significantly changed. However, FRS 102 has introduced the potential requirement to recognise a liability on the balance sheet for DB multi-employer schemes as well.

Where an organisation has an agreement in place to make deficit contributions to a multi-employer scheme that is accounted for as a defined contribution scheme, a provision must be included in the balance sheet for the present value of the contributions payable per the agreement.

Whilst in practice it is likely that some of the information required about the contributions payable may be provided by the pension scheme, for example correspondence or a contribution schedule, this is likely to create more work and cost for the charity as it will need to calculate the PV of the contributions that are outstanding at the balance sheet date which it has agreed to pay, using an appropriate discount rate specified in FRS 102.

Additionally, it is likely that the value of the balance sheet will be reduced further as a consequence of this new requirement.
Further information:
This guide is not intended to be a summary of all the requirements or a substitute for the Charities SORPs.

For more information concerning this briefing please contact Nick Sladden, National Head of Charities or your usual RSM contact.

A full copy of both SORPs together with some useful help sheets can be found at www.charitysorp.org.

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